ANNUAL REPORT
AAREAL BANK GROUP
2007

Aareal Bank

KEY GROUP FIGURES

	1 Jan-31 Dec 2007	1 Jan-31 Dec 2006	Change
Consolidated Income Statement	**€ mn**	**€ mn**	**€ mn**
Operating profit	380	160	220
Group net income/loss after minority interest income	290	107	183
Indicators			
Cost/income ratio (%) [1]	49.7	54.1	
Earnings per share (€)	6.77	2.49	
RoE after taxes (%)	25.0	10.9	

	31 Dec 2007	31 Dec 2006	Change	Change
Portfolio data	**€ mn**	**€ mn**	**€ mn**	**%**
Property financing	22,550	20,682	1,868	9
of which: international	16,878	14,289	2,589	18
Property financing under management [2]	23,992	22,771	1,221	5
of which: international	16,878	14,289	2,589	18
Shareholders' equity	1,627	1,372	255	19
Total assets	40,202	38,279	1,923	5
Regulatory Indicators	**%**	**%**		
Core capital ratio (German Banking Act)	8.0 [3]	8.3		
Total capital ratio (German Banking Act)	12.3 [3]	13.5		
Core capital ratio (BIS rules) [4]	7.3 [3]	7.3		
Total capital ratio (BIS rules) [4]	11.2 [3]	12.1		

	31 Dec 2007	31 Dec 2006
Rating		
Fitch Ratings, London		
Long-term	A-	A-
Short-term	F2	F2

[1] only in the Structured Property Financing segment
[2] The figure for property finance under management also includes property loans managed on behalf of DEPFA Deutsche Pfandbriefbank AG
[3] After confirmation of Aareal Bank AG's financial statements 2007. The inclusion of retained earnings transferred as part of Aareal Bank AG's liable equity capital as at 31 December 2007 is subject to approval by the Annual General Meeting
[4] The ratios were calculated in accordance with the definitions by the Basel Committee. No agreement regarding the determination of the ratios has been concluded with the German Federal Financial Supervisory Authority (BaFin).

Key Group Figures ◀

Imprint

Contents:
Aareal Bank AG, Corporate Communications

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Peter Stumpf, Düsseldorf
Goetzke Photographie, Rodgau

A view for new perspectives:
The photographs show our Wiesbaden Head Office
from unusual perspectives.

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CONTENTS I

AAREAL BANK GROUP – MILESTONES IN 2007

February

Award: Aareal Bank won the renowned ”CEE Real Estate Quality Award“ as the ”Best Banking & Services Company in Central and Eastern Europe“ for the second time – Aareal Bank's long-standing presence and expertise in the region is bearing fruit. The awards are given by a highly qualified jury of financiers, property developers and investors.

Training: a work-study executive programme was launched at the European Business School. Within the scope of the programme, Aareal Bank is specifically committed to training its employees, and to promoting expert and specialist careers in the company.

Presentation (I): Aareal Bank presented at ”E-World“ in Essen – a key trade fair for the utility industry – its special solutions for optimising the payment transaction processes of utilities and waste disposal companies.

March

Focused (I): Aareal Bank's FUTURE 2009 growth programme represents the foundation that paves the way for expanding the group in the future. It involves concentrating the business activities on the two segments, Structured Property Financing and Consulting / Services.

New issue: Aareal Bank placed its second jumbo mortgage bond on the capital market. The order book exceeded € 1 billion after only one hour, and the issue was two times oversubscribed upon order book closing. With 40 % of orders placed by international investors, Aareal Bank's jumbo Pfandbrief issues contribute substantially to the expansion and internationalisation of the investor base.

Sale: Aareal Bank sold a non-performing loan portfolio to Merrill Lynch Global Principal Investments, a professional property investor.

Expansion (I): within the framework of our three-continent strategy, the bank expanded its US presence.

Presentation (II): Aareal Bank attended the 18th International trade Fair for Commercial Property (MIPIM) in Cannes, France, to engage in a direct exchange of views with clients and business partners – the event is the ideal framework for industry specialists to maintain existing (and for establishing future) international business relationships.

April

Extension: Aareal Bank extended its company headquarters, clearly proving its commitment to its location in Wiesbaden. The new premises provide office space for roughly 190 employees, and were ready for occupation in December 2007. Approximately 800 employees work in the corporate headquarters in Wiesbaden.

Expansion (II): Aareal Bank launched its commercial property finance business in Estonia, thus strengthening its position in the Nordic region.

Raising the stake (I): Aareal Bank increased its stake in Immobilien Scout GmbH, acquiring approx. 23.7 % from private equity funds managed by Morgan Stanley and J. H. Whitney.

May

Expansion (III): Aareal Group opened its new representative office in Helsinki. In the latter course of the year, we converted our distribution centre for the Nordic region – based in Stockholm – from a representative office into a full branch. Scandinavia, including the Baltic States, is a key growth market. The Northern European region contributed approximately 16 % to Aareal Bank's new business in 2007. The bank has had a presence in the region since 1992.

Distribution: the Management and Supervisory Boards proposed to the Annual General Meeting to distribute a dividend of € 0.50 per share for the 2006 financial year. This means that shareholders will receive a dividend again for the first time since 2004, thus profiting from the successful turnaround of the company.

Event: Aareon held its seventeenth Aareon Congress. The three-day event held in Garmisch-Partenkirchen, Bavaria, is renowned across the industry: some 900 delegates from the property management sector took this opportunity to inform themselves about current trends and developments.

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July

Signing: Aareon AG signed a rental agreement for its new headquarters in Mainz. The new offices, which will be ready for occupation in 2009, will unite Aareon's staff of just under 500, who had been spread across four different locations in Mainz.

Raising the stake (II): Aareal Bank further increases its stake in Immobilien Scout GmbH, enhancing its strategic options.

Training: Aareal Bank entered the second phase of its new trainee programme that was launched in 2006. A good twelve university graduates passed through various departments within the scope of the twelve-month training programme, gaining a comprehensive overview of the bank's processes. The practical training is enhanced by seminars that are held at the European Business School as well as exchange programmes with students from the University of Cambridge.

August

Expansion (IV): the Asian subsidiary Aareal Bank Asia Limited received its merchant banking licence from the Monetary Authority of Singapore (MAS). This represents another measure of Aareal Bank's successful expansion on the Asian growth market. Operating from Singapore, the company has even more direct access to the Asian property markets.

Focused (II): Aareal Bank terminated its long-standing investment in the online portal Immobilien Scout GmbH, by selling a 66.22 % stake. The disposal enables Aareal Bank to raise its target for return on equity after taxes for 2007 from 13 % to well above 20 %.

Focused (III): Aareal Bank Group sold its Paco unlimited product line – an access control and automated micropayment billing system for the institutional housing sector developed by Aareal First Financial Solutions AG – within the scope of a management buy-out. The sale was a further step to sharpen Aareal Bank Group's focus.

Promotion: Aareal Bank extended its co-operation with the Real Estate Management Institute (REMI), the European Business School and the University of Cambridge. It supported the European Business School's property congress. At the same time, Aareal Bank trainees visit the University of Cambridge. With these activities, Aareal Bank is forging ahead with the important exchange between companies and science.

October

Commitment: underlining its role as a leading property finance house in Central and Eastern Europe, Aareal Bank supported the St. Petersburg Dialogue for the first time. Chaired by Chancellor Angela Merkel and Russian President Vladimir Putin, this conference to promote economic and political cooperation was attended by high-ranking German and Russian representatives who met in Wiesbaden in early October.

Representation: the tenth commercial property trade fair Expo Real was held in Munich and was attended by approx. 24,000 specialist visitors. Aareal Bank was represented at the trade fair with its sales teams, and subsidiaries Aareon, Aareal Estate, Aareal Valuation and BauGrund, where it pointed out the trend in the property sector.

December

Growth: more than 90 clients from the housing sector, property management and energy sector were acquired as new users of the BK 01 payment transactions system, including the two largest managers of commercial-use property in Germany.

LETTER TO SHAREHOLDERS

LETTER TO

LETTER TO SHAREHOLDERS

Dear Shareholders, dear business partners,

The financial year under review was the most successful one in our corporate history. Net income after minority interests was € 290 million – a record result. Return on equity after taxes increased to 25.0 %.

In addition to successful operating performance, this very positive result was also due to special effects, including the sales proceeds for our stake in Immobilien Scout GmbH, which we disposed of as part of our consistent focus on our core business activities. But even without these non-recurring effects, our results were up strongly, up 20 % to € 159 million.

Once again, we have proven that Aareal Bank Group is well on track, and that our strategic focus on profitable growth in our two business segments Structured Property Financing and Consulting / Services is right.

We would like to take this opportunity to express our sincere thanks to all members of Aareal Bank Group staff. Without their extraordinary commitment and contribution, the Group's successful performance in the financial year under review would not have been possible.

from left to right:
Thomas Ortmanns, Dr. Wolf Schumacher, Hermann J. Merkens, Norbert Kickum

Structured Property Financing: international profile enhanced further

At € 11.7 billion, new business in the Structured Property Financing segment both exceeded the previous year's figures and outperformed our own target. The geographical breakdown indicates the progress made in our endeavours to further raise the bank's international profile.

This development is attributable to our consistent three-continent strategy. Leveraging our successful European business model, we are establishing similar distribution structures in North America and in the Asia / Pacific region. We made significant progress in Asia in 2007, when our Singapore subsidiary obtained its merchant bank license. Our presence in Singapore will now be grown into our Asian hub, the distribution centre for the entire economic region. With our Nordic hub in Stockholm, our concept of central distribution networks has already established a successful track record. Our Stockholm office manages all business activities in Northern Europe and in the Baltic states. With great success: 16 % of new business in 2007 was originated in this region alone. We will also deploy a hub concept for our sales activities in Central and Eastern Europe (CEE), where Warsaw will be our regional sales centre. Our goal is to exploit growth opportunities in the CEE region even more efficiently than we have to date. We envisage New York-based Aareal Capital Corporation, which commenced operations in March 2008, to yield similar effects in the North American market.

Besides opening up potential for originating attractive new business in fast-growing regions, our three-continent strategy offers further benefits, particularly in a market situation characterised by great uncertainty: thanks to our regional diversification, we will be even better positioned in the future to offset any potential problems in individual markets by exploiting opportunities in others. The increasing degree of diversification is not only obvious in our new business, but also in our financing portfolio, where the share of Germany in the overall portfolio volume decreased from 37 % to 29 % during 2007. The relative weight of our domestic business will decline further over the years to come. Nevertheless, Germany will remain one of Aareal Bank's key markets in the future.

Refinancing costs: Pfandbrief issues taking centre stage

Sharpening the bank's international profile is just as important in our refinancing: by expanding our activities on an international scale, we not only gain access to new financing clients, but also explore new institutional investor groups. This was evident in the successful issue of Aareal's second jumbo mortgage bond, sized at € 1 billion, with approx. 40 % of all orders placed by international investors. It is in periods of market turbulence that the benefits of German asset-covered bonds – commonly known as "Pfandbriefe" – are particularly evident. Thanks to its statutory safety features, Pfandbriefe are enjoying a real renaissance at present, benefiting from solid investor confidence. We are determined to exploit this competitive advantage even further, and envisage to significantly boost the share of Pfandbriefe in our funding mix from its current level of 35 %.

The significant volume of deposits generated from institutional housing sector clients provides us with competitive advantages in terms of refinancing. At a remarkable average of € 4.5 billion in 2007, these funds help to clearly reduce the bank's dependency on the money and capital markets.

Consulting / Services evolving into a strong source of income

The Consulting / Services segment, serving the institutional housing sector, showed a strong performance across all its business line during the financial year under review. At € 30 million, the segment's operating result almost quadrupled, thus exceeding even our ambitious expectations. Having made a positive contribution to the Group's success now for six consecutive quarters, we expect further rising results for the years to come. Consulting / Services is thus evolving into an increasingly important source of income for the Group, which is largely unaffected by volatility in international financial markets and cyclical trends in property markets.

Our subsidiary Aareon AG further extended its market position as a leading consultancy and IT systems house for the property management sector. The success of Aareon's realignment, embarked upon in 2006, was visible during the financial year under review. We optimised internal processes, successfully enhanced the market position, and hence clearly improved Aareon's profitability. A particularly successful development was the multi-product strategy developed as part of the realignment process: the extended product range was very well received by the market, and the customer base was broadened and enhanced.

We also further strengthened our market position in the bank's Institutional Housing Business. The business is underpinned by the market-leading payments system "BK 01" for the institutional housing sector, for which we successfully acquired several large new customers during 2007. We increasingly exploited cross-selling opportunities arising from the interaction of Aareon and the bank's Institutional Housing Business. This is already visible in common client coverage, which is already at a high level, but still rising.

The successful realignment of the Consulting / Services segment also included a focus on core business activities. This process was largely completed during the year under review, with the sale of our stake in Immobilien Scout GmbH and the divestment of the Paco unlimited product line.

Two-pillar strategy proven in a challenging market environment

Aareal Bank Group is in a stronger position than ever before, as evidenced by the very successful results achieved in both segments during the 2007 financial year. We have returned the bank to profitability, after a successful turnaround. We have focused our strengths on what we do best. We are growing in all business lines, having achieved ambitious targets within a short period of time, based on a framework of a clearly-defined strategy. Our present business model, incorporating the two columns of Structured Property Financing and Consulting / Services, has proved to be correct and sustainable – particularly in the current market environment.

Having launched our FUTURE 2009 growth programme in March 2007 – 18 months ahead of schedule – we already made great progress. Reflecting the global financial markets crisis, we will adjust FUTURE 2009 to the new situation, with an extended planning horizon: the required adjustments to our organisational structure and processes will be undertaken within the framework of the adapted growth programme FUTURE 2010. This will also include further optimisation in the Consulting / Services segment.

Manageable impact of the financial markets crisis on Aareal Bank Group

Mark-to-market charges on securities positions have burdened aggregate net trading income for the third and fourth quarters with around € 31 million: the direct impact of the crisis on international financial markets on the bank has thus been manageable to date. The marking to market of securities portfolios in line with changed market conditions resulted in a loss of approximately € 16 million in the fourth quarter (Q3: € -15 million); these write-downs were attributable to asset-backed securities (ABS) and bank bonds in equal proportions (€ 8 million; Q3: € 7.5 million each). Net trading income also regularly includes ongoing expenditure for the bank's own securitisations; these amounted to € 2.5 million during the fourth quarter (Q3: € 2.2 million). The remaining expenditure of € 1.5 million (Q3: income of € 3.8 million) was attributable to standalone derivatives, government bonds issued by EU member states, and interest payments.

Aareal Bank is not exposed to the US subprime market, neither directly nor indirectly. Nor do we hold any investments of the type which have wrought havoc in other institutions, such as Collateralised Debt

Obligations (CDOs) or US Residential Mortgage Backed Securities (US RMBS). Furthermore, Aareal Bank holds no securities which are backed by US monoline insurers. More than 90 % of the bank's € 625 million ABS portfolio consist of AAA-rated issues; less than € 50 million are invested in US Commercial Mortgage Backed Securities (CMBS).

The crisis and turbulence affecting financial markets, accompanied by high volatility affecting mark-to-market results in particular, are not yet over. Therefore, even though we cannot rule out any further mark-downs, thanks to the quality of our portfolio, we are confident that we will be able to keep any economic default losses in this portfolio at very low levels. The negative impact of the crisis has, however, been accompanied by positive effects as well. For instance, the more adequate pricing of credit risk – which can be observed in the market – has a beneficial effect on our business, since margins are improving. And some of our competitors – those who have been hit by the crisis – have adopted a very reluctant stance in terms of market participation. For us, this opens up numerous opportunities to acquire attractive new business.

Unchanged dividend of € 0.50 per share proposed

To retain our ability to make targeted use of existing market opportunities, we propose to apply the significant non-recurring income generated during the financial year under review to strengthen our capital base, and hence, to further expand our market position. In this way, we will be able to create significant added value for the company. Of course, we would like to make sure that you, dear shareholders, participate in the performance of Aareal Bank Group. The Management Board and Supervisory Board thus propose to distribute an unchanged dividend of € 0.50 per share for the 2007 financial year. We would like to express our gratitude for the confidence shown. We will not falter in our commitment to justify this confidence by continued strong business performance.

Outlook for 2008: opportunities outweigh risks

Any specific forecasts are extremely difficult in the current market environment. We are nevertheless confident that we will be able to preserve the Group's successful business momentum, even if market conditions should remain challenging. In principle, the Management Board envisages the opportunities available to Aareal Bank Group to outweigh potential risk exposure. Barring any further serious distortions in the financial markets, we will match last year's good operative results in 2008 – or even improve on them, given the right market environment.

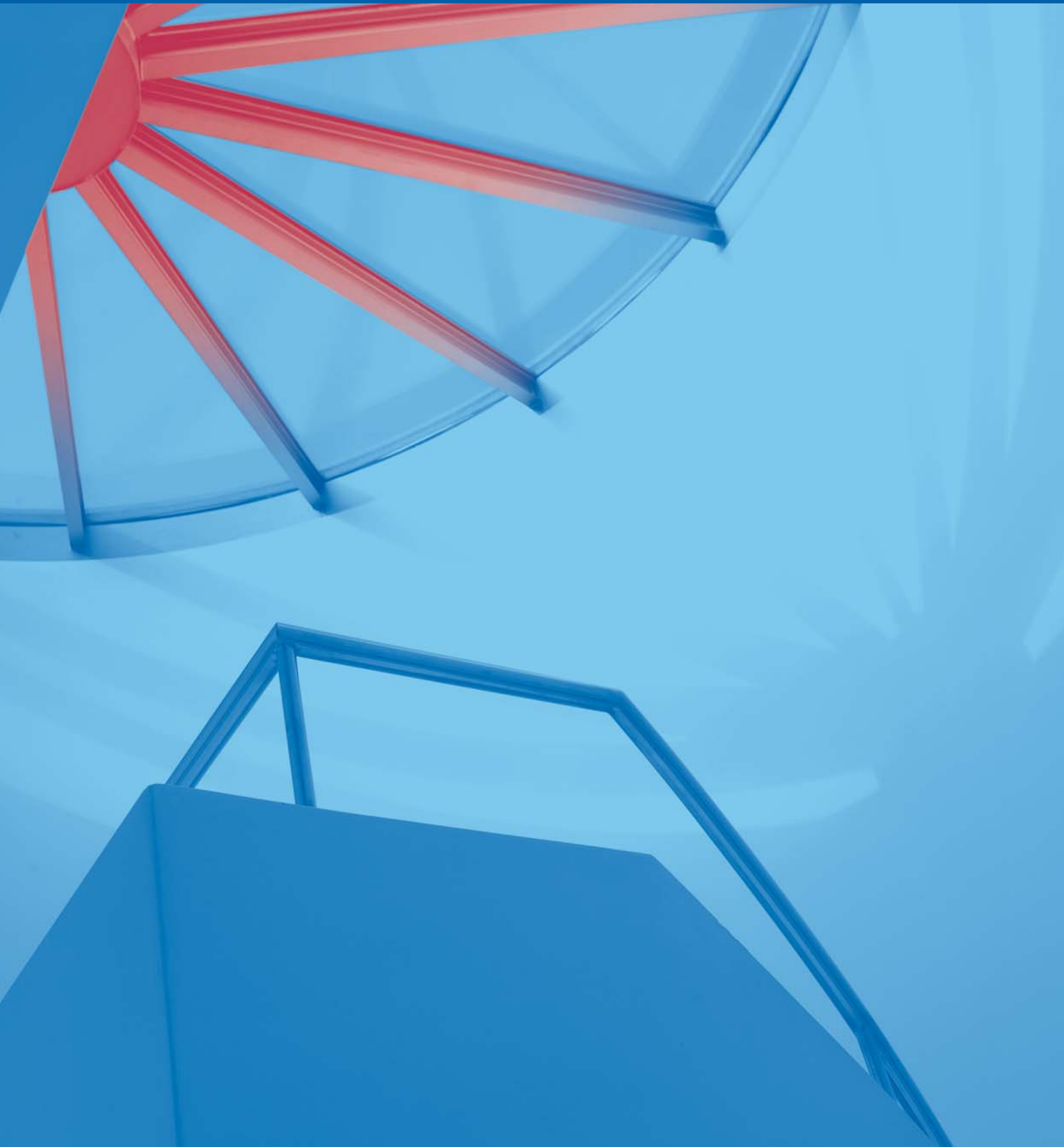
Our focus for the current year is on pursuing our growth strategy, whilst optimising our internal structures, systems, and workflows within the framework of our adapted growth programme – which is expected to further improve efficiency throughout the Group. This will secure the sustained competitiveness of Aareal Bank Group, providing the basis for continued success. We look forward to joining you, dear shareholders, business partners, and friends of Aareal Bank, to join us on the way ahead during the current financial year.

Yours sincerely,

Dr. Wolf Schumacher	Norbert Kickum	Hermann J. Merkens	Thomas Ortmanns
Chairman of the Management Board	Member of the Management Board	Member of the Management Board	Member of the Management Board

SHAREHOLDERS

THE AAREAL BANK SHARE



THE AAREAL BANK SHARE

Aareal Bank Group's strategy of focusing successfully on the two segments of Structured Property Financing and Consulting / Services was not reflected sufficiently in the performance of the Aareal Bank share in the 2007 financial year. The second half of the year 2007 was defined largely by the US sub-prime crisis. The resulting cautious stance vis-à-vis the entire financial services sector overshadowed the positive fundamental data. We responded to market uncertainty through proactive and intensive capital market communication in order to boost confidence in our business model and management team.

Equity markets worldwide

International equity markets pushed ahead significantly in the first half of the year on the back of positive global economic development and high market liquidity. Rising commodity prices and the fear of interest rate hikes did not impact overly on this positive trend. The slump on the Shanghai stock exchange and news about the difficulties experienced in the US property sector led only to a correction in the first quarter. This was followed by a second-quarter recovery, and the good economic environment in Europe in particular resulted in an excellent performance on equity markets.

By mid-July, the European benchmark index DJ EURO STOXX 50 had increased by around 9 % since the start of the year while the DAX was up by just under 20 % during the same period. The undisputed winners in this market environment were the shares of cyclical sectors, such as autos, commodities and chemicals. Financial and healthcare entities were trading at the lower end.

Since mid-July however, it became evident that the US sub-prime crisis not only represented a problem for the US market: it would also feed through to Europe. Numerous reports that European banks were facing liquidity difficulties shook the money and capital markets. The banks in question were exposed to US sub-prime credit through securitised loans (so-called Collateralised Debt Obligations or CDOs), or to investment companies (Structured Investment Vehicles or SIVs) – that were established for these investment purposes. These banks were forced to recognise substantial write-downs in line with the loss in value of the sub-prime loans exposure, which triggered a loss of confidence on a massive scale. As of this point, banks were no longer prepared to extend existing or new liquidity lines to other institutions. The central banks provided short-term funds in order to ensure adequate liquidity on the money markets.

The loss of confidence within the banking sector and continued uncertainty about the overall extent of the crisis led to panic sales, in particular of financial issues, despite good fundamental data.

The deterioration in the market conditions for trading asset-backed securities (ABS) forced the banks to make further value adjustments. Discussions about a potential recession in the US and fears of further negative surprises meant that the financial issues in question were no longer able to recover by year-end. This poor development was reflected by the CXPB (prime banks performance index) which reached an annual low of around 504 points in mid-November.

Despite the sub-prime crisis, most stock exchange markets performed well in 2007. The Dow Jones was up 7.2 % by year-end at 13,365.90 points. The DJ EURO STOXX 50 also performed well, increasing by 6.9 % to close at 4,404.64 at year-end 2007. The DAX was particularly resistant in the face of the US mortage crisis: it posted a significant rise of 22.3% and closed at year-end at 8,067.32 points.

The MDAX, in which our share is listed, rose by 4.9 % over the previous year despite the high degree of volatility in the course of the year and reached 9,864.62 points on the last trading day. The prime banks performance index (CXPB) – the primary benchmark index for the Aareal Bank share – on the other hand was down 8.7 % year-on-year and traded at only 550.43 points at year-end.

Key data and indicators	2007	2006	2005
Share price (€) [1]			
Year-end price	31.30	35.27	32.07
High	39.90	40.33	32.64
Low	24.93	29.15	22.36
Book value per share (€)	32.35	26.38	23.32
Dividend per share (€)	0.50 [3]	0.50	–
Earnings per share (€)	6.77	2.49	-1.40
Price / earnings ratio [2]	4.62	14.16	–
Dividend yield (%) [2]	1.6	1.4	–
Market capitalisation (€ mn) [2]	1,338	1,508	0

ISIN	DE 000 540 811 6
WKN (German Securities ID)	540 811
Quote symbols	
Deutsche Börse	ARL
Bloomberg (Xetra)	ARL GY
Reuters (Xetra)	ARLG.DE
Issued share capital (number of bearer unit shares)	42,755,159

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

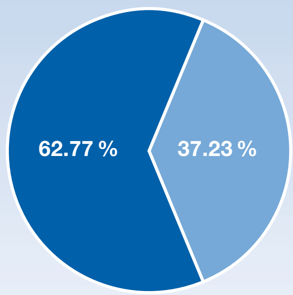
The Aareal Bank AG Share

Our share has been trading on the Frankfurt Stock Exchange since 17 June 2002 and has been included in the MDAX since 23 September 2002. Since 1 January 2003, it has also been included in the German Stock Exchange's Prime Standard segment.

Share performance

The Aareal Bank AG share started off the year 2007 on a positive note and showed a positive performance until the end of February. The share price recovered again after a short downside movement that ended mid-March, and reached the annual high of € 39.90 on 10 May. Although our share was unable to sustain this level, it traded soundly in the months to follow.

Shareholder structure

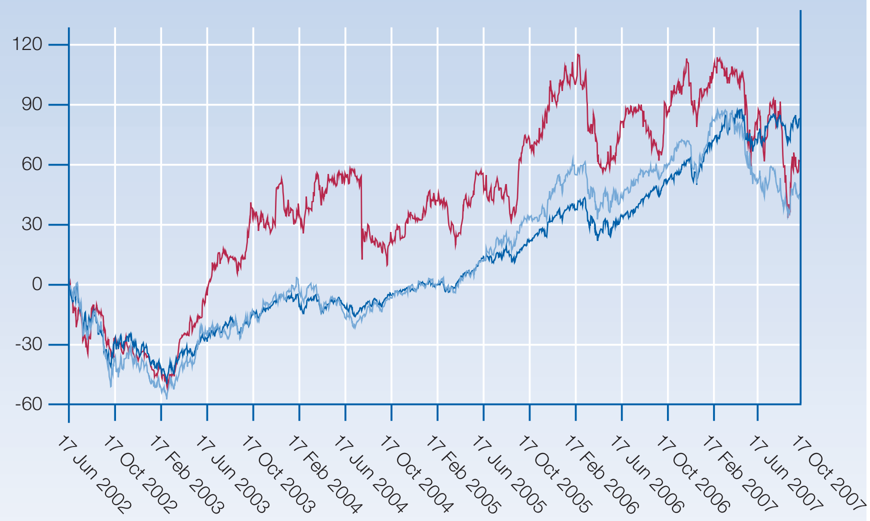


Aareal Holding Verwaltungsgesellschaft mbH

8,94 %	Bayerische Beamten-Lebensversicherung a.G.
8,94 %	Schweizerische Lebensversicherungs- und Rentenanstalt
6,68 %	Versorgungsanstalt des Bundes und der Länder
6,06 %	Bankhaus Lampe KG
5,25 %	Deutscher Ring Gruppe
1,36 %	Condor Lebensversicherungs-AG

Free float | Aareal Holding Verwaltungsgesellschaft mbH

Relative performance of the Aareal Bank share price since listing (%)



ARL GY | HDAX | CXPB

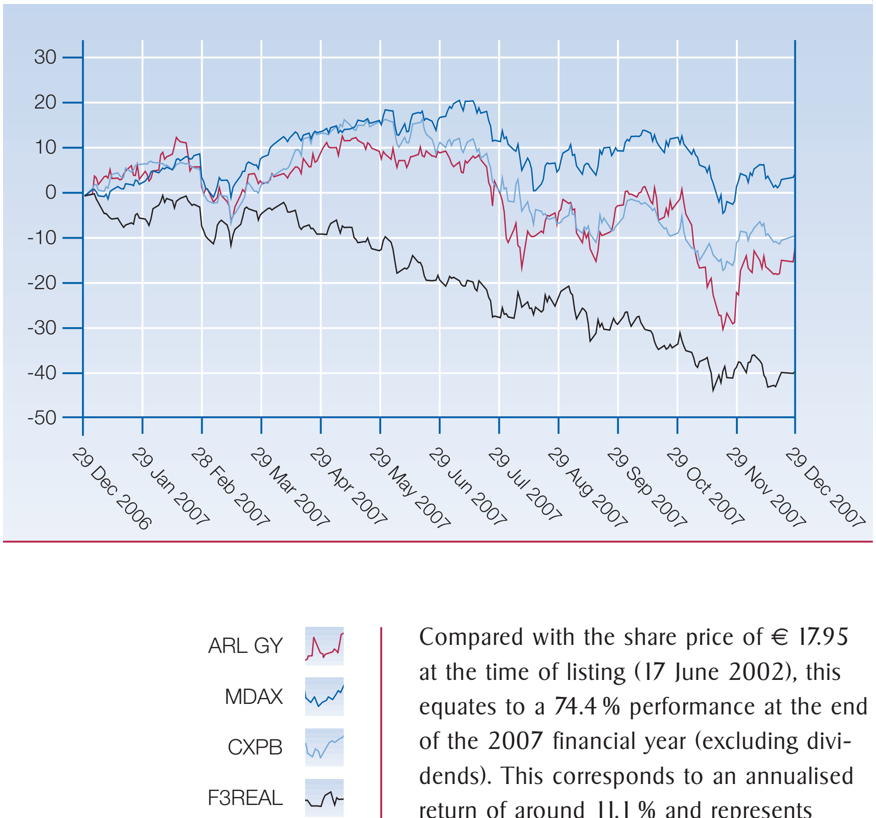
However, the onset of the sub-prime crisis in Europe led to a sustained downward trend. Although Aareal Bank has neither direct nor indirect exposure to the US sub-prime market segment, and showed good fundamental data throughout the entire year, our share was sucked into the negative market development that impacted on the entire financial sector. It reached its annual low of € 24.93 on 21 November 2007, but regained some ground by the end of the year. The share closed on the last trading day of the year at € 31.30, down 11.3 % year-on-year. Market capitalisation as at the reporting date was around € 1.34 billion.

Proposed dividend of € 0.50 per share

As in the previous year, Aareal Bank shareholders should also benefit from a dividend to be distributed for the 2007 financial year. The Management Board and Supervisory Board will propose to the Annual General Meeting on 21 May 2008 to distribute a dividend of € 0.50 per share.

The difference of € 15 between the highest and lowest level of our share is indicative of the immense volatility seen in 2007. Due to the turbulent developments on equity markets, intra-day share price volatility and average trading volume was considerably higher than the previous year. Nevertheless, the weighted average price in 2007 was able to improve by roughly 2.9 % to € 35.16.

Relative performance of the Aareal Bank share price during 2007 (%)



Compared with the share price of € 17.95 at the time of listing (17 June 2002), this equates to a 74.4 % performance at the end of the 2007 financial year (excluding dividends). This corresponds to an annualised return of around 11.1 % and represents an extremely profitable return on capital for those investors holding our share as a long-term investment.

Investor relations activities

Our capital market communication in 2007 was geared towards the results of the successful realignment, and our strategy of concentrating on our two core business segments Structured Property Financing and Consulting / Services. The turbulent developments on the stock markets were particularly challenging for Aareal Bank's investor relations activities. We adopted a proactive stance in communicating at an early stage that Aareal Bank had neither direct nor indirect sub-prime exposure. Furthermore, the members of our Management Board were increasingly available to answer queries within the scope of direct talks held with our investors.

Regardless of market turbulence in the second half of the year, open and transparent communication was again at the forefront of our investor relations work during 2007. We provided regular updates about our results and were in direct contact with players on the financial markets throughout the entire year. Our Presentation of the 2006 Financial Statements / Press Conference & Analysts' Meeting was held on 26 March 2007. We held an additional Analysts' Meeting one day later in London, where we presented our new growth strategy in detail for the coming financial year to press representatives and investors. We informed investors, analysts, and the press of our quarterly figures, in teleconferences held in May, August and November.

Additionally, throughout the year, the investor relations team together with members of the Management Board participated in numerous international capital market conferences and roadshows in Boston, Copenhagen, Edinburgh, Frankfurt, Helsinki, London, Milan, New York, Oslo, Paris, Vienna, and Zurich. We were available for personal discussions, where we explained current business development and the bank's outlook for the future. More than 350 individual discussions (one-on-ones) were held with investors and analysts.

We also provided extensive information to interested parties, shareholders and analysts on Aareal Bank, its strategy and business segments by way of our website. The ad-hoc disclosures and press releases, financial reports and current investor relations presentation can be downloaded from our investor relations page, which we revised in 2007.

We will continue to meet the capital market participants' appetite for information by means of proactive financial communication. Our objective is to further enhance and strengthen the trust placed in Aareal Bank, in order to achieve a sustained increase in the value of our share.

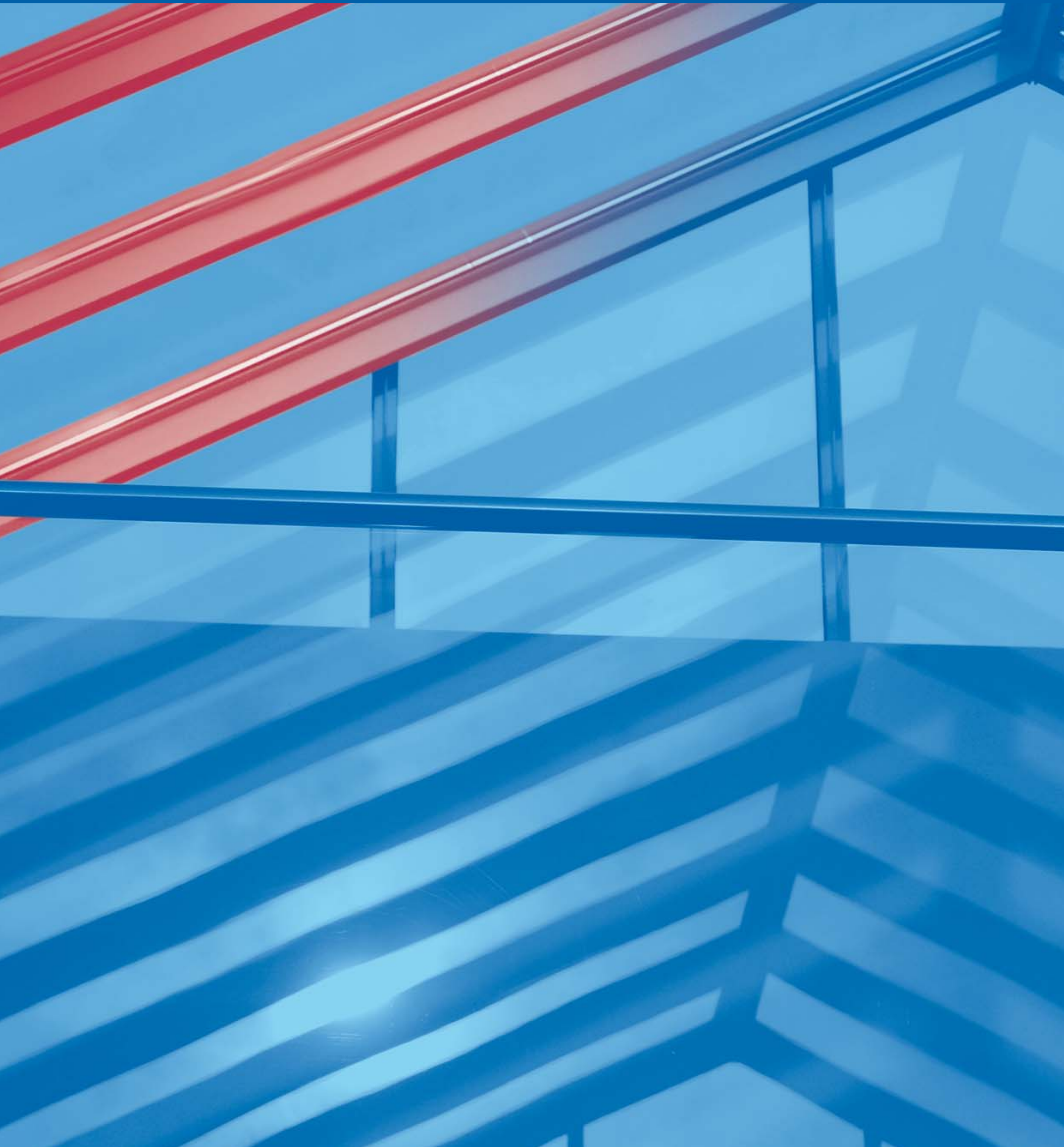
Analysts' opinions

Our transparent and open capital market communication is exceptional, and was rewarded during the financial year under review: analysts from 21 investment banks covered the Aareal Bank share and prepared independent research reports.

As at the balance sheet date, two analysts recommended our share as "hold", and two as a "sell". The other 17 analysts rated it as a "buy". Hence, most of the experts analysing our share confirmed the promising outlook for the bank's future.

STRUCTURED PROPERTY FINANCING

PROPERTY



STRUCTURED PROPERTY FINANCING

Our strategy of achieving growth through consistent internationalisation clearly defines the target for our Structured Property Financing segment. We already support national and international investors, plus clients in more than 25 countries across three continents. Our clients are specialists in their own fields, and therefore hold our expertise – which is second to none – in high regard: regional expertise paired with our sector-specific knowledge, plus a flexible and efficient service for financing solutions tailored to meet their requirements.

Products and services

As well as traditional products such as senior / first lien mortgage loans, we also offer our clients the entire range of modern financing instruments. Within the scope of selecting and combining classic and innovative products, we assign top priority in each case to the individual prerequisites of our clients and the special requirements of the transaction in question. Our broad range of financing products includes financing solutions for individual commercial properties as well as portfolios comprising various types of property. We use various refinancing vehicles to raise short-term and long-term capital on the money and capital markets, which we require for our lending business. The importance of the German Pfandbrief as a legally regulated refinancing vehicle has risen again – notably, against the background of the sub-prime crisis.

Strong position on three continents

We have set ourselves the objective of consistently expanding the international presence of Aareal Bank Group in the years ahead. This requires us to further strengthen our market position in North America, Asia and Europe within the scope of our three continent strategy. With this in mind, we are expanding our US business – where we have been operating since 1999 – as well as strengthening our activities in Canada. The first signs of success are already evident on the Mexican market.

In the Asian region, we are concentrating on growing our client base via our Singapore office, which we established in 2004. We are also expanding our business activities in China as well as analysing the market opportunities that may be available in other East Asian countries. Finally, in Europe we are concentrating on further market penetration and are pushing ahead with our business in Central and East European countries (CEE countries).

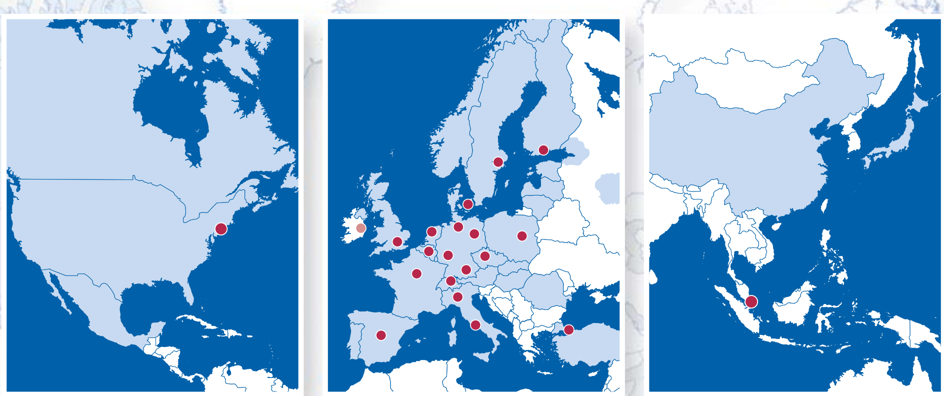
Cross-border distribution concept

Our successful European business model is central to our growth and internationalisation. We are also establishing this business model in Asia and North America. Centralised management of our activities through networked distribution centres is important to the success of this concept.

We create our so-called hubs where individual countries have become closely-related economic regions, and where our clients are not active only in one individual market but in an entire region. We therefore concentrate our distribution activities to correlate with the business activities of our clients. We view these networked economic regions – as they do – in their entirety, and take into consideration the similarities that define these countries.

With our Nordic hub in Stockholm, our concept of central distribution networks has already established the best track record.

where we are already well-established with a subsidiary – and are establishing a capital corporation that provides us with even more scope locally. We are already a step further in Singapore, where our subsidiary Aareal Bank Asia Limited obtained a merchant banking license in 2007. We successfully coordinate business development and distribution in the Asia / Pacific from Singapore.



Our local offices in Denmark and Finland are managed from our distribution centre in Stockholm. This means that we can create uniform distribution and marketing activities for the region and step up close cooperation between our specialists. Our local presence allows us to arrange, structure and syndicate loans. We are currently establishing the hub for Central and Eastern Europe, in Warsaw.

We are also working towards creating a networked distribution centre in New York –

Market and industry specialists

Our expansion is focused on a broad network of regional offices. Aareal Bank now has an active presence in 15 European countries, as well as in the US and Singapore. Employees from 30 different nations provide our clients with specific knowledge: they know the local markets, the business environment, and are familiar with the language and the culture. Our regional expertise is complemented by the sound knowledge of internationally-experienced specialists for different sectors. Individually structured teams comprising local and sector experts offer tailored financial solutions for the different types of commercial property transactions.

Diversifying the portfolio

Our target for the Structured Property Financing segment is a portfolio that is broadly diversified by region and by types of property. This will cushion against the effects on regional economic fluctuation, reducing our dependency on individual sectors and also facilitating greater diversification of risk. In essence, this makes us less dependent on individual markets.

We have successfully diversified our credit portfolio in regional terms during the past few years; to this end, we continuously increased the share of financing to international borrowers so that the share of new business originated in Germany was reduced from 37 % to 29 % during 2007.

CASE STUDY: WESTMONT HOSPITALITY, EUROPE PORTFOLIO PROJECT

Project profile: Europe portfolio transaction project

Europe Portfolio: 24 hotels in various locations in Austria, Belgium, France, Germany, Italy, Spain, The Netherlands

Buyer: Westbridge Hospitality Fund LP

Financing structure: Senior tranches and hedging products

Westmont Hospitality Group and Westbridge Hospitality Fund LP – a snapshot

The Westmont Hospitality Group is one of the largest hotel operators worldwide, owning or managing around 700 hotels in North America, Europe and Asia. The company operates worldwide, at various locations whose areas of responsibility are divided into regions.
In its search for investments, Westmont Hospitality Group cooperates closely with partners and subsidiaries such as Westbridge Hospitality Fund LP, and continuously sounds out international hotel markets for investment opportunities. In the last 30 years, the company has invested in many hotels and has achieved a significant operating and financial performance through active asset management.

Project description

24 hotels in seven countries and from three different quality categories – the ”Europe Portfolio“ is characterised by its regional as well as its qualitative diversification. It includes renowned hotels of the Holiday Inn Express, Holiday Inn and Crowne Plaza brands that are found in European cities. The previous owner pursued a strategy of concentrating on its core business of franchising, associated with a reduction in assets on the balance sheet, and hence decided to dispose of the portfolio.

In its search for a suitable financing partner, Westbridge Hospitality Fund LP turned to Aareal Bank and initially outlined the requirements of the financing solution. On the basis of the key data supplied, Aareal Bank’s hotel specialists developed a first convincing financing proposal: they included a comprehensive overview of the figures of the entire portfolio and the accounts of the individual hotels – a prerequisite for an extensive due diligence, and a necessity in order to estimate the risks and returns of the financing solution. Within the scope of the full analysis, Aareal Bank’s team examined the income and expense situation of every individual hotel and viewed it relative to local market factors using the local market expertise of its extensive branch network. The Europe Portfolio transaction faced the particular challenge arising from the different countries’ specific taxation and legislative regulations. However, this was achieved within a short timeframe: all of the factors driving risk and value were compiled, the plans for repositioning the hotels reviewed and the momentum and trends in the markets assessed.

Aareal Bank provided the funds for the portfolio acquisition, and structured the financing with senior tranches that were enhanced by appropriate hedging products. The bank also committed to further credit facilities for future renovations of individual hotels.

Interview with Kingsley Seevaratnam, Executive Vice President Europe and Neil Kirk, Director Transactions Westmont Management Limited

Mr Seevaratnam, Mr Kirk, why did Westmont choose Aareal Bank as a partner to provide the finance for the Europe Portfolio?

We knew that Aareal Bank and its staff could react flexibly and provide the necessary solutions. We have been cooperating with the bank in Europe since 1996, and our choice in the case of the Europe Portfolio project once again turned out to be the right decision. The initial negotiations with the seller involved Aareal Bank's hotel experts, who provided us with a first financing proposal a short while thereafter. This tailor-made response confirmed for us that Aareal Bank was the correct partner.

What does this mean exactly?

The structuring of the international portfolio was very complex. We were acquiring a company structure that extended across seven different jurisdictions. One of Aareal Bank's key strengths lay in its ability to present its own assessment of the countries and individual markets, as well as securing the financing. Aareal Bank is one of our key partners, with its regional and industry-specific experience that can also secure cross-border financing in the corresponding volume.

What general criteria do you apply to your choice of financing partner?

As an investor, we often have to react very quickly to seize acquisition opportunities. In such situations, it is decisive that our financing partner has the correct flair for the properties, and can assess their value and future business potential quickly and reliably. This is exactly what Aareal Bank's employees can deliver.

Interview with Helmut Mühlhofer, Managing Director Real Estate Structured Finance and Mirelle Gerding, Associate Aareal Bank AG

Ms Gerding, Mr Mühlhofer, what do you look for when financing hotel properties?

We generally concentrate on providing individual financing solutions for hotels in top locations and in the four to five star category. We finance portfolio transactions in Europe, North America and Asia. Our analyses concentrate on factors such as average bed occupancy, room prices, location and quality of the hotels. We also closely examine the business and disposal strategy that the buyer has in mind for the hotels in order to evaluate the risks and future business potential. In parallel to the analysis of the property, we develop the financing concept in line with the client's requirements.

What challenges did you face with regard to the financing of the Europe Portfolio project?

Simply put: insufficient time and lots of data. Although this is not unusual for portfolio financings, we faced the additional challenge of the individual hotels in the Europe Portfolio project being located in different countries. There are for example, major differences between the manner in which real property liens are established in different countries. We therefore had to contend with a series of further tax and legal differences that had to be taken into account in structuring the financing solution.

What does this require of your employees?

Apart from an analytical and disciplined approach to the working process and in-depth knowledge of the industry, our employees also require a large measure of perseverance and flexibility. It is generally not simply the case of financing a hotel portfolio. The Europe Portfolio has, for example, also changed since the acquisition by Westbridge Hospitality: two hotels were sold again in 2007 and a further disposal was pending at the start of 2008. These disposals were offset by the acquisition of a leased property that has been incorporated into the portfolio. Our specialists also support our clients with up-to-date market knowledge. They also examine the portfolio in view of changing parameters from a cash flow perspective, and provide additional finance if required.

Helmut Mühlhofer

Mirelle Gerding

CASE STUDY: RIVER OUEST, PARIS

Project profile: River Ouest office property, Paris

Developer: HRO

Construction company: CBC

Architect: Skidmore, Owings & Merrill, New York

Interior design: Alberto Pinto

Construction period: July 2007 to July 2009

Total area: 66,700 sqm

Office space: 63,400 sqm

HRO – a snapshot

HRO is one of the largest developers of office property in Europe and in the US. Founded by Howard Ronson in 1967, the company is headquartered in Paris and operates in Europe and in the US.

HRO has forged its reputation in the greater Paris region with its modern, top-quality office buildings. Its most recent projects include the Défense Ouest office complex and Rive Défense with 47,000 square metres of office space.

Project description

Thanks to its good location and improved transport infrastructure, the Paris suburb of Bezons creates the ideal base for HRO's latest development supported by Aareal Bank. River Ouest, which will be one of France's largest office complexes, will be built on an undeveloped site of roughly two-and-a-half hectares. The complex has been under construction since July 2007; after completion, it will comprise around 63,400 sqm of office and conference space spread out on seven floors. As of 2009, River Ouest will provide office space for more than 5,000 people.

River Ouest was designed by the international architecture firm Skidmore, Owings & Merrill, whose trademarks include elegant design and innovative construction technology. Furthermore, the complex has been awarded the highest certification from the French environmental organisation HQE. Confronted with rising energy prices and politically-driven ecological demands, top priority is given to advanced technologies that can reduce the tenants' operating costs, and which are simple and cost-effective to use. Future users will not only appreciate the view of the river Seine and the building's highest level of practicality: the complex will also be characterised by its architectural symphony of restaurants, shops and parks. It is no surprise that River Ouest has already received an award: the jury for the annual property prize "Pierres d'Or" praised the successful combination of modern, environmentally-friendly and functional construction technology, awarding first place to River Ouest in the "Project" category.

However, the project funding has to be in place before the first sod is turned. With a view to securing the finance for this project, HRO approached a number of different banks to prepare and present them with offers. A decision was reached within a very short space of time – after only a few weeks: Aareal Bank is financing the River Ouest project. Besides the competitive terms, the scales were tipped above all by the level of expertise and flexibility shown by the staff of Aareal Bank's French subsidiary. Aareal Bank's specialists – with their knowledge of the industry and the market, together with bespoke financing solutions – scored on all points, whether in relation to assessments on the future potential demand for office property or possible rental price development. The mutual trust that was cemented through earlier projects was also a contributory factor here. River Ouest is the ninth office building for which Aareal Bank is providing HRO with funding.

Interview with Tom Stauber, Managing Director and Jason Lockyer, Project Director with HRO

Mr Stauber, Mr Lockyer, how in your opinion, does Aareal Bank differ from other property finance houses?

Aareal Bank is a specialist in its field – just like HRO. This common ground unites us. Aareal Bank is staffed by experts who bring aboard sound specialist knowledge and many years of experience to joint projects. They also command a remarkable level of practical experience in relation to office property, and are able to adapt to meet our requirements exactly. Regardless of whether it's in Paris or Lyon, Aareal Bank's staff are familiar with the tenant structures and price range, as well as the supply and demand situation – these are vital requirements for assessing the potential and opportunities for success that are presented by a new property. Furthermore, the team understands the entire property development process – from start to finish. Aareal Bank is therefore in a position to offer bespoke offers and services designed to meet our specific needs.

How exactly would you describe the cooperation?

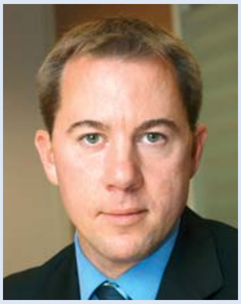
Uncomplicated! Aareal Bank's employees react – for example – to requests in a quick and competent manner. However, an even more important aspect is that they always think outside the box and contribute new constructive pointers. We therefore regard them as valuable and innovative partners in our projects. Our day-to-day dealings with each other are defined by flexibility and professionalism.

Could you give an example?

If we are in a position to start individual construction phases ahead of schedule, a brief discussion with the respective contacts suffices to allow us to draw on the next credit line early. They act reliably and quickly to ensure the loans are advanced and therefore contribute substantially to the success of our property developments.

What were the key factors behind your decision to cooperate with Aareal Bank on the River Ouest project?

My answer will hardly be surprising: competitive terms and conditions, which are of course a key issue from the client's perspective.
But having a reliable financing partner is just as important to us. Covering a total area of just under 67,000 sqm, River Ouest is a major project for us. In fact, it exceeds all other office buildings we have developed in Paris over recent years. Being able to rely on a top-quality partner thus represents a crucially important factor for success. Aareal Bank has proven to be a reliable partner – yet again.



Tom Stauber

Jason Lockyer

Interview with Nicolas Rousse-Lacordaire, General Manager Aareal Bank France S.A.

From the perspective of the service provider, what aspects are critical to successful property financing?

With projects of this magnitude, both parties must be satisfied with the end result. The key prerequisites for this are mutual trust, together with a sound understanding of the project and its requirements. My colleagues and I always try to view the project in terms of the bigger picture. We listen closely to descriptions, put ourselves in the client's shoes and carry out detailed analyses. This allows us to give additional impetus for the distribution and marketing aspects of a property. Ultimately, a favourable rate of interest is one factor, but equally important at least is direct, constructive dialogue with the client.

How would you define the cooperation between HRO and Aareal Bank?

Our relationship with HRO is solid evidence that a long-term and intensive analysis of a client's requirements is worthwhile. It is no surprise that River Ouest is the ninth office building for which we are providing HRO with a financing solution. We are connected by a history of success and many years of experience. Some of our team members have known their contacts at HRO practically from the onset of our first joint project. They are familiar with the processes and procedures at HRO, and what aspects are important to the individual contacts.

Which aspects were incorporated in preparing the financing solution for River Ouest?

As a bank, we focus on two factors: the quality of the building and future potential with regard to rents and utilisation. River Ouest for example, is being constructed in the Paris suburb of Bezons, in a business district that is not yet fully established. Our team has therefore weighed up precisely the opportunities and risks, the potential offered by Bezons and River Ouest, and the necessary planning periods; we matched the financing solution on the basis of these factors.

Nicolas Rousse-Lacordaire

REFINANCING

REFINANCING

As an international property finance house, refinancing via the capital market is vital to our success. Our presence on the capital market guarantees a reliable financing partner for our clients. Pfandbrief issues in particular play a major role in our refinancing strategy.

Broad refinancing mix

Owing to the increasing degree of flexibility of the lending operations, modern property finance houses must exploit all of the relevant capital market instruments available to them in order to cap their refinancing costs and successfully position themselves in a competitive environment. The Pfandbrief business is a key component, and one that Aareal Bank will develop continuously.

Our international business model has resulted in a highly-diversified cover portfolio with financing activities in 16 different countries and a German share of less than 25 %. The Pfandbrief is therefore being used increasingly as a cost-effect refinancing tool that meets with good demand.

The liberalisation in recent years of the cover assets pools, which may now include high-quality international exposures, provides property finance houses with the freedom necessary to successfully implement their business models. The German Pfandbrief Act is an important contributory factor that enables international property banks such as Aareal Bank to compete in the international property business.

The long-standing tradition of the Pfandbrief, together with the stringency of the German Pfandbrief Act, provides the investor with a high level of security – unlike other European covered bond products – and therefore represents an obvious funding advantage for the issuing Pfandbrief banks. This is particularly obvious during turbulent market phases such as we are experiencing since the outbreak of the US sub-prime crisis, with banks facing rising borrowing costs.

The German Pfandbrief benefits especially in this market situation from its premium product status. Our Pfandbrief licence, and good reputation as an issuer, allow us to raise sufficient long-term funds at attractive terms through this financing instrument.

We have also been an active issuer of Jumbo Pfandbriefe since 2006. A key advantage of jumbo issues is the high minimum volume of € 1 billion on the one hand, and our bank's raised profile outside of Germany, plus the related development of international refinancing sources on the other.

Institutional housing sector as an additional refinancing source

Our structure comprising the two segments – Structured Property Financing and Consulting / Services – secures us an additional advantage in relation to a reliable financing source: the current account balances and term deposits of our clients in the institutional housing sector are a component of our refinancing activities.

Our deposit-taking business provides us with an additional and stable source of liquidity, especially during volatile times on stock markets, when it is difficult or expensive to raise money on the capital market.

CASE STUDY: SECOND AAREAL BANK JUMBO PFANDBRIEF

Project description

WKN (German Securities ID): AAR003

Coupon: 4 %

Maturity: 1 February 2010

Fitch Ratings: AAA

Date of announcement: 28 March 2007

Value date: 5 April 2007

Issue size: € 1 billion

In early 2007, Aareal Bank planned a second jumbo Pfandbrief issue following its successful debut on the market in 2006. Its intentions were to raise another € 1 billion on national and international capital markets. The process was already under way a quarter of a year before actual issuance. Aareal Bank's five-man team presented the bank's business and refinancing strategy within the scope of talks held with many international investment houses. The objective was to find suitable partners who would support the placement of the jumbo Pfandbrief by way of a syndicate, and to assume market-making duties so as to secure the tradability of the jumbo issue.

On the basis of the market analysis, Aareal Bank's capital market experts together with the three syndicate banks prepared the key features of the jumbo Pfandbrief, which included syndicate structure, maturity, coupons and price range. The time of issuance was also determined, a major criteria in the success of the transaction.

Aareal Bank heightened the awareness of institutional investors through a road show designed to contact an increasing number of international investors and to receive a reaction to the issue features of the jumbo, so that these could be finalised. Three Aareal Bank teams travelled through seven European countries over a one-week period. Investors were not only convinced by Aareal Bank's business model and capital market presence, but also by the unique geographical diversification of its cover assets pool.

The order book for the second jumbo Pfandbrief was finally opened on 28 March. Due to the high level of demand, the price range was already fixed that afternoon at 5.5 basis points below mid-swap. The issue was two times oversubscribed upon order book closing, and the share of international investors exceeded 40 %.

Interview with Dr. Bernd Bach, Managing Director, Global Head of Treasury Aareal Bank AG

Dr Bach, how important are Jumbo Pfandbrief issues to Aareal Bank?

Jumbo issues are an important cornerstone of our refinancing mix and contribute to the diversification of our capital raising efforts, in terms of cost and regional presence. A jumbo generates long-term liquidity at favourable terms – in and outside of Germany. We are not the only beneficiaries here – our stakeholders also reap the rewards. Refinancing through Pfandbriefe in particular, allows us to provide our property clients with sound financing at competitive terms. At the same time, the efficient refinancing impacts positively on profitability - another key argument for our shareholders.

Another advantage has emerged against the background of the US sub-prime crisis: investors are highly confident in the German Pfandbrief as a premium product, irrespective of whether it is a jumbo or smaller Pfandbrief issue. This leads to stable and a favourable refinancing base throughout, even in a turbulent market environment.

Trust: why exactly are German Pfandbriefe held in such high esteem by investors?

Pfandbriefe are a high-quality capital market product and are therefore considered one of the more conservative forms of investment. The German Pfandbrief is held in particularly high esteem by investors because it is regulated by law and features several downside cushions. Outstanding Pfandbriefe must always be collateralised by the same volume of loans; in fact, the rules and regulations specify 2 % over-collateralisation of the Pfandbriefe, even in stress scenarios. The cover assets pool comprises top-quality loans. Additionally, only 60 % of the loan-to-value ratio of a property can be refinanced through Pfandbriefe and investors would be covered two-fold in the event of insolvency: through the preferential recourse to the cover assets and the issuing bank. The Pfandbrief business is also monitored by the German Federal Financial Services Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin).

How does the second Aareal Bank Jumbo Pfandbrief differ from the first one?

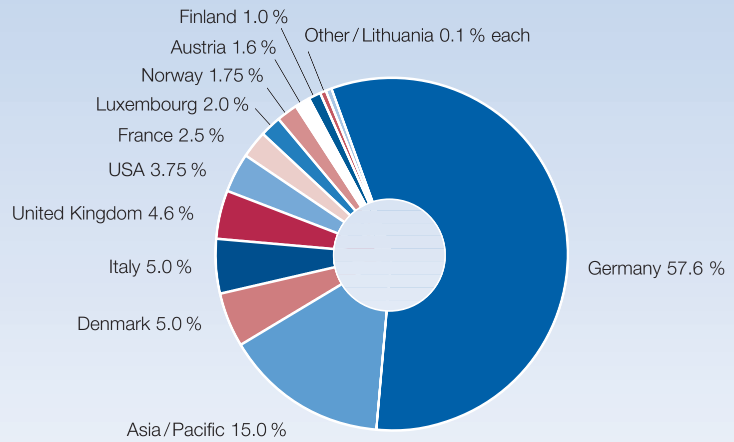
The cover assets pool for our second jumbo included a greater volume of hedging derivatives, thus providing the Pfandbrief holders even better protection against general change in market interest rates. We also focused the placement of the second jumbo on international investors and increased the share of Asian investors more than three-fold over the first issue, to 15 %.

What is Aareal Bank's Pfandbrief strategy for the year 2008?

We have already established an excellent reputation on the market with our Pfandbriefe. In light of the high level of confidence enjoyed by German Pfandbriefe, they will also represent a key refinancing source for us in 2008. Whilst banks that do not hold a Pfandbrief licence have to pay dearly for borrowings, we are well positioned: Pfandbriefe will account for half of our new issuance in 2008. Smaller registered mortgage bonds and privately-placed MTN issues will play an equally important role to any additional jumbo placement.

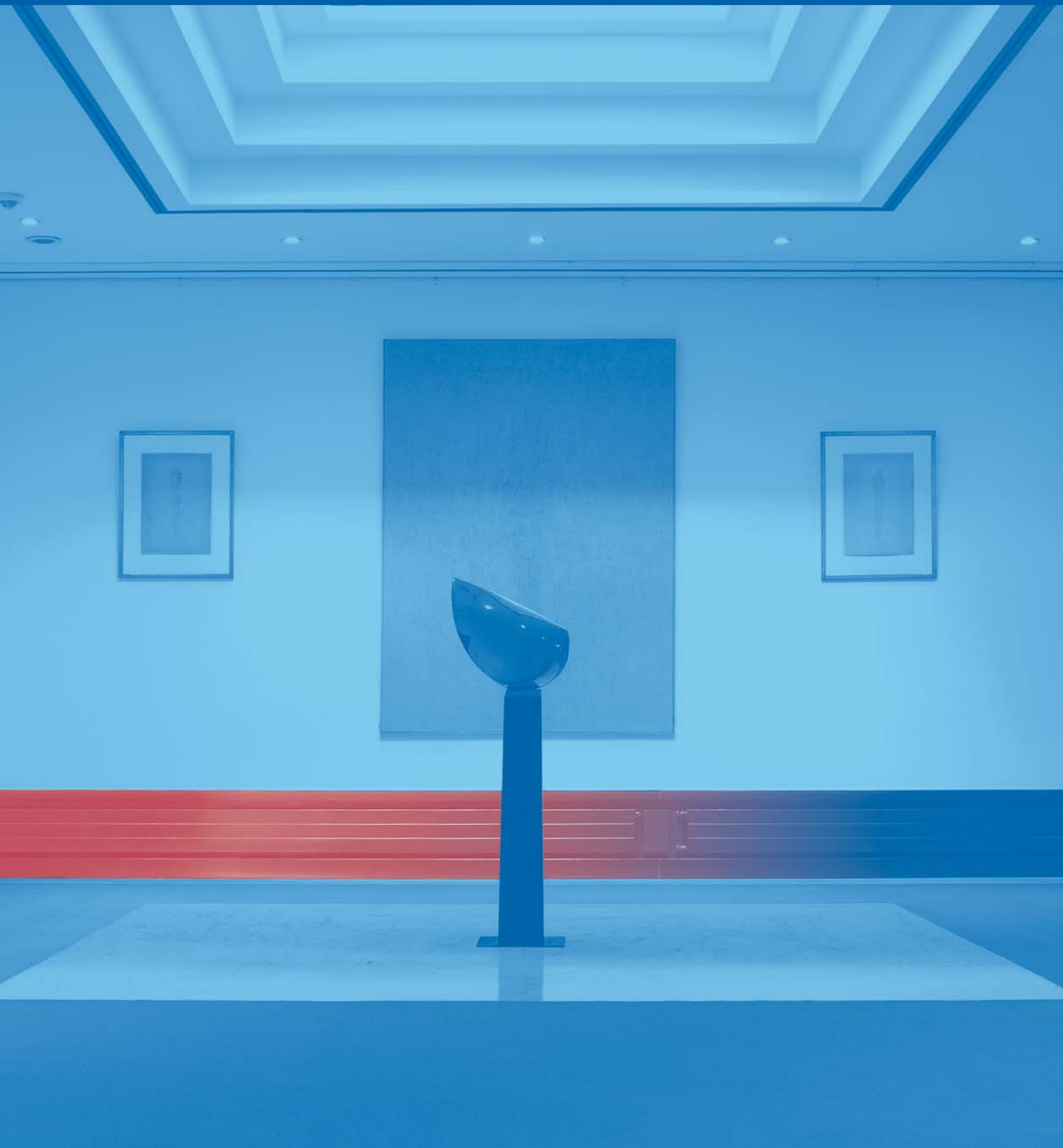
Dr. Bernd Bach

Country allocation of the Jumbo issue



CONSULTING / SERVICES

CONSULTING /



CONSULTING / SERVICES

Our strength lies in a strategy of consistently focusing on the property management sector – this also applies to the second cornerstone of our business model, the Consulting / Services segment. We understand the requirements of our institutional housing sector clients and can therefore develop optimum property management-related solutions. Our success is justified: we are an innovative market leader in the institutional housing sector. This position is supported by the IT systems and services of Aareon AG as well as the solutions for the integrated processing of payment flows offered by our Institutional Housing Business and our subsidiary Aareal First Financial Solutions AG.

Aareon AG – advice, software, services

In our fifty years of business, Aareon AG has developed into the leading consultancy and IT systems house for the property management sector. Aareon is now the largest subsidiary of Aareal Bank, with 13 locations in Germany and a further eight offices in France, Great Britain and Italy. It has around 1,000 employees and a customer base of around 2,200 companies in Germany and Europe, including private, cooperative, church and municipal housing companies as well as managers and commercial property companies.

Aareon concentrates on the optimisation of IT-supported business processes related to the operation and management of residential and commercial property. The services portfolio is geared specifically towards the requirements of customers, where Aareon offers corporate software solutions, so-called enterprise resource planning (ERP) solutions and extensive advisory and IT services. Additionally, it offers a series of integrated services that support the property companies in their operative business and in networking with their customers and business partners.

Multi-product strategy

The functions that IT systems have to fulfil for customers in the property management sector are becoming increasingly more complex. The latest legal regulations stipulate that landlords must provide tenants with even greater transparency when invoicing operating costs. This requires additional retrieval and presentation of data by the institutional housing companies that can only be carried out in an efficient and reliable manner using modern and efficient IT systems.

Aareon's differentiated product strategy services the many and varied systems requirements with four different software solutions: the new Blue Eagle solution that is based on SAP® ERP 6.0, the established GES and WohnData systems; and Wodis, the solution for SMEs that was acquired a year ago.

Aareon is the leader in Germany in the SAP real estate market with roughly 120 advisors and developers, and more than 60 productive customer systems. The Blue Eagle application was established in cooperation with SAP AG on the basis of SAP® ERP 6.0 and SAP NetWeaver™. It is particularly suitable for companies that have to manage complex business processes, for which they require flexible and multi-layered data management and sophisticated reporting. Aareon offers its clients standardised systems or individual solutions, depending on the requirement profile and company strategy.

GES, the leading established system, is the tried-and-tested ASP (application service providing) solution for customers who have standardised requirements with high process automation of their IT systems. WohnData in turn, is an in-house solution. Both systems are easily integrated in existing IT systems and are developed continuously to meet the latest requirements of the market.

Unlike the large companies, medium-sized housing companies operate more frequently with more streamlined products that have less complex structures. Wodis, which is designed precisely to meet the requirements of these companies, rounds up Aareon's product portfolio. The basic Wodis modules cover the central core processes – including renting and maintenance – of the SMEs. Additional module packages are available, not only for cooperatives or for the management of units owned by third parties, but also for extensive and special administrative functions. Wodis is offered as an ASP (Application Service Providing) as well as an in-house application.

Integrated services and advice

All ERP solutions can be enhanced with the addition of a series of integrated services. The Aareon NetOffice product family for example, supports document-based business processes, to enhance speed and transparency. Its document management system allows far more than just archiving and document administration; it also automatically supports, amongst other things, the mass correspondence of a property company.

The Mareon service portal links property companies with business partners such as tradesmen and suppliers. If for example, a tradesman needs to be instructed to carry out repairs to a specific apartment, the entire process – starting from the instruction through implementation and documentation of the repair to payment of the invoice – can be covered through Mareon. The tradesmen receive their orders and confirm their completion online. Finally, they forward their invoice to the property company via the service portal as well. Mareon creates transparency, automates the compilation of invoices, reduces errors, saves post, transport and docking times throughout the internal invoicing process, hence reducing invoice throughput times. Considerable cost savings are made by this process optimisation.

The Aareon clients are also advised on IT strategy development, process optimisation and SAP projects. System hosting and IT outsourcing, together with training and support round up the offer.

Bank solutions for the housing and property management sector

As part of the services it offers to commercial property companies, Aareal Bank's Institutional Housing Business together with our subsidiary Aareal First Financial Solutions AG offer efficient solutions for mass payment transaction processes. Our Institutional Housing Business is responsible for strategic development, distribution and client services, while Aareal First Financial Solutions is charged with the development and maintenance of the solutions.

The objective of this close cooperation between the two sectors is clearly defined: as market leader, they want to act as a reliable and innovative partner for the clients in the property management sector, offering solutions that match the gradual increase in market requirements. Close contact with our clients is necessary for acquiring detailed market and industry knowledge. With seven branches and a presence throughout Germany we can guarantee our clients a real-time personal service. Our long-standing client relationships and strong market presence firmly anchor us in the property management sector, providing us with the knowledge of what impacts on the industry and our clients. This enables us to offer personalised and perfect solutions.

BK 01® – the leading industry system for settlement of mass payment flows

These payments involve considerable administrative expenditure for property companies that often manage thousands of residential units, regardless of whether in relation to the management of rental income and operating costs or deposit payments. Cash remittances must be checked against the accounting and booked, while disbursements – for example to utilities or insurers – must be paid and also recorded.

BK 01 is a highly-automated premium solution, designed to manage these complex processes. Aareal Bank has firmly established the BK 01 procedure in the property management sector as a standard solution for account management and payment transactions.

The core benefit of BK 01 lies in a significant improvement to the quality of processing daily payments, since BK 01 offers almost fully-automated cash remittance and disbursement processing.

The offer comprises more than the pure settlement of electronic payments. Individual additional software modules allow the integration of the BK 01 payment transaction system in industry-specific IT systems. This integration is part of the product offer, and a prerequisite for the excellent allocation ratios of the bank's payment information to the items in the clients' corporate accounting.

By licensing the procedure for selected IT manufacturers, the users of the leading systems – such as for example the users of SAP software – work with our solutions without the risk of software version incompatibility.

Exclusive contracts entered into many years ago with leading providers of industry software allow the users of the corresponding systems to enjoy a major, gradually expanding functionality in the settlement of mass payment transactions through BK 01.

BK 01 has set the standard for payment transactions for decades, and is the market leader in the institutional housing and property management sector. It has more than 2,200 clients. At the same time, our property financing business benefits from the payment flows generated through current account balances and term deposits on an ongoing basis: the bank uses these funds as a stable element of its funding mix.

Synergies through networking

We want to create further synergies in both software development and in distribution. To this end, we have networked Aareon, the Institutional Housing Business and Aareal First Financial Solutions even more closely together. An example of this cooperation is the development of BK XL®, the payment transaction process for integration in Aareon's Blue Eagle software. BK XL offers the exclusive added value over other procedures of an integrated electronic signature for releasing payments – a USP in electronic banking.

BK 01 is almost standard among the users of Aareon systems; even with the recently-integrated Wodis application, more than one-third of the users is optimising payment transactions via BK 01. All in all, 80 % of Aareon customers who have implemented the BK 01 and BK XL payment procedures maintain a business relationship with Aareal Bank.

Recognising trends, identifying new business potential

Our strength lies in our ability to recognise new sector-specific trends at an early stage, through the extensive exchange of information with our clients. Aside from continuously optimising our software systems, we set the groundwork for exploring new business potential. Our IT experts in Aareal First Financial Solutions have developed a new current account system. The new system is one of the first in Germany to use the XML standard format and is therefore already equipped to meet the requirements of payment services in a standard European payment zone – the single euro payments area (SEPA).

In order to expand our market leadership and to continue meeting our clients' requirements in the best way possible, we have invested consistently in our solutions for the institutional housing sector.

We also want to tap new markets; our successful BK 01 solution for companies in the energy industry has already been adapted for this purpose.

CASE STUDY: WANKENDORFER BAUGENOSSENSCHAFT FÜR SCHLESWIG-HOLSTEIN EG

Wankendorfer Baugenossenschaft für Schleswig-Holstein eG – a snapshot

Wankendorfer Baugenossenschaft für Schleswig-Holstein eG ("wankendorfer") manages roughly 14,000 apartments in its capacity as a leading housing company in the German state of Schleswig-Holstein. The company, which was founded in 1947, currently employs a staff of around 160.

Wankendorfer's company strategy focuses on four core elements: energetic modernisation, convertibility, regional relationship and intensive communication with the members of the cooperative. The company earned its reputation especially through the modernisation of its own housing stock: mod cons are ideally combined with energy-saving, environmentally-friendly technology.

Project description

wankendorfer has seen a gradual rise in demand for efficient data management, whether for property administration, drawing up invoices for operating costs, requesting tradesmen or strategic business planning. Efficient IT systems contribute to success, in meeting the increasing legal and market-specific demands.

wankendorfer sounded out the market for corresponding specialist software. Having conducted a comprehensive analysis, the company decided on Aareon's Blue Eagle IT solution. wankendorfer has already cooperated successfully for ten years with the consultancy and systems house for the property management sector. The conclusion was reached that Blue Eagle on the basis of SAP® was the suitable system for complex real-time data management. Aareon's project team conducted an intensive preliminary study together with wankendorfer's professionals to define the basic functions and additional services that Blue Eagle should take on. On the basis of the functional features determined, Aareon's specialists finally combined the individual application modules. Blue Eagle now provides Wankendorfer with extensive property management functions, and also forms the basis for the cost centre invoicing and for dividing the company into profit centres.

The outcome of the cooperation was an IT solution that was integrated seamlessly into their existing IT landscape. After the successful implementation and data migration, Blue Eagle contributes significantly to higher data quality, better customer service and more competitive company management for wankendorfer.

Interview with Helmut Knüpp, Chairman of the Board of Wankendorfer Baugenossenschaft für Schleswig-Holstein eG

Mr Knüpp, why did wankendorfer choose Blue Eagle?

There are various reasons. Our duties as a building cooperative are very complex and combine a variety of processes such as the administration, financing and modernisation of properties. One of the key requirements of the new system was not an individual solution, but one that could become a part of our existing IT platform. Furthermore, Blue Eagle allows us to use Aareon's integrated services. It was therefore easy to integrate with the Mareon service portal, which we have been using for many years. A particular advantage was the fact that Blue Eagle is based on tried-and-tested SAP® technology that is already established in the market. Finally, cost was the third key consideration, since Blue Eagle could be introduced as standard and did not require any costly adjustments."

How does Blue Eagle benefit your day-to-day work?

The effects of Blue Eagle are positive in both administration and business management. Besides real-time processing, other advantages are the clarity, transparency, speed and self-explanatory nature of the system. These are also appreciated by our staff. Blue Eagle also contributes significantly to competitive company management. We can now access information on a daily basis, which is beneficial – for example – during extensive modernisation projects, where we can call up the steps in the building schedule and investment necessary for each building, and see which construction work has already been completed and paid for.

You have been cooperating with Aareon for many years already. What aspects of the cooperation in particular do you regard highly?

Simply put, the commitment and expertise of the staff. It was evident when implementing Blue Eagle that Aareon's employees were totally committed to their task, and that they knew their job. The project team comprises an ideal combination of IT specialists and property experts. From the very beginning, Blue Eagle not only guaranteed us a technical solution but also a system that takes into consideration all factors of the property sector and was tailored to meet wankendorfer's requirements."

Helmut Knüpp

Interview with Carsten Jeschka, Head of Regional Sales for Northern Germany Aareon Deutschland GmbH

How, in your opinion, does Aareon differ from other consultancy and software companies?

Customers repeatedly confirm their high opinion, especially with regard to our experience and customer proximity. We have a presence throughout Germany with Aareon, so that our clients have a fixed individual contact person who is entirely familiar with their structures and does not require any lengthy training. This is an advantage especially when help is required immediately. Additionally, our software offer is not made up of individual solutions but of integrated services. Ultimately, we have the entire institutional housing sector on our radar. Our systems provide solutions for all sectors, and for large and medium-sized companies.

What are the prerequisites for the successful introduction of a software application?

As a rule, no two projects are the same. Even though we always implement the same software systems, an IT solution is used and integrated differently in every company. This is why it is necessary for us to know our clients' requirements of an IT system in advance and what company objectives should be supported. The preliminary work requires intensive and close cooperation between both parties. Following this, our specialists get to work and prepare the individual solution.

What characterised the implementation of Blue Eagle at wankendorfer?

The entire project was very constructive, and both parties enjoyed themselves tremendously. The long-standing relationship between the companies was of course a contributory factor. We were also frequently on-site, and had extensive exchange of information with the responsible people at wankendorfer throughout the entire project.

Carsten Jeschka

CASE STUDY: GBO GEMEINNÜTZIGE BAUGESELLSCHAFT MBH OFFENBACH

Project profile

Client: GBO Gemeinnützige Baugesellschaft mbH Offenbach

Project: Implementing the BK 01 deposit module

Project duration: September to October 2007

GBO Gemeinnützige Baugesellschaft mbH Offenbach – a snapshot

GBO is the largest housing company in Offenbach, close to Frankfurt / Main, with some 20,000 tenants residing in more than 5,000 apartments. The company also manages around 1,000 apartments and houses on behalf of third parties – a business area that offers tremendous potential for the future. As the owner of important event centres, such as the Capitol theatre and concert hall, GBO also contributes significantly to the development of the city of Offenbach.

Project description

BK 01®

In order to efficiently manage the data relating to their own housing stock as well as that managed on behalf of third parties, GBO has been using solutions provided by Aareal Bank Group for more than 30 years. Aareon's GES institutional housing ERP system and Aareal Bank AG's BK 01 integrated payment transaction system enabled manual operations such as matching payments and pending items to be fully automated. GBO uses the procedure for invoicing and recording the rents paid by its tenants.

For this project, GBO now wanted to employ the potential efficiency of BK 01 for deposit management too – a small-sized but complex business process, where maintaining savings books does not allow the money to be invested in an economically worthwhile manner. The data management is also hampered by isolated deposit-management programmes that often cannot be integrated in ERP systems – a double database is unavoidable.

Aareon and Aareal Bank provide a solution: the BK 01 deposit module resorts to the same data as for processing rent and operating costs. This simplifies data maintenance and facilitates automatic invoicing. The bank manages all of the deposits – which are still identified as individual deposits – in a single trustee master account. The interest for each depositor is calculated and credited automatically.

The technical introduction of the new module at GBO took only a few weeks. The fact that the GBO staff were also familiar with the functions of the BK 01 module from their existing work was advantageous. Training could be kept to a minimum. The quick execution also meant that the a new trustee account for a BK 01 customer could be opened with Aareal Bank, without going to too much trouble.

Interview with Winfried Männche, Managing Director of GBO

Mr Männche, what has been your experience with Aareal Bank in relation to the introduction of the new system?

In cooperating with Aareal Bank Group, we appreciate above all that all services are from a single source – IT expertise, excellent sector knowledge and the bank's expertise. It starts with Aareon, who operate our ERP system. The great advantage with this ERP system is that BK 01 incorporates the best integrated payment transaction systems on the market. We can rely on our contact in the group for projects such as this expansion of the automatic payment transaction processes. All members of Aareon staff are familiar with our requirements and processes.

What in your opinion are the advantages of a BK 01 payment transaction system for the day-to-day work?

The greatest advantage is that it frees us up to concentrate on our actual work. We want to provide the tenants in our properties with attractive housing. This means creating barrier-free housing for the aged and the disabled, renovating old buildings and developing new buildings. This is why we use every opportunity to relieve our 60 employees from duties that do not benefit our tenants directly. Thanks to the solution provided by Aareal Bank, we can automate labour-intensive duties such as the recording of rental income and – from now on – deposit statements, allowing us to gain valuable time to be used more sensibly elsewhere.

What exactly was your motivation to manage your deposits using BK 01?

It makes sense: since we already use other BK 01 modules, we could rationalise some time-consuming and monotonous duties cost-effectively and quickly. Two incompatible systems, managing two databases for the same customer, do not make economic sense. We can also benefit from using two connected workflows across one module, such as for example the interface to the correspondence."

Winfried Männche

Interview with Maria-Antonietta Ricciardi, Senior Manager Institutional Housing Unit Sales Rhine-Main area Aareal Bank AG

Ms Ricciardi, what kind of client is GBO?

GBO is a traditional client in the institutional housing sector. Along with many of our clients, GBO has relied on BK 01 as the premium payment transaction process for many years. Thanks to such long-standing client-relationships, we are always kept up to date on the latest developments in the industry. We can adapt our technology to react to the changed requirements. Clients such as GBO also contribute to our success in maintaining our leading role in the market.

Do clients often gradually buy additional modules?

It is in fact often the case that companies initially implement solutions that benefit their day-to-day business best in the short term. This is of course the case with BK 01, where entries are made to the bank on a daily basis that have to be checked against the accounting. The deposits are often not managed until in a second or third step. This is also because the terms laid out in the deposit investment division are subject to tremendous competitive pressure. However, we can often score with the process optimisation potential, as we did with GBO, when the client has experienced the corresponding added value.

How would you describe the contact between Aareal Bank and clients in the institutional housing sector?

The contact was very friendly and did not involve a classic call frequency, since we do not want to supply a new product every year. BK 01 is an established procedure that we continuously develop with our clients. We also remain in contact with our clients outside of the daily cooperation, at conferences and industry events. In this respect, we are not an external service provider but a part of the institutional housing sector. It is exactly this format that generates quality.

Maria-Antonietta Ricciardi

OUR EMPLOYEES

OUR EMP

OUR EMPLOYEES

Our employees are familiar with the needs of our clients: whether providing financing to the commercial property management sector or IT applications for the institutional housing sector, our experts in their specialist areas always respond to the client's individual requirements, thus arriving at the best possible solution. This approach contributes significantly to the success of Aareal Bank.

Market and industry experts

Our clients appreciate Aareal Bank as the specialist for specialists. As a global company, employees with a high degree of international and inter-cultural expertise are particularly important to us. We currently employ people from more than 30 different countries. They are experts in the markets for their respective home countries, and are familiar with their conditions and potential. Besides regional knowledge, our employees also have specific market knowledge that extends well above the financial sector. Our hotel experts, for example, are often additionally qualified as hotel manager, or have pursued studies with an emphasis on hotel management. This sector knowledge defines Aareal Bank's credo as specialist for the specialists – an approach that is appreciated by our clients.

Attractive employer

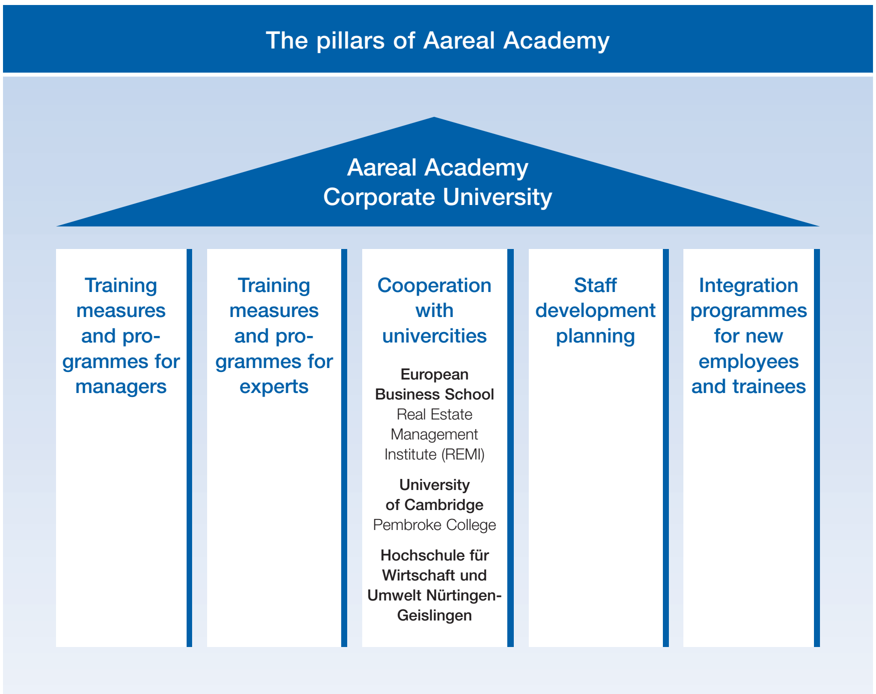
Aareal Bank secures this particular quality through a comprehensive training programme, which also distinguishes us from rival institutions in the face of intense competition for qualified employees. Aareal Bank offers newly-qualified as well as experienced employees attractive development potential with a view to promoting sustained loyalty to the company.

Aareal Academy

Aareal Academy is a virtual corporate university, through which we have promoted upcoming and motivated employees in recent years. It is based on the successes of our previous employee development programme (MEP) and adopts our training philosophy that employees work permanently on enhancing their expertise.

We offer our employees internal as well as external training measures, including not least an intensive exchange with two first-class universities: the Real Estate Management Institute (REMI) at the European Business School, and the Department of Land Economy at the University of Cambridge. Aareal Bank also supports property management trainees and awards the three best final theses at the FWI Management Academy for Housing and Real Estate Economics (FWI Führungsakademie des Europäischen Bildungszentrums der Wohnungs- und Immobilienwirtschaft). Together with Aareon AG, we also endow a property professor at Nürtingen-Geislingen University for a property management course of studies.

These cooperations extend over and above the concept of purely imparting information: we work together with the universities on



research projects, and promote international networks in the property sector. We stepped up our cooperation in particular with REMI – the Real Estate Management Institute – during the year under review. Aareal Bank has endowed the Aareal Foundation Chair for Property Investment and Financing since 2006. We are also committed through the role of Dr. Wolf Schumacher, Chairman of the Management Board as member of the Advisory Council of REMI.

For the first time last year, Aareal Bank awarded the research prize ”Aareal Award of Excellence in Real Estate Research“ together with REMI. In future, the research prize will be awarded annually, and will distinguish superior scientific endeavour in the field of property economics.

Trainee programme – round two

For the last two years, we have offered university graduates an updated training programme that serves as a launch-pad for around twelve young people every year. We focus explicitly on sponsoring new talent in the area of international property financing. The positive points of the programme, which is tailor-made for each individual graduate, include seminars in conjunction with the European Business School, international exchange programmes with University of Cambridge students, and participation on one of the key modules of their ”Real Estate Finance“ master seminars. Given that most of the participants have completed a course of study abroad or have acquired international work experience, they also introduce an international perspective to the programme. By the end of the programme, their active participation in the specialist departments means that the trainees are familiar with the processes of a property finance house. The trainees are then fully equipped to embark on a career in one of the sector or regional teams.

Promoting experienced staff

Training is a key success factor for us. Aareal Bank is therefore committed to training its experienced employees. One of the pillars within this concept are training programmes; these allow our employees to further extend and enhance the depth of their knowledge, irrespective of whether this is in project management or in relation to specific issues such as the derivatives business with property clients.

The time horizon for the workshops and short seminars on offer is flexible and can be arranged to fit in with the daily work routine.

Aareal Bank will open up a variety of routes – depending on potential and personal preferences – to achieve long-term growth together with its employees. We have explored new territory since last year in promoting expert and specialist career paths. A key example was a work-study executive programme launched at the European Business School, which was attended by nine employees. The courses of study extended from property investment management through to property investment banking to international property valuation. The success is justified: we have recruited 80 % of our expert and management personnel from among our own staff.

Management guidelines as a component of a modern corporate culture

The long-term loyalty of our employees is a reflection of the positive working climate that must be maintained continuously through a modern corporate culture. For example, Aareal Bank introduced new management guidelines in January 2007 with its "Fit for Leadership" programme. It provides our managers with a binding set of values which is flexible enough to be adjusted to meet the specific working environment.

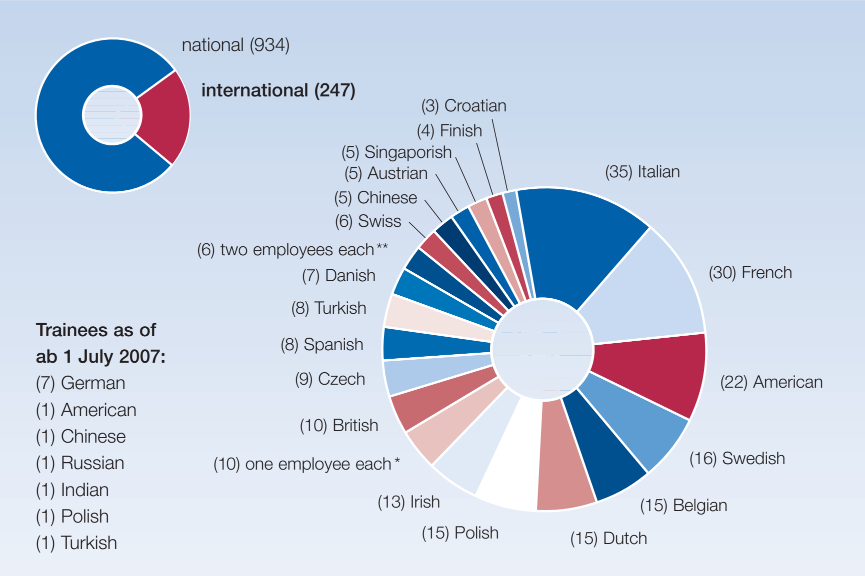
At the same time, we have revised the Code of Conduct and introduced an extended form in the company during summer 2007. Our Code of Conduct must be observed by all our employees – regardless of their functions and duties – and also includes guidelines for integrity and responsible trading. At the same time, it represents a clearly-defined set of rules and regulations regarding the respectful approach to colleagues, clients and business partners. Our Code of Conduct is firmly enshrined throughout the group, and is a major contributory factor in strengthening the trust placed in the bank within all of our stakeholder groups.

Participating in the bank's success

Our corporate culture promotes the entrepreneurial spirit of its staff. Commitment should be worthwhile: we are committed to corporate joint responsibility and allow our employees to participate in the business development.

We initiated a new remuneration system for all of Aareal Bank's employees in 2007, whereby management are rewarded for their

Aareal Bank's international employee structure



** Bulgaria, Estonia, India, Iran, Japan, Luxembourg, Morocco, Mexico, Portugal, Ukraine*

*** Greece, Romania, Russia*

own personal performance and also participate financially in the company's success, through the bonus system.

Aareal Bank is not only a fair partner for its employees whilst in employment. It has become even more important nowadays to make provisions for the future, in order to fulfil one's life expectations in later life. Aareal Bank offers a modern, fund-based employer-financed pension scheme: we also support our employees in making their own provisions by means of deferred compensation in retirement schemes, and by offering working hours accounts.

Looking for tomorrow's experts

Aareal Bank has a lot to offer its employees. It also holds interesting and long-term perspectives for graduates in particular. We are acting increasingly to recruit the experts of tomorrow, for example within the scope of the European Business School graduate congress, at "Career in Europe", an international university trade fair in Berlin and Brussels, and the Cologne graduate congress.

Specialists for longevity

Long-term employee loyalty is the basis for economic success. Our specialist staff combine expertise that has been built up over the years with a detailed knowledge of clients' requirements. This creates trust for long-term client relationships – values that form the basis on which we will shape a successful future together.

GROUP MANAGEMENT REPORT

GROUP MANAGEMENT REPORT

Business and environment

Group structure and ordinary activities

Aareal Bank Group is one of the leading international specialist property banks and a provider of finance. It also provides advisory and other services to the commercial property and institutional housing sectors. It supports German and international clients as their financing partner and related service provider.

Aareal Bank's business model is made up of two segments:

1. Structured Property Financing

Structured Property Financing, which brings together all the property finance and treasury activities of Aareal Bank, is at the core of Aareal Bank Group.

Aareal Bank has more than 15 years experience in domestic and international commercial property finance, and services clients in more than 25 countries. It is active in Europe, North America and Asia within the scope of its "three-continent strategy". Leveraging its successful European business model, we are establishing similar structures in North America and in the Asia / Pacific region. We provide our clients with an established network of regional market experts and industry specialists in our target markets to offer financing solutions tailored to meet their requirements.

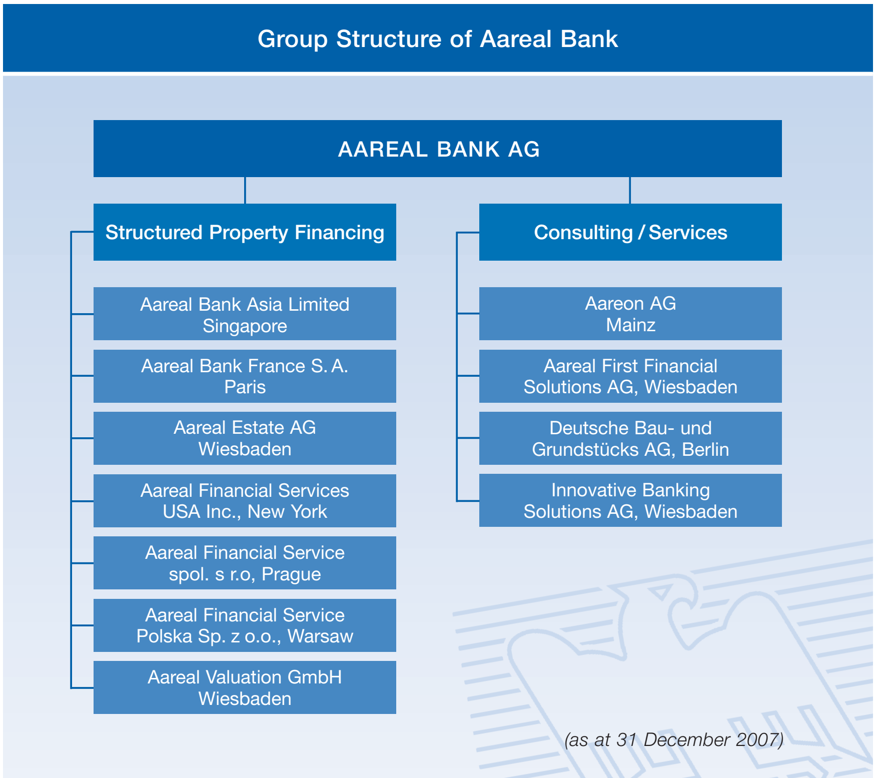
Aareal Bank is an established issuer on the capital market, where it covers a wide range of refinancing tools including asset-covered bonds to cater for a broad investor base.

2. Consulting / Services

The Consulting / Services segment offers the institutional housing sector services and products for managing residential property portfolios and processing payment flows. Within this segment, the Institutional Housing Business cooperates closely together with the two Group subsidiaries Aareon AG and Aareal First Financial Solutions AG.

We operate our IT system consultancy and related advisory services for the institutional housing sector through Aareon AG, which can boast more than 50 years experience. Aareon offers its customers advisory and training services, as well as software products plus support and IT services.

Aareal Bank operates a highly-automated mass payments system for its clients that is integrated in their administrative processes, namely the operating and deposit management system known as BK01. The settlement of payment transactions via Aareal Bank generates client deposits that can also contribute to the refinancing mix of the entire Group.



The Group subsidiary Aareal First Financial Solutions services the BK 01 system as well as carrying out additional functions. It also ensures the consistent development of the system.

Macroeconomic and industry-specific environment

Global business environment

Although global economic development eased slightly in 2007 after the surge in 2006, the global economy was robust overall. The sharp rise in commodity prices and the crisis on financial markets, owing to the sub-prime crisis in the US, had not yet impacted severely on economic growth in 2007.

Gross domestic product in 2007 rose by a total of 3.6 % on a global scale, supported by sustained positive economic development in the US and the European Union. Economic growth in the emerging markets remained at the high level of recent years – this is particularly true for China, but also for India and Russia. Southeast Asia, Latin America and the Eastern European countries continued on the path of further growth.

Towards the end of the year, the positive economic environment was overshadowed by accelerating inflation. This development is particularly worrying since, in conjunction with the crisis on financial markets, it places the central banks in a difficult situation in terms of deciding whether to combat inflation or support the economy through monetary policy.

The good economic environment initially led to positive development on international financial markets, albeit not without volatility. Contributory factors were the predominantly positive corporate results, relatively stable outlook and reliable monetary policy together with a fiscal policy that was focused mainly on stability. Equity prices climbed and bond yields fell.

However, the situation changed with the onset of the sub-prime crisis in the US and the ripple effects on individual American and European banks. The "sub-primes" are loans extended for owner-occupied houses in the US high loan-to-value ratio, offered to private borrowers with poor credit rating.

Given that the sub-prime loans were refinanced, amongst other things, by securitised investments on the capital market, the crisis extended to other banks and economic areas. As a consequence of this, activities on the market for securitised transactions practically dried up – a situation that still persists. Significant amounts of all kinds of loans and advances were traded on these markets in recent years. The securitisation markets were also important in the business of transferring risk. The associated relief to the balance sheets allowed the lending banks in particular to extend their new business significantly.

The collapse of the securitisation markets, the faltering provision of liquidity on the primary markets plus the uncertainty governing the extent and valuation of banks; and investors' commitments burdened by the crisis resulted in a considerable loss of confidence among the banks and to a scarcity of liquidity in the interbank market.

The European Central Bank (ECB), the US Federal Reserve and other central banks provided the markets with considerable amounts of short-term liquidity through quick tenders, in order to bridge the credit crunch. A quick tender is a fine-tuning instrument used by the central banks to smooth out the effects of liquidity fluctuations on the interbank market for a very short timeframe.

The financial crisis spread out to other sectors as well, resulting in drastic declines in corporate transactions in the leverage buyout (LBO) sector, most of which had been previously debt-financed, thus mirroring the situation on the securitisation market.

The necessary downgrades by the rating agencies served to intensify the situation. Following the substantial write-downs made by the banks and investors, the sub-prime crisis reached its preliminary peak with the crisis affecting the bond insurers, or so-called monoliners, in the US.

The European Central Bank determined in its monthly report for December 2007 that corporate loans in the US, UK and the eurozone were subject to considerably stricter lending criteria in the third quarter of 2007. In the eurozone, the guidelines for retail lending were adjusted to a much lesser extent than for corporate lending. This differs significantly from the US, where the guidelines for retail housing construction loans were tightened substantially. The banks gave the more difficult conditions for accessing market finance and lower risk tolerance as material reasons for these measures.

Conditions on the market for securitisations, where off-balance sheet loans were placed, were considerably more difficult in the second half of the year.

The confidence and liquidity crisis gradually led to a sharp rise in term deposit interest rates on the interbank market compared with secured borrowing in the repo market. The difference between 3-month Euribor and the 3-month Eurepo rate, which was only around seven basis points at the start of the year, rose to 93 basis points at the peak. The interest rate spreads on senior unsecured issues have also risen considerably – by 50 to 100 basis points in part – even for well-rated banks. The Pfandbrief (asset-covered bonds) market on the other hand, remains relatively unaffected by the fallout from the sub-prime crisis.

Global commercial property markets

Following a record number of transactions in the property sector in 2006, the first half of 2007 was also defined by good demand for commercial property. At first, strong demand from investors drove down the yields on commercial property worldwide; these fell to a particularly low level on the long-established markets. As interest rates rose and the more restrictive lending environment took effect, demand for property eased in the course of the year. The volume transacted in commercial property in the second half of 2007 was therefore down considerably on the same period of the previous year.

The more difficult situation on the market for securitised transactions in the second half of the year impacted primarily on the Anglo-Saxon and Western European markets, consequently reducing the loan offers for commercial property finance. CMBS (commercial mortgage-backed securities) were particularly affected by the collapse of the securitisation market.

The volume of new issues launched in the first half of the year was € 45.2 billion (compared with € 23.1 billion in the first half of 2006). Issuance in the second half of 2007 amounted to only € 2.6 billion.

Large-sized property transactions in particular, and those with a high borrowing ratio, were blocked; in some cases, individual transactions were even called off. External studies calculated that the volume of commercial property transactions concluded in Europe in the second half of 2007 was down 25 % year-on-year. On a one-year comparison, the decline was 13 % compared with 2006.

A fall in property prices was evident in some cases, so that yields that had fallen in the first half of the year stabilised in many places or rose towards the end of the year. Many markets for commercial property were characterised by stable to rising rents with falling vacancy ratios.

Positive global economic development also had an affirmative effect on the retail market in many countries. Retail premises in good locations were able to command mainly stable to slightly rising rents. Rent increases were seen in the dynamic markets of Asia in particular. The fall in yields on retail property investments in the first half of the year was halted or turned around in the second half.

The hotel industry was another beneficiary in 2007 of the positive trend in the global economy. Hence, demand for hotel property investments was generally good, particularly in Asia, where investors favoured upmarket and luxury hotels.

The logistics industry, and hence the associated financing of logistics properties, also gained from the positive economic development and related increase in international trading. However, the yields for logistics property investments varied greatly, with established markets such as the UK yielding around 6 % and growing markets such as Russia generating approx. 13 %.

Performance of key regional markets

Europe

In the European Monetary Union (EMU) the positive growth trend of the previous year lasted into autumn of 2007. However, a few of the trend indicators collapsed in the final months of the year. This was due to the continued rise in the price of oil, the financial and liquidity crisis as well as the appreciation of the euro.

The enduring good economic environment and continuation of the budget consolidation substantially improved the negative balance of public-sector authorities. All in all, growth of 2.9 % in the European Union was only slightly lower than the previous year. The engines of growth in the EMU included Ireland, Slovenia, Finland, Spain, Austria and for the first time in many years, Germany. Further there was another strong reduction in unemployment across the European Monetary Union, to close to 7 %.

By mid-2007, the European Central Bank had increased the main refinancing rate to 4 %, adhering to its commitment of pursuing a policy of stability. The crisis on financial markets emanating from the US led to a sharp increase in money market rates. This factor, coupled with the significant appreciation of the euro, prompted the European Central Bank to leave key rates unchanged, despite the looming threat of inflation in the second half of the year.

Germany

The German economy continued to recover in 2007: gross domestic product rose by 2.5 % and unemployment fell to 8.1 % year-on-year, which is the lowest rate recorded since 1995.

Residential construction investment fell in 2007 as it continued to be affected by the abolition of the "Eigenheimzulage" home-ownership subsidies that came into effect in 1 January 2006. Domestic demand by private consumers dropped considerably after the 1 January 2007 VAT increase, but rose again in the course of successive quarters to reach the previous year's levels. Private consumption fell by 0.3 % on an annual basis. Inflation, particularly energy and food inflation, gathered pace towards the end of the year.

Rising employment generally raises the demand for office property, which is reflected in higher turnover of office space. At the same time, vacancies declined – with the exception, on this occasion, of the Munich market. Top rents increased for office space in Munich, Frankfurt, Hamburg and Dusseldorf, which are the key locations for office properties. The only market in which rents remained unchanged from last year was Berlin, which is the fifth largest market for office properties.

The trend for retail property rents in good inner-city locations was stable or rising.

The increasing importance of Germany as a logistics location enhances demand for good logistics property, in line with prevailing market conditions and with close proximity to transport routes. Rents were stable to rising.

The transaction volume for hotels in Germany in 2007 was unchanged from the previous year. The first half of the year was defined by buoyant investment activity on the hotel markets and also accounted for roughly two-thirds of the transactions conducted. Owing to the sub-prime crisis, the volume of transactions concluded was lower in the second half of the year.

In 2007, occupancy rates and the recovery ratio per hotel room in Berlin increased over the previous year, while in Frankfurt vacancies were unchanged and the recovery rate fell only slightly.

Overall, there was a shift in the second half of the year, with investors willing to commit to a higher level of equity investment. Open-ended property funds reduced their stakes in German property during 2007. The decline in yields halted in the third quarter, with increases reported in some cases.

The Act on the Introduction of REITs, which entered into force with retrospective effect from 1 January 2007, created a new, indirect, and tax-effective property investment opportunity, the effects of which remain to be seen. Two REITs were listed on the German stock exchange during the past financial year.

France / Spain / Italy

While Spain's real gross domestic product posted high growth of 3.8 % in 2007, growth in the French and Italian economies of 1.9 % each fell short of the European Union average growth rate of 2.9 %. In all three countries, rents for office properties in the key locations of Madrid, Barcelona, Paris, Milan and Rome were stable or rose slightly. A slight easing of the trend was reported however in Rome, although top rents in the city centre were practically unchanged from the previous year due to a shortage of high-quality office properties. The vacancy ratios remained constant in all three countries. Whilst low in Spain and France, vacancies were higher in Italy, especially in Milan.

Rents for retail properties were unchanged to slightly higher in all three countries. There was evidence of a trend in Spain and Italy towards smaller shopping centres outside of the major conurbations. In Italy, Milan remains the key location for business hotels. At the same time, there was an increase in investor interest in tourist hotels in top-class locations. Average hotel bed utilisation in Barcelona, Paris and Milan remained unchanged in 2007. It fell slightly in Madrid but was somewhat higher in Rome. All of the aforementioned locations posted growth in income per room, albeit ranging widely between approx. 14.5 % in Barcelona to just above 1 % in Rome.

Rents for logistics properties were down slightly in Paris compared with a slight rise in Madrid, Barcelona and Milan.

Property investment in France was focused on the greater Paris region.

Switzerland

Overall economic growth in Switzerland was down 2.3 % in 2007 over the previous year.

Office rents varied in the key locations; Zurich posted a rise compared with a decline in Geneva. Demand for hotel beds rose in both the business and the tourist segments. Occupancy and recovery ratios per hotel room were up in Geneva and Zurich.

Logistics properties on the other hand are less important on the Swiss market. They are frequently owner-occupied and are therefore not available to investors. Retail rents in the top location of Zurich increased during the previous financial year. The Swiss market for commercial property is becoming increasingly interesting for international investors.

Scandinavia

The Scandinavian economies continued their above-average progress in 2007, with growth rates of 4.3 % and 1.9 % reported for Finland and Denmark respectively. Nevertheless, the momentum has eased in all countries.

Vacancy ratios for office space remained low in the capital cities Helsinki, Oslo and Copenhagen. The level of vacancies was higher in Sweden, although it fell in 2007 in the key locations of Stockholm, Goteborg and Malmo. Top rents paid for office space in key locations in Scandinavia were stable, with Oslo even reporting a rise. Retail property rents in key locations were stable. On the other hand, top rents for logistics properties rose in Copenhagen, Oslo and Stockholm whilst remaining stable in Helsinki. The average bed occupancy rate in the four capital cities' hotels was around 70 %. While this figure rose in Oslo, Stockholm and Helsinki during 2007, Copenhagen reported a decline. Average returns per available room rose in all four countries; Oslo posted high growth in average returns, followed by Stockholm.

Benelux

At 2.7 %, economic growth in the Netherlands mirrored that of Belgium. The number of vacant office properties fell slightly in the Netherlands, albeit from a very high level, especially in the Amsterdam region Supply and demand of office rental space, and hence rents, remained stable in the Netherlands' key locations for office property: Amsterdam, Den Haag, Rotterdam and Eindhoven. In Utrecht, the other key location, rents have recently risen slightly.

The market for office property in Belgium is focused mainly on Brussels. Demand is defined mainly by the public sector and by the European Union in particular. Nevertheless, there was an increase in the demand by private companies for office space in 2007. The vacancy ratio in Brussels fell only slightly, whereby vacancies are low in the city centre and high in the peripheral locations. The logistics sector is very important in the Netherlands and Belgium. Rents here remain stable. On the other hand, retail rents have risen in both countries. The occupancy ratio for hotels in Brussels increased by around 2 % compared with a slight fall in Amsterdam, which however still enjoys a high occupancy ratio overall of just over 80 %. The average return per room rose in Brussels and Amsterdam, whereby the level in Amsterdam is considerably higher than in Brussels.

United Kingdom

The United Kingdom economy progressed well in the first three quarters, before the first effects of price declines on the British residential property market fed through to the fourth quarter and the slowdown in the course of business in the financial sector was noticeable. This had the effect of slowing down the rate of economic expansion, so that the annual growth rate was ultimately 3.1 %.

The rental situation for London office property was stable in 2007: the level of vacancies was low and top rents climbed. However, the high price level for commercial property and turbulence on financial markets generated uncertainty on the commercial property market, with the result that planned property transactions were increasingly called off. Commercial property in the UK suffered a particular loss in value in the second half of the year, and the previously very low yields rose again. Rents on retail and logistics properties were stable. Tourism is very important for the UK. The occupancy rate for hotels remained high in London at more than 81 %. Average returns per hotel room rose by around 10 % in 2007.

Central and Eastern European Countries (CEE)

The high growth rates of the previous year continued unabated in 2007 in most of the CEE countries. Gross domestic product in Poland climbed by 6.5 %, in the Czech Republic by 5.8 %, in Slovakia by 8.7 %, in Bulgaria by 6.3 % and in Romania by 6.0 %. Russia posted a 7.5 % rise in gross domestic product, which was however, accompanied by high inflation. Hungary is an exception among the CEE states, with below-average growth of only 2.0 % due to the necessary consolidation measures taken by the government.

Investment in the CEE countries has risen continuously in recent years. There are some signs of saturation in the markets in the established key locations within Poland, the Czech Republic and Slovakia, which led to a shift to niche markets or to other cities outside of the key locations. Rents for office space as well as for retail properties were stable in the important cities of Moscow, Prague and Warsaw. Rents for logistics properties in the aforementioned locations were also constant, apart from Warsaw, which was still able to post slight growth. Returns per hotel room fell in Moscow, although it still remained at a high level of € 200. There was a slight rise in occupancy rates, as was also the case in Prague, which also posted a slightly improvement in the returns per room.

The yields on various types of property in the CEE states have been falling for several years, although the upside trend has meanwhile slowed down. There are considerable differences between the high yields in Moscow and somewhat lower returns in Warsaw and Prague, although by and large they remain above the Western European level. Germany, Austria and the UK accounted for more than 50 % of investors in the CEE states.

Turkey

The high level of economic growth in Turkey continued in 2007, although at 5.1 %, the gross domestic product increase was down on the previous year. Demand for office property increased, and the number of vacancies declined again. There are practically no empty office properties to be found in the centre of Istanbul, where sites for developing new office properties are scarce, and therefore expensive. Rents for retail properties rose slightly in 2007. High yields, compared with Western Europe, could be attained in the logistics sector. A large proportion, especially of modern properties, is owner-occupied. Additionally, the hotel sector is becoming increasingly important. The occupancy ratio, as well as returns per room, rose in 2007.

Although yields on commercial property in Turkey fell in 2007, they were considerably higher than in Western Europe. Foreign investors have invested heavily in the Turkish market, particularly in retail property and hotels.

North America

Although general economic momentum in the US eased in the first half of the year, it posted a surprisingly strong increase in the third quarter, despite the onset of the mortgage and financial crisis. The fourth quarter followed with a substantial easing. Gross domestic product growth for the year 2007 as a whole was around 2.1 %, down from the previous year's figure of 2.9 %. Inflation, which had eased initially, rose again strongly in the last months of the year to over 4 %. The Federal Reserve ended its restrictive policy in September when it cut the key overnight rate on Federal funds, thereby placing more importance on the credit and liquidity crisis than on combating inflation. By year-end, it had been reduced to 4.25 %.

The property market in the USA throughout 2007 was defined by the sub-prime crisis. Prices for residential property came under pressure. The rental market for office property showed strong form, despite the sub-prime crisis. Office property rents showed a distinct variability according to region. For example, while rents for example in San Francisco or Seattle rose sharply in some cases, they fell in Atlanta. However, rents were unchanged or rising in most major locations. Vacant office space also varied greatly, from just under 5 % in Manhattan to close to 28 % in Detroit. Yields on commercial property rose in the second half of the year.

Vacancies among retail properties varied greatly from region to region in the USA. Rents in the top locations of New York, Los Angeles and Chicago were stable or slightly rising. Vacancies in logistics properties also varied greatly by region, showing no uniform trend. The hotel market in the USA is dominated by the large chains. Average returns per room rose slightly, even in locations such as New York and Washington D.C.

Gross domestic product growth in Canada and Mexico also fell year-on-year to 2.6 % (2006: 2.8 %) and 2.9 % (2006: 4.8 %) respectively.

In Canada, the banks extended relatively few sub-prime loans to their customers. Nonetheless, the high level of dependency on exports to the USA represents a threat to the Canadian economy. However, prices for commercial property were stable, on unchanged to slightly rising rents. Yields on logistics properties showed no uniform trend in Canada, although they remained largely stable for retail property.

Rents in the market for office property in Mexico were unchanged at the two key locations of Mexico City and Monterrey. The vacancy ratios, which were particularly high in Mexico City, were reduced. The logistics property market grew, especially in locations close to the US border and in Mexico City. Demand was seen in the capital city for high-quality properties.

Asia / Pacific region

The sub-prime hardly impacted on Asia during 2007. The economy in the Asian region again posted strong growth, in some parts. China was ranked first, with economic growth of 11.3 %. The Chinese central bank hiked interest rates several times in order to keep economic development in check. Economic growth in India, as well as South-east Asian countries such as Vietnam and Indonesia was high as well.

In contrast, growth rates in Japan – the second-largest economy worldwide – have been low for many years. Economic growth in 2007 was 1.9 %.

Most of the markets for office property in the East Asian region have progressed steadily in terms of rental activity. Demand from the financial sector drove office space vacancies in Singapore down to a historical low. Office property markets in China and India also enjoyed robust demand, especially for first-class property. Rents in Beijing on other hand eased slightly. Vacancies in Japan were low. Retail trade expanded in the Asian region, with the result that the number of vacant retail properties was correspondingly low in 2007.

Dynamic economic development in China was accompanied by high demand for logistics properties. The upcoming Olympics in 2008, and the World Expo in 2010, have already impacted positively on China. Increased demand was seen in 2007 for storage facilities close to the airport in Beijing. International hotel companies are focusing increasingly on the cities of Beijing and Shanghai.

The highest rents for logistics properties in the Asia region were in Tokyo, followed by

Hong Kong. Rents mainly increased in 2007. On Asia's hotel market, average returns per room in 2007 increased slightly over the previous year.

The share of cross-border investments increased, particularly in Asia. Private equity funds have shown an interest for this region, as have German open-ended property funds – although only in the last few years.

The German institutional housing sector

Ever since the international capital market has focused on the German property market as an investment opportunity, the institutional housing sector has become more heterogeneous and even more professional in some areas. The corresponding changes in the ownership structure on the German housing market have been largely maintained in 2007. Following the spate of large-volume residential property transactions in the first quarter of last year, investor trading eased off in the wake of the turbulence on the credit markets. The significance of opportunistic buyers on the investment market has diminished, to be replaced increasingly by national investors, and strategically oriented international investors with less ambitious return targets.

The general momentum of the German economy also had a beating on the residential property sector in 2007. Years of stagnation were followed by an average increase of 1.6 % in rents over the previous year. However, there was considerable regional variation. Rents have increased by 3.6 % in Baden-Wurttemberg and Bavaria, compared with northern Germany, where they stagnated or declined in some cases.

The onset of a recovery on the housing market led to increased investment activity at the same time by housing companies. The large majority of investments in existing property comprised energetic refurbishment of buildings, mainly due to the new energy saving regulations (EnEV) that came into force in October 2007. In the light of rising energy costs, this trend is likely to continue and will contribute substantially to the continued trend among property management companies to optimise existing properties, hence leading to higher rents.

Although vacancy ratios fell on average, the situation remains problematic in some parts of Germany. Apartments are meanwhile not the only products being marketed. The attractiveness of rental properties is also heightened by approaching target customer groups and the provision of supplementary services.

Group profitability

Aareal Bank Group posted its best result ever in the 2007 financial year. Operating profit of € 380 million represented a further basis for the successful future of Aareal Bank Group.

Net interest income was increased by 5.7 %, from € 389 million in the 2006 financial year to € 411 million in 2007.

At € 77 million, net loan loss provisions for the 2007 financial year were lower than the forecasted target corridor of € 80-90 million.

Net commission income of € 142 million was close to matching the previous year's figure of € 145 million.

Net trading income of minus € 26 million reflected current expenditure for our own synthetic securitisation transactions to be recognised, plus the results from standalone derivatives and the valuation of the trading portfolio in a volatile market environment. These comprise in particular senior unsecured bonds issued by the banks and ABS securities. Roughly 90 % of the ABS securities totalling € 625 million are rated AAA. The share of US CMBS securities in the entire ABS portfolio is less than € 50 million.

The bank is not invested in US sub-prime issues, US RMBS issues, CDOs and ABCPs / SUVs. Furthermore, the bank does not hold any issues that are guaranteed by monoliners.

Results from non-trading assets of € 206 million were predominantly defined by the successful sale of the stake held in Immobilien Scout GmbH. This item also included the results from the disposal of securities from the available-for-sale portfolio, and further income from the disposal of shareholdings in asset management entities.

The net result from investments accounted for at equity of € 68 million in the year under review was characterised by the € 5 million to which Aareal Bank was entitled from its stake in Immobilien Scout GmbH (which was subsequently sold), and in particular by the mark-up from the measurement of participating interests in Deutsche Interhotel (DIH). Income from the disposal of assets and companies held by DIH Holding provided Aareal Bank Group with attributable income of € 63 million.

Results from investment properties contributed € 1 million.

Administrative expenses rose from € 356 million in 2006 to € 361 million in 2007; the increase was reflected in staff expenses of € 2 million and other administrative expenses of € 5 million. This increase was predominantly attributable to the international expansion of Aareal Bank Group, offset by successful cost-reduction measures implemented within the scope of realigning Aareon AG.

The positive contribution of net other operating income and expenses of € 18 million for 2007, after charges of € 8 million in 2006, and impairment of goodwill in 2007 of € 3 million, complete the components of operating profit, which amounted to € 380 million.

An income tax burden of € 72 million for the year 2007 included a charge of € 13 million from the adjustment of deferred taxes to future domestic tax loss carryforwards, owing to the reduction in the tax rate agreed upon by the legislator.

After taking into account the result of € 18 million due to minority interests, consolidated net income for the financial year amounted to € 290 million. This equates to a return on equity after taxes of 25 %, and earnings per share of € 6.77.

Segments

Structured Property Financing

Business development

We increased the volume of new loan commitments in the Structured Property Financing segment by roughly 18 % over the previous year, from € 9.9 billion to € 11.7 billion, thereby clearly exceeding our € 10 billion target for 2007. At the same time, we increased our share of international business: international markets accounted for around 89.5 % of new loan commitments, and Germany for 10.5 %.

Three-continent strategy

Aareal Bank pursues a "three-continent strategy" that extends across Europe, North America and Asia. Leveraging its successful European business model, the bank is establishing similar structures in North America and in the Asia / Pacific region.

Key regional markets

Europe

Germany
In Germany, we have offices in Berlin, Hamburg, Munich and Wiesbaden.
The volume of new business concluded in 2007 amounted to € 1.2 billion, spread

across various types of property. At 38 %, residential property accounted for the largest share, followed by retail and logistics properties with around 15 % each.

France / Spain / Italy

With our Paris subsidiary, Aareal Bank France S.A., our representative office in Madrid, our branch offices in Rome and Milan, we are optimally positioned in the French, Spanish and Italian markets. We more than doubled new business in France over the previous year to around € 1.1 billion. The level of new commitments in Spain amounted to € 0.6 billion. At around € 1.5 billion or 12.4 % of the total volume, Italy contributed substantially to new business generated, as it has done in previous years.

Switzerland

We have established a presence in Switzerland with our Zurich branch office, where we generated new business in the amount of € 0.3 billion during 2007.

Scandinavia

In the Nordic countries this year – including the Baltic region – we generated the highest volume of new business compared with all the other regions, amounting to around € 1.8 billion, or 15.5 % of all new business.

Within Scandinavia, Sweden remains the largest sub-market with new business totalling € 1.1 billion. New business in Finland amounted to around € 0.4 billion, with Denmark and Norway accounting for € 0.2 billion and € 0.03 billion respectively. For the first time, we provided financing solutions in the amount of around € 0.1 billion in the Baltic States.

The opening of a representative office in Helsinki in May 2007 has further enhanced our presence in the Northern European markets. This marks the third location in our regional distribution centre for Northern Europe, after the representative office in Copenhagen and branch office in Stockholm.

Benelux

In 2007, we achieved new business in the amount of € 0.8 billion in the Benelux countries, where we have branch offices in Amsterdam and Brussels.

United Kingdom

The volume of new business generated in the UK was € 0.8 billion. We service clients from our London branch office.

Central and Eastern European Countries (CEE)

We are in the process of expanding our distribution network in the CEE countries in order to further increase our new business, which stood at € 1 billion in 2007. We started by preparing for a representative office in Moscow in 2007. Aareal Financial Service Polska Sp. z.o.o. was also converted into a branch office, which will serve in future as a regional hub for the CEE countries. We also have a presence in Prague with our subsidiary Aareal Financial Service spol. s.r.o.

Turkey
The volume of new business achieved in Turkey, where we have a representative office in Istanbul, was a respectable € 0.5 billion in 2007.

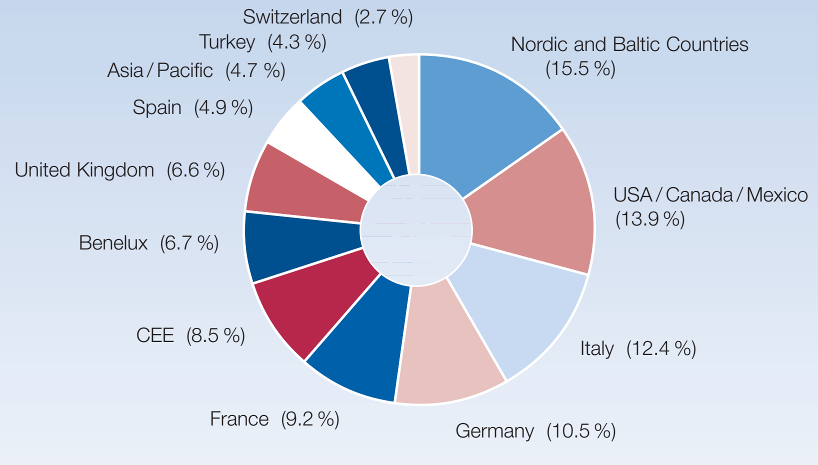
North America (NAFTA states)

We doubled the volume of new business in North America, from € 0.8 billion to € 1.6 billion. This equates to a share of around 13.9 % of total new business. We expanded our presence particularly in the US, which is the core market of this region, with an active presence in New York through our subsidiary Aareal Financial Services USA, Inc. Aareal Bank has neither direct nor indirect exposure to the sub-prime market.

Asia / Pacific region

During 2007 we continued to expand successfully in the vibrant Asian economic region. Our Singapore-based subsidiary Aareal Bank Asia Limited (previously structured as Aareal Financial Services (Singapore) Pte. Ltd) obtained its merchant banking license in August 2007. Singapore acts as the regional hub for the Asia / Pacific region. We have submitted an application to license a representative office in Shanghai. New business in the region grew by € 0.6 billion, with the focus on China. However, we also extended finance in Singapore, Macau, Japan and the Maldives.

New business commitments by region in 2007 (%)



Pooling the resources of industry specialists nationwide

Our success is based on regional expertise combined with the knowledge of our industry specialists, providing financing for shopping centres, hotels and logistics in particular.

Shopping centres

In cooperation with the decentralised country units, new business in the amount of approx. € 2.1 billion was concluded in the retail property sector in 2007. Regional focus was on Turkey, Finland, Spain and Italy.

Hotels

We generated around € 1.5 billion in new business for hotel financings. This new business was built up on a broad basis that spanned 19 countries in three continents.

Logistics properties

During 2007, Aareal Bank achieved new business in financing logistics properties in the amount of € 0.9 billion. This was achieved predominantly in Italy, Germany and the CEE countries.

Segment result

Net interest income in the Structured Property Financing segment reached € 347 million in the 2007 financial year. This corresponds to an increase of 2.1 % over 2006.

Due to the improvement in our portfolio quality, we were able to reduce the figure for net loan loss provisions; this amounted to € 77 million in the year under review, down 13.5 % from the previous year's figure of € 89 million.

Net commission income fell by 27.3 % in the financial year under review, to € 24 million. The second half of the year was defined by considerably lower prepayments, and hence by a decline in prepayment fees. Last year's result of € 33 million also included a € 7million in non-recurring income from an asset sale by a fund.

Net result on hedge accounting totalled € 1 million.

Net trading income of minus € 26 million reflected the change in the market situation since mid-2007. Lower marking to market of ABS securities and senior unsecured notes issued by banks are echoed here. This item also included mainly expenditure for the bank's own synthetic securitisation transactions as well as standalone derivatives.

The result from non-trading assets of € 52 million was unchanged from last year, and included the realisation of price gains on available-for-sale securities as well as income from the disposal of the remainder of our shareholdings in asset management entities.

The rise from € 1 million in 2006 to € 63 million for the year under review in the net result from investments accounted for using the equity method is accounted for by the measurement of participating interests in Deutsche Interhotel (DIH). Income from the disposal of properties and companies held by DIH Holding provided Aareal Bank Group with attributable income in this amount.

Administrative expenses, which in 2007 climbed by 6.5 % over the 2006 financial year to € 212 million, reflected investments in the international expansion of the business and our efforts in exploring new markets. Furthermore, the item includes special payments made to staff, as a measure of our thanks for their excellent work within the scope of the successful realignment of the Group.

Net other operating income and expenses improved from minus € 8 million in 2006 to € 25 million in the year under review. This improvement resulted mainly from a compensation payment of € 37 million from DEPFA Deutsche Pfandbriefbank AG. An agreement had been reached with DEPFA with regard to offsetting the tax rebate arising from the completed tax audit of Deutsche Interhotel Holding GmbH.

Structured Property Financing segment Bank income statement pursuant to IFRS	1 Jan - 31 Dec 2007 € mn	1 Jan - 31 Dec 2006 € mn
Net interest income	347	340
Net loan loss provisions	77	89
Net interest income after net loan loss provisions	**270**	**251**
Net commission income	24	33
Net result on hedge accounting	1	9
Net trading income / expenses	-26	13
Results from non-trading assets	52	52
Results from investments accounting for using the equity method	63	1
Results from investment properties	1	-13
Administrative expenses	212	199
Net other operating income / expenses	25	-8
Impairment of goodwill	1	
Operating profit from continuing operations	**197**	**139**
Income taxes	61	31
Results from discontinued operations		
Segment result	**136**	**108**

Overall, Structured Property Financing generated income before taxes of € 197 million, compared with € 139 million the year before.

The tax position of € 61 million included € 13 million from the effect generated by the reduction in the tax rate already referred to under Group Profitability.

Altogether, we achieved a segment result after taxes of € 136 million in Structured Property Financing in 2007, after € 108 million in 2006.

Consulting / Services

Institutional housing sector

Aareon AG

Our wholly-owned subsidiary Aareon AG extended its market position as a leading consultancy and IT systems house for the property management sector in the 2007 financial year.

The success of Aareon's realignment, embarked upon in 2006, was visible during the last fiscal year. The main objective was to strengthen market presence and therefore to enhance the viability of the company, as well as increasing the profitability of the entire segment. A particularly positive development was the multi-product strategy as part of this process. This customer-focused product orientation comprises the four enterprise resource planning (ERP) systems Blue Eagle on the basis of SAP ERP 6.0, GES, WohnData and Wodis. Aareon's systems provide property management solutions that are designed to suit the needs of its customers, offering efficient data management and additional integrated services.

The product portfolio that was introduced at the start of the year was very well received, and viewed as positive by the market. Our stable existing customer base allowed us to attract renowned customers for the software systems from our competitors, and significantly increase our turnover in the Consulting / Services segment. A new sales management system has also reinforced the profit-oriented and customer-focused approach for the segment. Additionally, the desired income synergies are also emerged from the multi-product strategy.

Aareon enjoyed significant sales success in the 2007 financial year with regard to the SAP®-based Blue Eagle system. Existing Aareon customers also decided to switch to this product: more than 60 companies in Germany are now using Blue Eagle.

Numerous clients using our established GES and WohnData property systems extended their contracts.

Wodis, the solution for SMEs acquired last year, has been successfully incorporated into the Aareon product portfolio during the

2007 financial year and all existing Wodis customers were easily integrated.

Furthermore, all ERP solutions were enhanced with the addition of integrated services and extra products, such as Mareon. Around 6,500 orders and invoices are processed daily through Mareon, the user-friendly and uncomplicated services that links customers and suppliers by offering them time and cost-saving settlement of business processes in the property management sector. The volume of forwarded orders processed through Mareon tripled in 2007 to a total of € 1 billion.

Targeted organisational measures enabled us to improve the processes within Aareon during 2007, which should realise synergies and cost-savings.

Aareon started to expand its own distribution network in North Rhine-Westphalia during the first half of the year, covering customers throughout the western part of Germany from the Dortmund office. Contacts, who are completely familiar with the structures and processes of the companies and who therefore offer the best possible technical support and individual advisory service, provide the complete service from a single source.

Aareon signed a rental agreement for its new headquarters in Mainz halfway through the 2007 financial year. This clear commitment to the location means the company will be merging its four sites into one.

Payments and deposit-taking

We also further strengthened our market position in the bank's institutional housing sector business.

The business is underpinned by the market-leading payments system "BK 01" for the institutional housing sector. Developed by our subsidiary Aareal First Financial Solutions AG together with the bank, this is a payments system with a high integration capability and facilitates a significant degree of process automation in the client's systems.

In the financial year under review we were able to acquire 93 housing companies managing a total of 154,000 units and two of the largest commercial property managers, as well as one energy supplier for payments and deposit-taking business. The average investment volume with the property companies was increased to approx. € 4.75 billion in the fourth quarter of 2007. The average for any one month was around € 4.5 billion over the year 2007 as a whole. We also developed and optimised the processes in relation to our product line for managing key money. Aside from BK 01 enhancing the IT systems with our clients, this also represents stable, regular cash flows boosting our deposit base and securing refinancing funds.

Significant synergies are generated with Aareon AG's IT systems: roughly 80 % of the customers maintain and business relationship with our bank and with Aareon. This cooperation between the bank and Aareon is enhanced through the targeted acquisition of customers that use our Wodis IT system.

Paco unlimited product line

The Aareal Bank Group has sold its "Paco unlimited" product line – comprising access control and automated micropayment billing systems for the institutional housing sector – within the scope of a management buy-out. The bank thus continues to pursue its strategy of focusing on two core business segments.

Segment result

The positive earnings trend seen in the Consulting / Services segment in the last two years continued into 2007.

During the financial year, the segment result was defined largely by the disposal of the stake in Immobilien Scout GmbH. Also, the first successes achieved from the realignment of the institutional housing sector became clearly apparent.

The segment result is presented here using a statement of income for an industrial entity, including reconciliation to the bank's income statement.

Consulting / Services segment Statement of income for an industrial entity in accordance with IFRS	1 Jan-31 Dec 2007 € mn	1 Jan-31 Dec 2006 € mn
Sales revenues	223	221
Own work capitalised	2	3
Changes in inventory	0	-1
Other operating income	162	25
Cost of materials purchased	36	55
Staff expenses	102	112
Write-downs	16	14
Results from investments accounted for at equity	5	3
Miscellaneous other operating expenses	55	49
Interest and similar income / expenditure	0	0
Results from ordinary activities	**183**	**21**
Income taxes	11	5
Segment result	**172**	**16**

Reconciliation of the income statement (IFRS) from an industrial enterprise classification to a bank classification – Consulting / Services segment

			Income statement – bank classification									
			Net interest income	Commission income	Net income from non-trading assets[1]	Results from investments accounted for at equity	Administrative expenses	Net other operating income / expenses	Impairment of goodwill	Operating profit	Income taxes	Segment result
	2007		0	186	154	5	154	-6	2	183	11	**172**
	2006		0	167	14	3	164	1	0	21	5	**16**
Income statement – industrial enterprise classification												
Sales revenue	2007	223		222				1				
	2006	221		221								
Own work capitalised	2007	2		0			2					
	2006	3		1			2	0				
Changes in inventory	2007	0						0				
	2006	-1						-1				
Other operating income	2007	162			154		1	7				
	2006	25			15			10				
Cost of materials purchased	2007	36		36				0				
	2006	55		55								
Staff expenses	2007	102					102					
	2006	112					112					
Write-downs	2007	16					14		2			
	2006	14					14		0			
Results from investments accounted for at equity	2007	5				5						
	2006	3				3						
Other operating expenses	2007	55					41	14				
	2006	49			1		40	8				
Interest and similar income / expenditure	2007	0	0									
	2006	0	0									
Results from ordinary activities	**2007**	**183**	**0**	**186**	**154**	**5**	**154**	**-6**	**2**			
	2006	**21**	**0**	**167**	**14**	**3**	**164**	**1**	**0**			
Income taxes	2007	11						0			11	
	2006	5									5	
Segment result	**2007**	**172**										
	2006	**16**										

[1] *Including € 153 million from the sale of our stake in Immobilien Scout GmbH*

Sales were up from € 221 million to € 223 million.

Net other operating income of € 162 million included € 153 million in income on deconsolidation realised from the sale of the stake in Immobilien Scout GmbH. In 2006, income from the exchange of shareholdings with Techem was stated here.

The cost of materials purchased fell significantly from € 55 million in 2006 to € 36 million in 2007, due in particular to the lower cost of services purchased from Aareon. Further costs were accounted for by the sale of the urban development business of BauGrund in 2006.

Despite additional expenses incurred within the scope of the management buyout of the ”Paco unlimited“ product line, staff expenses were reduced through cost-cutting measures, by € 10 million to € 102 million. The figure for the previous year included restructuring expenses of € 6 million for the restructuring of Aareon.

At € 16 million, write-downs were close to the previous year’s level. This amount includes write-downs of € 1 million on the Blue Eagle software, plus goodwill impairment of € 2 million.

The net result from investments accounted for at equity included € 5 million to which Aareal Bank was entiled from its stake in Immobilien Scout GmbH (which was subsequently sold). This figure was € 3 million in 2006.

Other operating expenses totalled € 55 million, after € 49 million the year before. This item includes advisory, office, motor, travel, advertising and other costs.

We increased the result from ordinary activities in the Consulting / Services segment by € 162 million, from € 21 million in 2006 to € 183 million in 2007.

Excluding the income on deconsolidation from our stake in Immibilien Scout GmbH, the result from ordinary activities was € 30 million in 2007 compared with € 8 million the year before.

Taking into account a net tax refund claim of € 11 million, we achieved a segment result after taxes for 2007 of € 172 million.

Financial situation

Total assets

Consolidated total assets as at 31 December 2007 amounted to € 40.2 billion, after € 38.3 billion as at 31 December 2006.

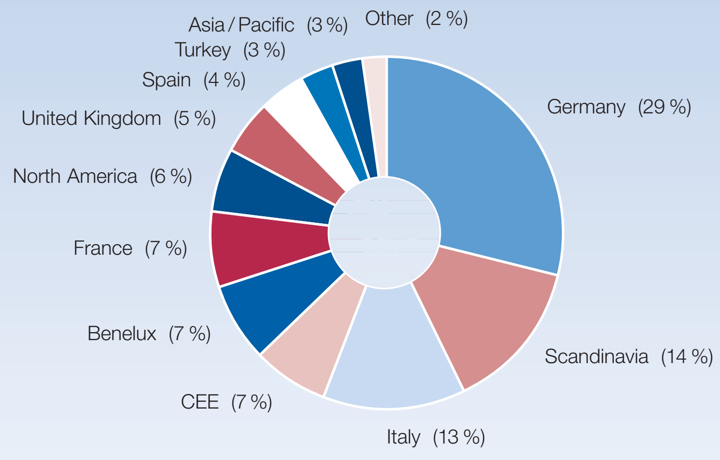
Assets

Property financing portfolio

As at 31 December 2007, international property financing under management accounted for € 24.0 billion. This corresponds to an increase of 5.3 % over the previous year's figure of € 22.8 billion. The rise is attributable to the successful expansion of the international financing business. Additionally, there was a considerable reduction in loan prepayments as a consequence of the sub-prime crisis in the second half of the year.

We were able to raise the share of international financings in the overall portfolio in the financial year past by 18.2 %, to € 16.9 billion. This had the effect of reducing the German share of the portfolio by 16.5 % to € 7.1 billion. We therefore further optimised the diversification of our loan portfolio.

Property financing portfolio by region (as at 31 Dec 2007)



Portfolio management and exit strategies

Our Credit Portfolio Management and Credit Treasury units manage the overall structure of property financing portfolio. We use syndications, and to a lesser extent securitisations, in particular to optimise and manage the portfolio. The Credit Portfolio Management unit is responsible for designing risk and return-oriented strategies for our financing portfolio. Within this context, it evaluates suitable market and business data, thus facilitating an early reaction to changes in the market. Credit Portfolio Management ensures that we allocate our equity in what are the most attractive products and regions from a risk / return perspective within the scope of our three-continent strategy. We apply portfolio limits so as to guarantee a high degree of diversification within the portfolio.

The Credit Treasury unit is responsible for implementing exit strategies that are consistent with the management of the portfolio. Our activities in this unit are focused in particular on syndication, whose advantages lie in fast, flexible placements of financing solutions related to single exposures. The structuring of securitised transactions on the other hand is complex and cost-intensive. Furthermore, such transactions require the relevant market environment in which to trade.

Syndications and synthetic securitisations

The year 2007 was defined by two distinct halves. The market environment functioned normally until the sub-prime crisis in late summer. Markets for exit instruments largely came to a standstill in the second half of the year.

We syndicated lending volume of just under € 0.7 billion (compared with € 0.4 billion the year before) to our international partner bank network during the period under review. These activites were concentrated mainly in the first half of the year. The change in the market environment brought about by the sub-prime crisis and associated reticence of market participants resulted in a significant decline in these business activities as of autumn 2007.

The unfavourable environment meant that securitisations could not be used as exit instruments. As at 31 December 2007, the volume of Aareal Bank's synthetic securitisations placed in the market amounted to € 2.4 billion, compared with € 3.5 billion as at 31 December 2006.

The considerably more flexible manner of placing financing solutions in the market via securitisations proved itself as a suitable means of portfolio management for Aareal Bank in 2007. Nonetheless, we will continue to take advantage of opportunities presented by the capital market in the medium term, in order to conduct synthetic securitisations.

Reducing the NPL portfolio

One important step of early 2007 was the consistent reduction of the volume of non-performing loans (NPL) in our portfolio and the successful exploitation of the market opportunities presented to us. Following the sale of an additional portfolio in the amount of € 132.0 million, including interest and fees, together with targeted individual sales, the volume of the NPL portfolio was around € 0.4 billion as at year-end 2007. The current portfolio is at a normal and acceptable level.

Refinancing

Refinancing structure

Aareal Bank refinances its lending activities on the capital market mainly in medium-term and long-term maturities. It refinances its money market activities through institutional housing sector deposits, client deposits and interbank transactions. The long-term refinancing portfolio, comprising unsecured issues and asset-covered bonds, amounted to € 23 billion as at 31 December 2007. The average monthly deposit volume from the institutional housing sector amounted to € 4.5 billion and from institutional money market clients € 5.2 billion. These funds are offset by a property loan portfolio to be refinanced in the amount of € 22.8 billion. The excess liquidity is invested in a portfolio of liquid, high-quality securities with a volume of € 7.8 billion, which serves as a liquidity reserve that can be used in the short term, depending on the situation. Further short-term investments are carried out in the money market and via repo transactions.

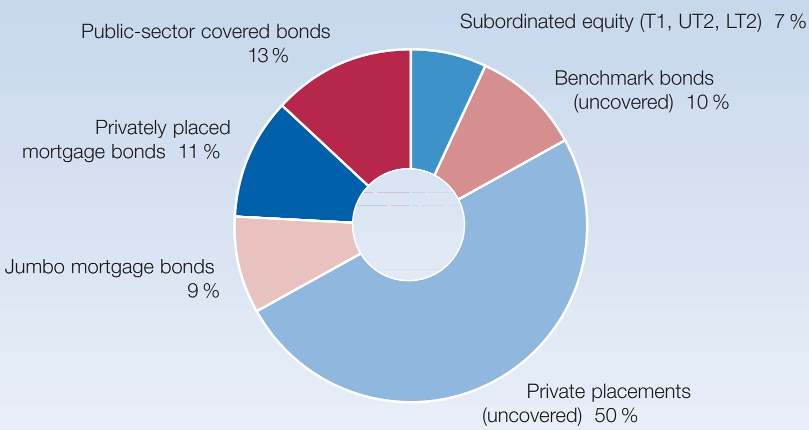
The long-term refinancing funds have an average term of over five years. The volume of funds maturing annually is roughly € 3 billion at present.

As at 31 December 2007, the long-term refinancing funds of € 23 billion comprised 20 % mortgage bonds, 13 % public-sector covered securities, 60 % senior unsecured issues and 7 % subordinated issues.

Refinancing activities in 2007

Aareal Bank successfully expanded its presence on the capital markets during 2007. By 31 December 2007, it had raised a total of € 4.6 billion of long-term refinancing funds. At € 2.2 billion, mortgage bonds and public-sector covered securities accounted for just short of 48 % of new issuance. The refinancing activities include the successful issue of Aareal's second jumbo mortgage bond, sized at € 1 billion. The majority of private placements (€ 2.5 billion) were issued in the form of registered securities, including promissory note loans and registered mortgage bonds. Additionally, € 940 million in privately-placed and € 150 million in public bearer bonds (mainly MTNs) were issued on the capital

Refinancing mix as at 31 Dec 2007



market. In 2007 the share of asset-covered bonds (mortgage bonds and public-sector covered securities) was increased further to roughly one-third of Aareal Bank's long-term refinancing portfolio.

In view of the level of quality, legal requirements and successful capital market history, asset-covered bonds offer a refinancing option at favourable terms, particularly during turbulent market phases. Aareal Bank benefited particularly from this, through the private placement of mortgage bonds in the last quarter of 2007.

During the financial year under review, we collaborated successfully with more than 40 partners on the capital market, including large and smaller investment houses as well as more highly-specialised institutions. This provided for a strong level of diversification within our investor base.

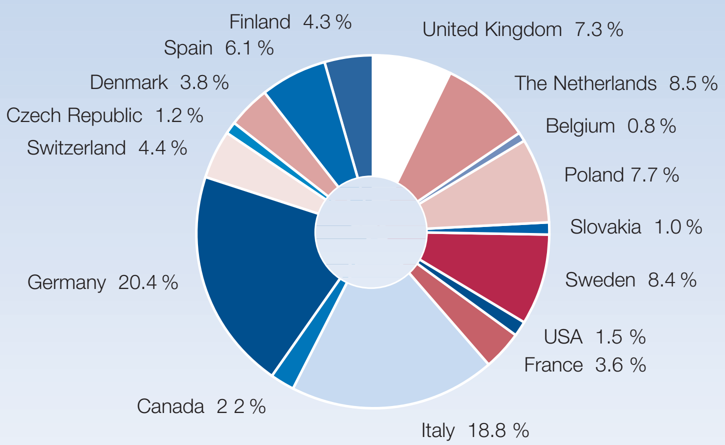
Refinancing strategy

Aareal Bank increasingly uses mortgage bonds to refinance its international loan portfolio. Roughly one quarter (€ 5.3 billion as at 31 December 2007) of the mortgage loans to be refinanced are included in the cover assets pool for mortgage bonds. Aareal Bank's international business model has resulted in a highly-diversified cover portfolio, with financing activities in 16 countries. Asset-covered issues are an important instrument for Aareal Bank in its efforts to explore a new range of investors, and to reduce its refinancing costs. New investors, especially in Europe, are attracted to asset-covered bonds, primarily jumbo Pfandbriefe owing to their liquidity and quality.

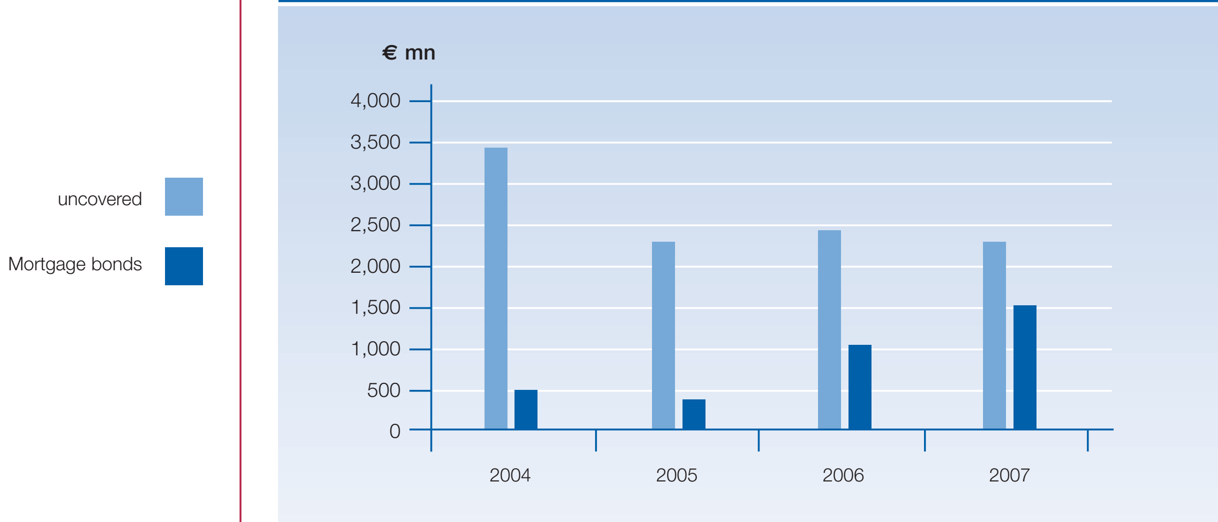
The strategy pursued by Aareal Bank to issue jumbo Pfandbriefe on a regular basis represents a key step towards the increasing internationalisation of our investor base. The second jumbo Pfandbrief issue attracted many new investors, particularly from Asia, the UK and the Benelux countries. The share of asset-covered bonds relative to refinancing should be increased gradually in 2008, so as to further optimise the liabilities side of the balance sheet.

Aareal Bank offers international property financing solutions in a wide variety of liquid currencies. Our foreign currency-denominated issues are another aspect of the internationalisation of our capital market debut. We issued mortgage bonds denominated in Japanese yen, pound sterling and US dollar during 2007. Since the start of 2006, we have also included derivatives in the cover asset pool for the interest rate and currency management of the entire asset-covered bond business. This has enhanced the efficiency of our refinancing, and improved the quality of the asset-covered issues.

Diversification of the cover assets pool for mortgage bonds as at 31 Dec 2007



New issue volume of mortgage bonds vs. senior funding



Aareal Bank's medium-term notes programme (MTN) is an internationally renowned documentation framework for securities issues, and is sized at € 10 billion. It allows drawings in subordinate, uncovered debt securities, as well as in mortgage bonds and public-sector covered securities, in all the required currencies and structures. Aareal Bank is a regular issuer of uncovered promissory note loans, registered bonds and bearer instruments.

Settlement of payment transactions for institutional housing sector clients generates residual current account balances and term deposits of over € 4.5 billion on a monthly average. The volume has been stable and rising slightly over recent years. Aareal Bank is also increasingly generating a stable deposit volume from institutional money market clients.

Regulatory indicators

Upon confirmation of the financial statements, Aareal Bank Group's liable capital in accordance with section 10a of the German Banking Act totalled € 2,702 million, of which core capital accounted for € 1,760 million. The capital ratios according to the German Banking Act (Grundsatz I) stood at 8.0 % (31 December 2006: 8.3 %) for the core capital ratio and at 12.3 % (13.5 %) for the total capital ratio. Aareal Bank Group's risk-weighted assets according to the German Banking Act amounted to € 22,050 million. This figure includes € 88 million in assets exposed to market risk.

When measured according to Bank for International Settlements (BIS) rules, the core capital ratio (upon confirmation of the financial statements) was unchanged from last year at 7.3 %, while the total capital ratio was 11.2 % 1(12.1 %), based on core (tier 1) capital of € 1,701 million, and risk-weighted assets of € 23,503 million (including € 88 million in assets exposed to market risk).

Risk Report

1. Aareal Bank Group Risk Management

The targeted handling of risks – based on a professional risk management – is crucially important to a bank's business performance. Moreover, banks must also meet extensive qualitative and quantitative requirements laid down by supervisory authorities, as defined by their business focus. The importance of risk management quality as an appraisal factor for analysts, rating agencies and investors alike has increased in recent years. Against this background, we consider the continuous development and refinement of our risk management system as a key management task.

1.1 Risk management – scope of application and areas of responsibility

Aareal Bank Group' 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 the risks generally associated with banking business across all entities of the Aareal Bank Group.

Areas of responsibility for risk management and monitoring			
Overall responsibility: Management Board and Supervisory Board of Aareal Bank AG			
Type of risk		**Risk management**	**Risk monitoring**
Market price risks		Treasury, Dispo Committee	Risk Controlling
Liquidity risks		Treasury	Risk Controlling
Credit risks	Property finance (single exposures)	Credit Business Market, Credit Management	Risk Controlling, Credit Management
Credit risks	Property finance (portfolio risks)	Credit Management, Credit Portfolio Management	Risk Controlling
Credit risks	Transactions with financial institutions	Treasury, Counterparty and Country Limit Committee	Risk Controlling
Credit risks	Country risks	Treasury, Credit Management, Counterparty and Country Limit Committee	Risk Controlling
Operational risks		Process owners	Risk Controlling
Investment risks		Corporate Development	Risk Controlling, Corporate Development, Controlling bodies
Process-independant monitoring: Internal Audit			

Since the risks the Consulting / Services segment is exposed to differ profoundly from those of the banking business, specific risk monitoring methods have been developed and deployed to suit the relevant risk exposure at the respective subsidiary. In addition, risk monitoring for these subsidiaries at a Group level is carried out via the relevant control bodies and investment controlling.

Overall responsibility for risk management and risk monitoring remains with the Management Board and the Supervisory Board of Aareal Bank AG.

The diagram shown above provides an overview of the responsibilities assigned to the respective organisational units.

1.2 Strategies

The business strategy of Aareal Bank Group set by the Management Board, and approved by the Supervisory Board, provides the conceptual framework for risk management. Taking this as a basis, and strictly considering the bank's risk-bearing capacity, we have formulated detailed strategies for managing the various types of risk, which are designed to ascertain risks are dealt with consciously and professionally.

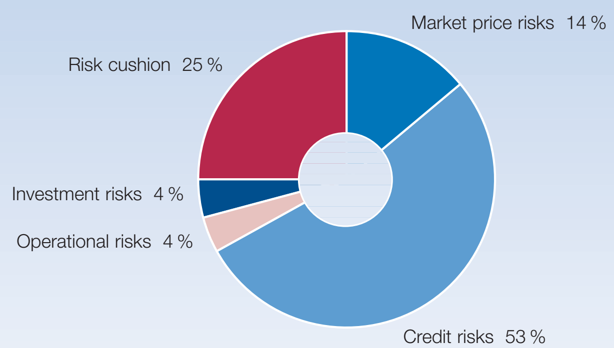
Accordingly, these strategies include general policies, to ensure a uniform understanding of risks across all parts of the bank, and providing a cross-sectional, binding framework applicable to all departments. The bank has implemented adequate risk management and risk control processes to implement these strategies, and to ensure the bank's risk-bearing capacity. In line with the overall business strategy, risk strategies are revised at least once a year, and are approved by the Management Board.

1.3 Risk-bearing capacity and risk limits

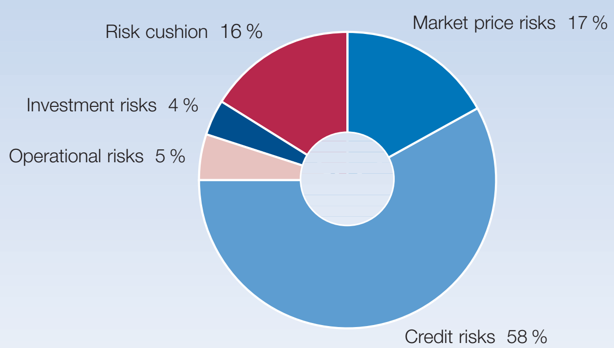
The risk-bearing capacity of Aareal Bank – which is defined by the amount of aggregate risk cover – is a core determining factor with regards to the structuring of its risk management system. Aggregate risk cover is defined as the core capital (tier 1 capital) in accordance with the BIS definition, plus the budgeted net income before taxes. The calculation does not include additional funds such as supplementary and subordinated capital, or existing reserves. The aggregate risk cover is updated at least once a year, and additionally in the event of significant changes occurring (such as a capital increase, or a change in earnings projections).

We have thus implemented a system based upon limits defined in a conservative manner, and differentiated according to the type of risk. The aggregation of individual limits is based on the assumption that no risk-mitigating correlation effects exist amongst different types of risk. We also maintain a significant part of our aggregate risk cover (around 25 % as at 31 December 2007) as a risk cushion, which is not applied to risk limits, and is thus available for risk types that cannot be quantified (for example,

Allocation of aggregate risk cover 31 Dec 2007



Allocation of aggregate risk cover 31 Dec 2006



reputational or strategic risks). Overall, limits are set in a way to ensure Aareal Bank's ability to bear risk at any time.

The diagrams shown on page 90 illustrate the allocation or aggregate risk cover across individual types of risk as at 31 December 2007 and 31 December 2006, respectively.

Concerning liquidity risk, aggregate risk cover is not an appropriate measure to assess risk-bearing capacity. Therfore, we have defined special tools for managing this type of risk. These tools are described in detail in the section "Liquidity risk".

2. Organisational structure and workflows

2.1 Credit business

2.1.1 Division of functions and voting

Aareal Bank's structural organisation and business processes are consistently geared towards effective and professional risk management. This includes the extensive implementation of regulatory requirements regarding the structural organisation and workflows in the credit business.

Processes in the credit business are designed to consistently respect the clear functional division of market and risk management units, up to and including senior management level. In addition, the Risk Controlling unit, which is not involved in making lending decisions, is responsible for monitoring all material risks whilst ensuring an adequate and targeted risk reporting.

Lending decisions regarding credit business classified as relevant for the bank's risk exposure require two approving votes submitted by a market unit and a risk management unit. The bank's Assignment of Approval Powers defines the relevant lending authorities within market and risk management units. Where discretion holders 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 Counterparty and Country Limit Committee (CCC), which consists of executives from non-market units is responsible for the risk management vote regarding the approval of counterparty, issuer, or country limits. We have implemented the clear separation of market and risk management processes across all relevant units.

2.1.2 Process requirements

The credit process comprises several phases: specifically, these include credit approval, further processing, and monitoring of loan processing. Credit exposures subject to increased risks involve separate processes for intensified handling, the handling of problem loans, and – if necessary – for risk provisioning. The corresponding processing principles are laid down in the bank's standardised rules and regulations.

Important factors determining the counterparty 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. Furthermore, the risk assessment results are taken into account for pricing purposes.

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.

2.1.3 Early risk detection procedures

The early identification of an increased 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 the exposure and the parties involved (such as borrowers or guarantors) throughout the credit term, assessing quantitative and qualitative factors, using periodic monitoring and internal ratings. The intensity of the ongoing assessments is based on the risk level and size of the exposure. The bank's internal risk management processes ensure that counterparty risk is assessed at least once a year.

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

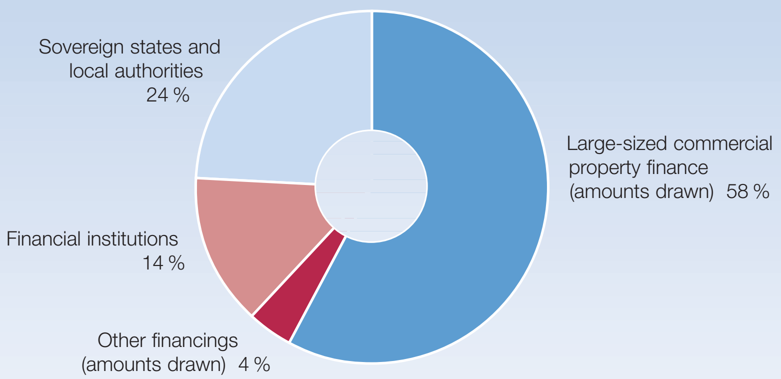
Actively managing client relationships is crucially important in this context: approaching clients in time to jointly develop a solution to any problems which may arise. Where necessary, we use the support of experts from the independent risk prevention, restructuring, and recovery units.

2.1.4 Risk classification procedure

Aareal Bank employs various risk classification procedures for the initial, regular, or event-driven assessment of counterparty 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 is outside the market units.

The ratings determined using internal risk classification procedures are an integral element of the bank's approval, monitoring, and management processes. Unless described otherwise, these procedures were already applied in the previous year.

Breakdown of exposure by rating procedure (31 Dec 2007: 100 % = € 36,5 bn)



The bank employs a two-step 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, with the relative impact of the two components on the rating result 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), through an assessment of collateral provided. The bank's maximum risk exposure (plus a cushion for potential fees and charges incurred) is determined for this purpose: expected proceeds from the realisation of collateral, and from uncollateralised residual receivables, are deducted from this exposure at default (EaD). When evaluating collateral, haircuts are applied or estimated recovery rates used, depending on the type of collateral involved and specific realisation factors.

The expected loss (EL) in the event of default of an exposure is determined as the product of PD and LGD. A methodology to classify and map expected loss levels was established during the financial year under review.

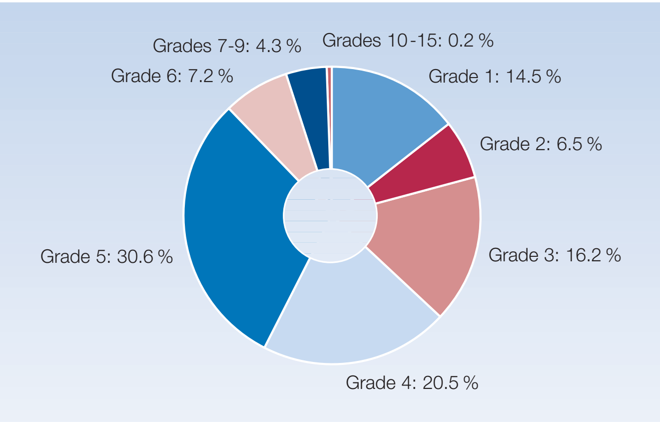
The diagram shown below depicts the distribution of lending volume by EL classes as at 31 December 2007, based on the maximum current or future drawdown. This loss distribution chart does not include any overdue or impaired receivables. Detailed information is provided in the section "Information required under IFRS 7".

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, investment companies, 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.

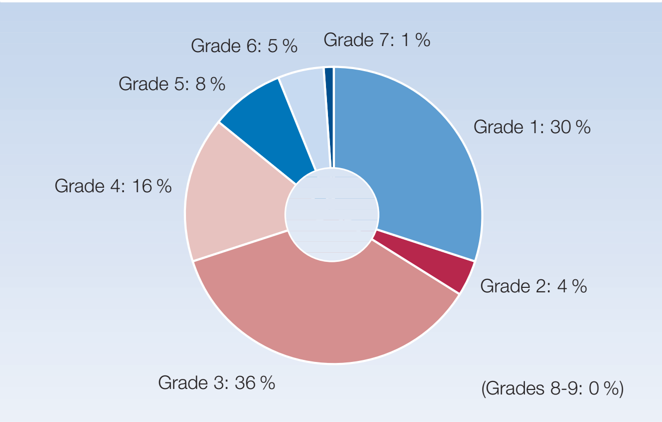
Furthermore, Aareal Bank introduced a new rating procedure for **sovereign states** in 2007. In this context, rating grades are assigned using clearly-defined risk factors, such as fiscal flexibility or the level of debt. The expert knowledge of our rating analysts is also taken into account for the rating.

A rating method for **regional governments, local and other public-sector entities** was launched in parallel with the sovereign rating procedure, based on a comparable methodology. This procedure incorporates rating-relevant information regarding the clients concerned.

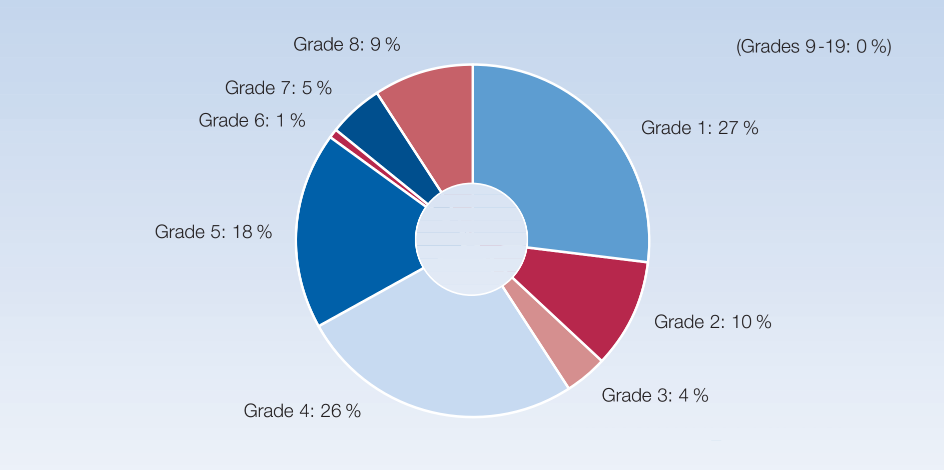
Large-sized commercial property finance, classified by expected loss grades



Financial institutions by rating grades



Sovereign states and local authorities by rating grades



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

2.2. Trading activities

2.2.1 Functional separation

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

On the market side, the processing chain comprises Treasury and Credit Treasury, whilst risk management tasks are carried out by the independent units of Operations and Risk Controlling. Beyond this Finance 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 entire processing chain; these are adapted to prevailing circumstances without delay. 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") set out by BaFin. 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.

Within the scope of trading activities, Credit Treasury is responsible for entering into credit derivatives on the bank's behalf, in individual cases requiring specific approval in each case.

Operations is responsible for controlling trading activities, confirming trades to counterparties, and for trade settlement. The unit 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 documentation / master agreements.

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

2.1.2 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.

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 market units in their business activities.

As part of the limit monitoring process, the Management Board and Treasury are notified of limits and their current usage on a daily basis. Clearly-defined escalation and decision-making processes have been set out to deal with limit breaches.

3. Risk exposure by type of risk

3.1 Credit Risks

3.1.1 Definition

Aareal Bank defines credit risk or counterparty 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 risk. Counterparty 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 risk.

3.1.2 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. Proposals for the credit risk strategy are prepared jointly by market and risk management units, and adopted by the entire Management Board.

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. This process is instigated by management, and implemented by the market and risk management units, who submit a proposal (on which they are both agreed) to management. 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.

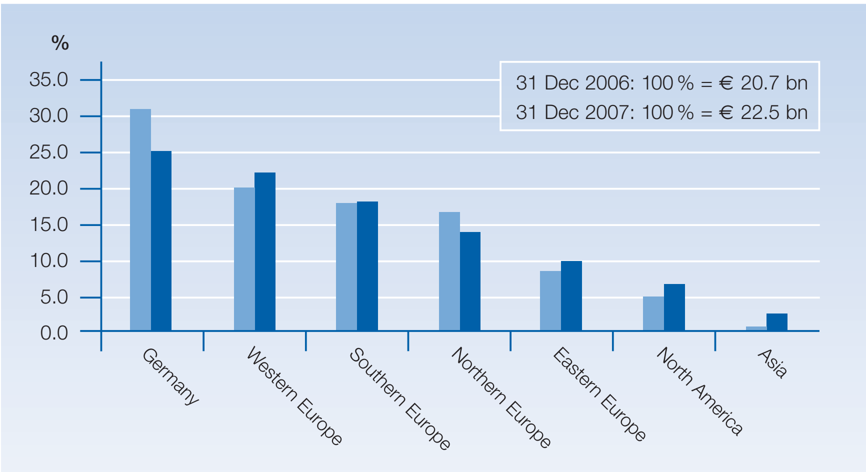
Aareal Bank AG's credit risk strategy comprises the Group Credit Risk Strategy, containing general guidelines, plus individual sub-strategies (lending policies) defining the type of new business the bank wishes to generate, with respect to various markets and types of business. Given the hierarchical structure of the credit risk strategy, the Group credit risk strategy overrides individual sub-strategies.

3.1.3 Risk measurement and monitoring

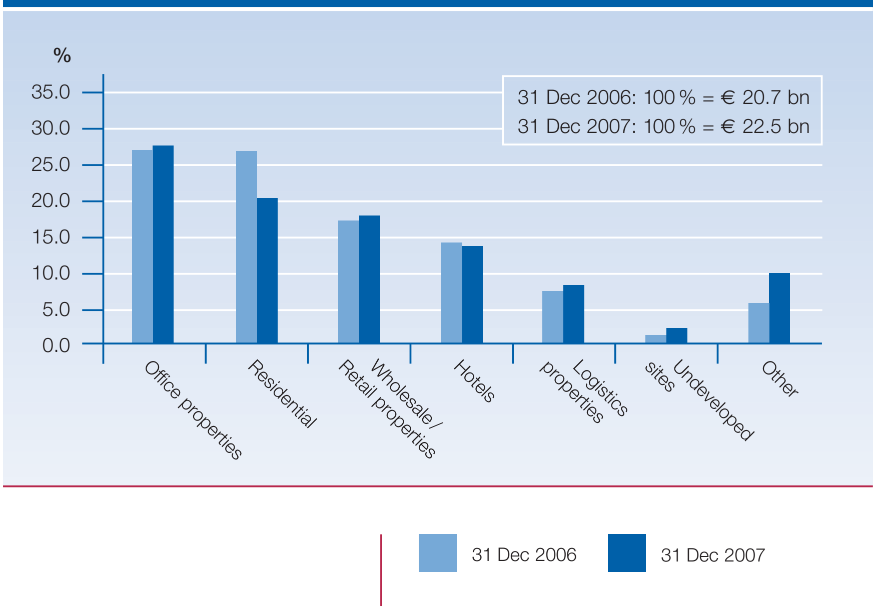
The credit business is subject to a variety of risk measurement and monitoring processes. This includes the application of two different credit risk models incorporating concentration and diversification effects at a portfolio level. Both the expected and unexpected loss (credit-value-at-risk) are derived using this model. Credit value-at-risk corresponds to the maximum amount by which the actual loss can exceed the expected loss for a given confidence level.

Based on the results of these models, the bank's decision-makers are regularly informed of the performance and risk content of large-sized property finance exposures,

Property financing volume (amounts drawn) by country group



Property financing volume by type of property



and of business with financial institutions. The models permit to identify, measure, monitor and manage risks at a portfolio level.

In addition, the bank uses specific tools to monitor individual exposures on an ongoing basis where this is required: besides the tools already described, this includes monitoring of construction phase loans or residential property developers, or the monitoring of payment arrears.

A risk report is prepared and submitted to the bank's senior management on a regular basis, at least quarterly. The report provides extensive information regarding the key structural counterparty risk features of the credit portfolio.

Trading activities are generally restricted to counterparties for whom the requisite limits are in place. Replacement and settlement risks are taken into account when determining counterparty limit usage. Persons holding position responsibility are informed about relevant limits and their current usage without delay. Trading activities also require the establishment of issuer limits.

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. Any limit breaches are documented, together with action taken in response. Where limit transgressions exceed an amount defined in line with risk considerations, these are escalated to the responsible members of senior management.

3.1.4 Credit risk mitigation

The bank accepts various types of collateral to reduce default risk exposure from the extension of credit. 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. Loans are granted and the security interest perfected in accordance with the jurisdiction in which the respective property is located.

Market values and mortgage lending values are set 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 an independent appraiser; 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 appraisers.

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 concerning the valuation of such 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.

Netting agreements (close-out netting) and / or collateral agreements are concluded with trading counterparties in order to reduce the credit risk exposure associated with derivatives.

Our approach to managing our credit portfolio includes synthetic securitisation and syndication techniques, as well as the sale of sub-portfolios. This active ”buy, manage, sell“ strategy is designed to optimise our credit portfolio on an ongoing basis, in order to achieve an optimal risk / return ratio.

Any assets acquired upon the realisation of collateral are predominantly properties. The consideration received upon disposal is applied to repay the underlying financing. An immediate sale is generally sought for such properties.

3.1.5 Country risk

Definition

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). These types of risks arise only if the borrower is located in a different country from the lender, or if the financed property is located in another country.

With the main focus of the portfolio being on the member states of the European Union and North America, exposure is concentrated in countries with very low risk potential.

Country risk measurement and monitoring

Geographical diversification and the avoidance of concentration risks are of greater importance, from the bank's overall perspective, than the observation of transfer risks. The system for managing country risk, utilised within the overall management of the bank, was designed in such a way that it takes both criteria into consideration.

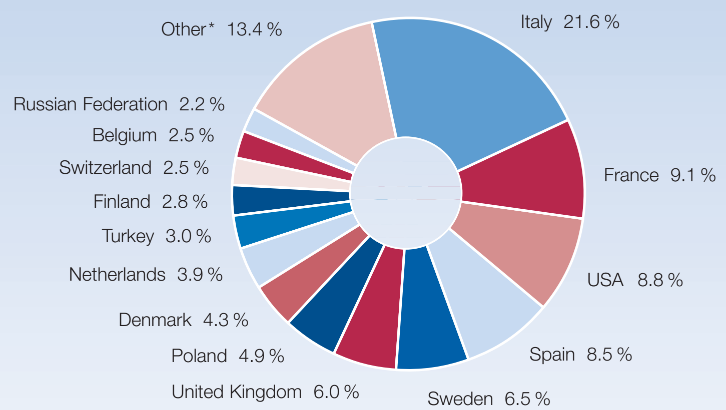
Country risk exposure is managed using a cross-divisional process. The Counterparty and Country Limit Committee carries out a risk assessment of the relevant countries, grades them in country risk groups, and conducts an annual review in terms of country rating. The limits are set by the Management Board. The Risk Controlling unit is responsible for the continuous monitoring of country limits and for monthly reporting on limit utilisation.

In addition to monitoring the bank's international exposure, internal limit monitoring reports utilisations for the bank's domestic business, broken down by German federal states.

The following diagrams illustrate the risk exposure by country in the bank's international business, at year-end.

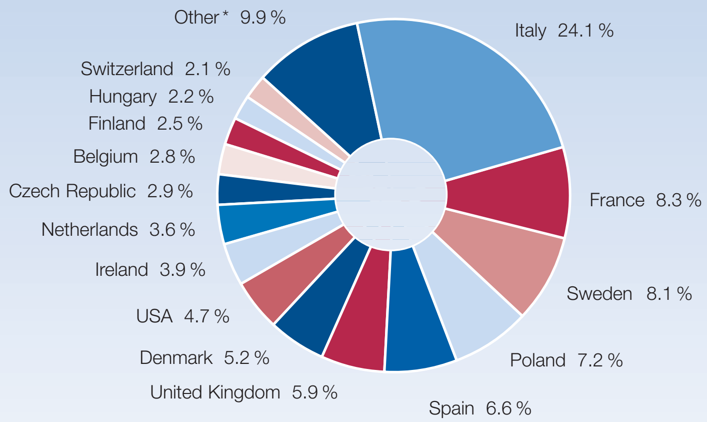
In the property finance business, country exposures are allocated by location of the property used as collateral. For exposures not collateralised by property, the allocation is based on the borrower's country of domicile. This reflects the exposure of the property finance business, as well as the activities of Treasury.

Breakdown of country exposure – international business 2007 (%)



*Country exposure of less than 2 %

Breakdown of country exposure – international business 2006 (%)



*Country exposure of less than 2 %

3.1.6 Information required under IFRS 7

The overview shown below outlines the carrying amount of all financial asset (as defined in IFRS 7) after deduction of impairment, without taking into account any collateral:

	31 Dec 2007	31 Dec 2006
	€ mn	€ mn
Loans and advances to banks	**2,245**	**2,691**
Term deposits and current account balances	431	659
Public-sector loans	333	354
Other receivables	1,481	1,678
Loans and advances to customers	**24,835**	**23,037**
Property finance	22,431	20,378
Public-sector loans	1,738	1,735
Other receivables	666	924
Positive market value of derivative hedging instruments	**899**	**883**
Trading assets	**1,818**	**726**
Non-trading assets (LaR)	**955**	**1,020**
Fixed-income securities	955	1,020
Equities and other non-fixed-income securities	–	–
Non-trading assets (AfS)	**7,856**	**7,490**
Fixed-income securities	7,258	7,007
Equities and other non-fixed-income securities	594	478
Other participations	4	5
Other assets	**186**	**320**
Trade receivables	34	128
Other receivables	152	192
Financial guarantees	**733**	**603**
Irrevocable loan commitments	**4,600**	**2,780**
Total	44,127	39,550

	31 Dec 2007	31 Dec 2006
	€ mn	€ mn
> 3 months – 6 months	18	32
> 6 months – 1 year	23	68
> 1 year	177	167
Total	**218**	**267**
Fair value of property collateral received (land charges)	203	244

The overview above indicates property loans overdue for which no impairment has been recognised, broken down by bands of arrears and together with the value of related collateral.

In addition to property collateral, further collateral in the form of assignment of claims, guarantees and securities has been provided to cover the portfolio. Given the collateral pledged, no impairment was recognised. On the reporting date, there were no other overdue financial assets for which no impairment has been recognised.

The following overview indicates the amount of impaired property loans under management [1], together with the related loan loss allowance and the value of related collateral.

[1] The figure for property finance under management includes property loans managed on behalf of DEPFA Deutsche Pfandbriefbank AG

	31 Dec 2007	31 Dec 2006
	€ mn	€ mn
Amounts drawn before provision for loan losses	362	862
Risk provisioning	184	367
Fair value of collateral received	178	495

On the reporting date, there were € 2 million in impaired trade receivables. The relating impairment amounts to € 2 million. The carrying amount of assets acquired upon realisation of collateral during the 2007 financial year, and held as at 31 December 2007, was € 10 million (2006: nil). The carrying amount of loans for which terms were negotiated subsequently was € 7 million at 31 December 2007 (2006: € 45 million).

3.2 Market Risks

3.2.1 Definition

Market price risk is broadly defined as the threat of losses due to changes in market parameters. Aareal Bank's market price risk exposure predominantly comprises interest rate risks, whilst currency risks are largely eliminated through hedges. Commodity and other price risks are irrelevant for the bank's business. Hence, the primary market price risk exposures are related to the risk parameters interest rates, equity prices, exchange rates, and implied volatilities. All relevant parameters are covered by our management and monitoring tools.

Derivative financial instruments are entered into predominantly in the trading book, whilst in the banking book they are primarily used as hedging instruments.

Spread risks between the various yield curves (e.g. government / Pfandbrief / swap curve) are also taken into account.

3.2.2 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 market price risk exposure on a daily basis. In addition, the entire Management Board is informed on a monthly basis, within the scope of an extensive risk report. A quarterly report is submitted to the Supervisory Board.

Value-at-risk (VaR) has been broadly accepted as the predominant method for measuring general market price risk. The VaR for market price risk quantifies the exposure as a negative divergence from the current aggregate value of the bank's financial transactions. This absolute amount, expressed in euros, indicates the potential loss incurred before counter-measures take effect. Since this is a statistical approach, the forecast for the potential loss that may be incurred within a specific period of time is for a given confidence interval only.

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, it takes into account the correlation between the individual types of risk. The statistical parameters used in the VaR model are calculated on the basis of an in-house data pool over a period of 250 days. The loss potential is determined applying a 99 % confidence interval and a ten-day holding period. Besides general market price risk exposure, the daily determination of specific risks for bonds held in the trading book was introduced in 2007.

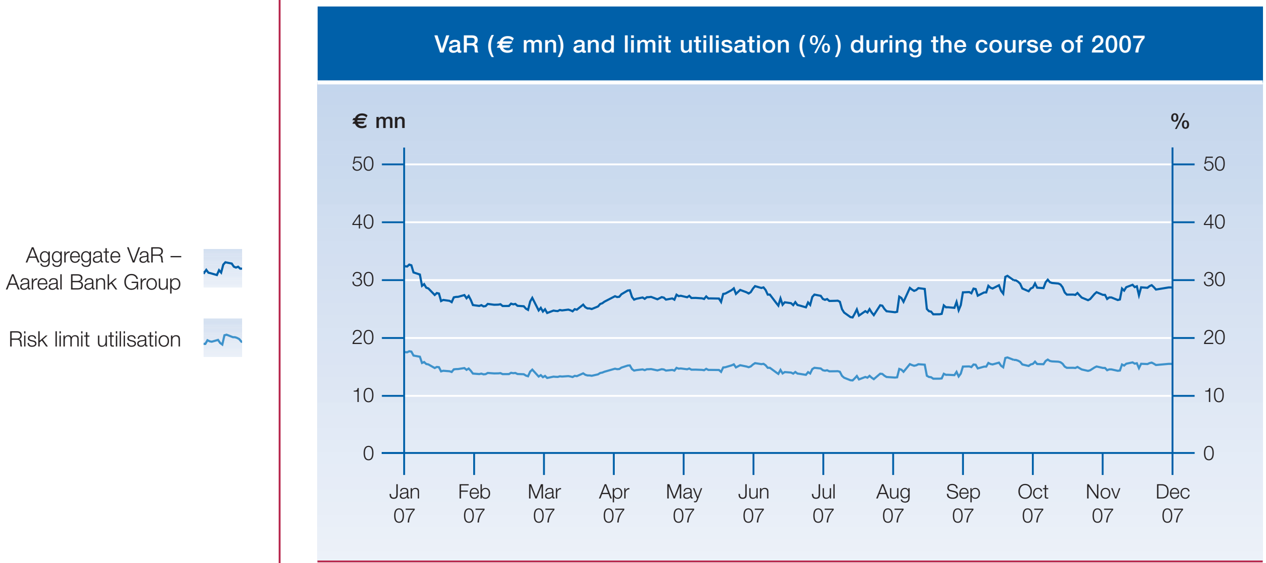
The limit set for the VaR figure is derived from the analysis of the bank's risk-bearing capacity, which is carried out at least once a year. Limits are defined at Group level as well as for the individual Group entities. Being authorised to maintain a trading book, Aareal Bank AG has defined an additional trading book limit, plus a separate value-at-risk limit for fund assets held.

2007	MAX	MIN	Mean	Limit
Aggregate VaR – Aareal Bank Group	32.6	23.7	27.1	181
Group VaR (interest rates)	27.2	10.0	15.2	
Group VaR (FX)	7.0	1.7	3.7	
VaR (funds)	26.4	17.9	21.7	60
Aggregate VaR in the trading book	4.0	0.1	0.9	20
Trading book VaR (interest rates)	2.8	0.1	0.7	
Trading book VaR (FX)	0.2	0.0	0.0	
VaR (equities)	3.6	0.0	0.5	
Specific VaR	5.3	0.6	3.7	

Previous year comparison:

2006 (99 %, 10-day holding period)	MAX	MIN	Mean	Limit
Aggregate VaR – Aareal Bank Group	40.2	28.6	33.5	181
Group VaR (interest rates)	37.2	22.6	28.6	
Group VaR (FX)	5.4	2.4	3.3	
VaR (funds)	19.9	10.5	17.0	60
Aggregate VaR in the trading book	2.3	0.4	1.0	20
Trading book VaR (interest rates)	2.3	0.3	1.0	
Trading book VaR (FX)	0.1	0.0	0.0	
VaR (equities)	0.0	0.0	0.0	
Specific VaR	0.0	0.0	0.0	

Aggregate VaR – Aareal Bank Group



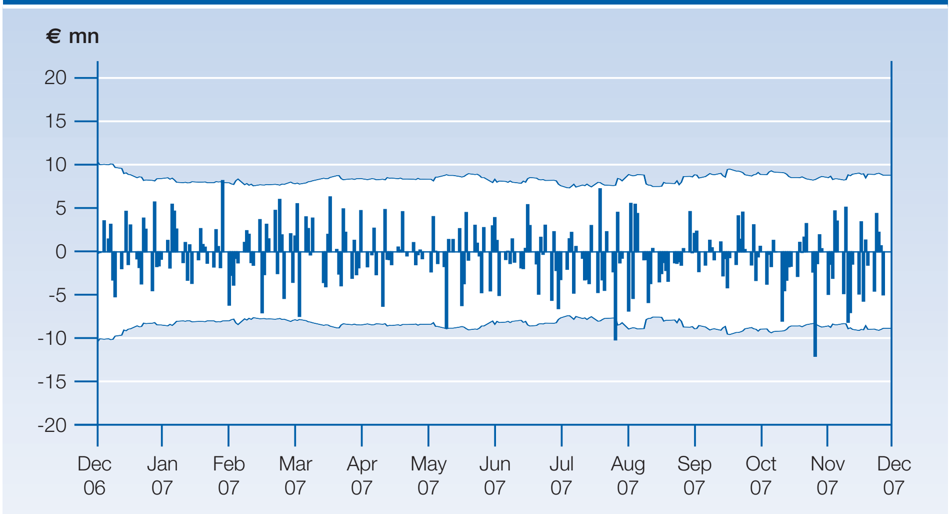
Limits were unchanged during the 2007 financial year. No limit breaches were detected, and overall limit usage was low.

Back testing

The quality of forecasts made using this statistical model is checked through a weekly 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 (< 5 for a 250-day period).

The number of negative outliers at Group level was always lower than three during 2007 (always lower than two at Group level in 2006), affirming the high forecasting quality of the VaR model we use.

Present values and 1-day VaR during the course of 2007 (€ mn)



Value at risk (99 % / 1-day holding period)

Change in present value (1 day)

Stress testing

Although VaR has become a standard tool, the concept may fail to adequately project the actual risk in extreme situations – for example, the 1997 crisis in Asia. For this reason, the VaR projection is supplemented by simulating stress scenarios on a weekly basis.

Aareal Bank calculates present value fluctuations both on the basis of real extreme market movements over recent years (German reunification, Asian crisis, September 11, etc.), and also using simulated market movements (parallel shifts, structural changes, steepening of the yield curve). This analysis requires that all positions are revalued fully on the basis of these market scenarios. The resulting impact on present value is compared against a special stress limit within the scope of weekly and monthly reporting.

The "worst-case" scenario used in the financial year under review was a 100 basis point upwards parallel yield curve shift. This scenario is identical to the interest rate shift scenario for limiting the interest rate risk exposure of mortgage banks, as prescribed by BaFin until the coming into effect of the German Pfandbrief Act in 2006. This scenario implied a present value loss of 13 % of the limit as at 31 December 2007. No breach of set limits occurred during 2007.

Interest rate sensitivity

An additional instrument used to quantify interest rate risk exposure is the calculation of interest rate sensitivity, expressed by the 'delta' parameter. The first step to determine this parameter requires calculating the present values of all asset and equity / liability items on the balance sheet. 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.

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.

Trading book

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 for the purposes of the capital ratio according to the German Banking Act (Grundsatz I). Given the small number of transactions and low volumes concluded during 2007, trading book risks played a low role in the overall risk scenario.

During the 2007 financial year, the processes employed proved to be able to quantify the risks arising from market price fluctuations in a timely and accurate manner, also for new products introduced.

3.3 Liquidity Risks

3.3.1 Definition

Liquidity risk in the narrower sense is defined as the risk that current or future payment obligations cannot be met on time. Aareal Bank'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.

3.3.2 Risk measurement and monitoring

Treasury is responsible for managing liquidity risks, whilst Risk Controlling ensures the continuous monitoring, including a weekly 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:

a) 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 cash flow profile of products without a fixed contractual lifetime.

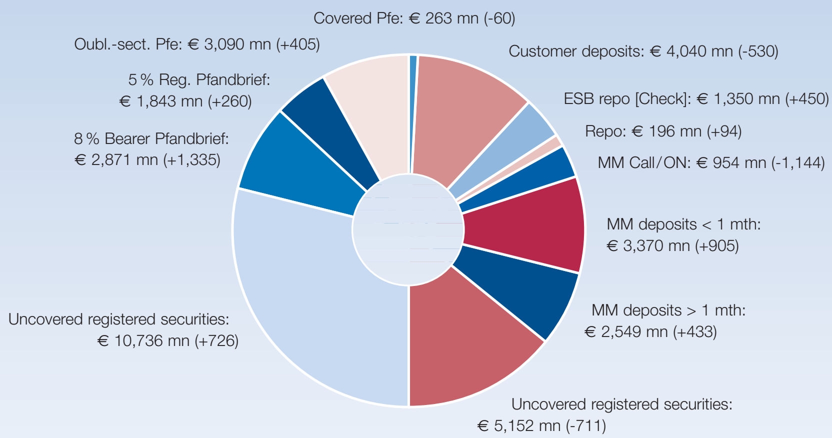
b) Liquidity run-off profile

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 (i.e. all assets which 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.

c) 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.

Refinancing portfolio diversification by product



Stress tests

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

The scenario regularly having the most significant impact on Aareal Bank's liquidity situation is a "rollover failure", where rolling funding via the money market is disrupted.

The bank still has sufficient reserve funds even in this most extreme stress scenario.

Liquidity ratio according to the German Banking Act (Grundsatz II)

The requirements of the liquidity ratio in accordance with section 11 of the German Banking Act (Grundsatz II), which is relevant to liquidity management, were always complied with, as were the limits set by reference to the liquidity run-off profile.

3.4 Operational Risks

3.4.1 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. In contrast, strategic, reputational and systematic risks are not included.

3.4.2 Risk measurement and monitoring

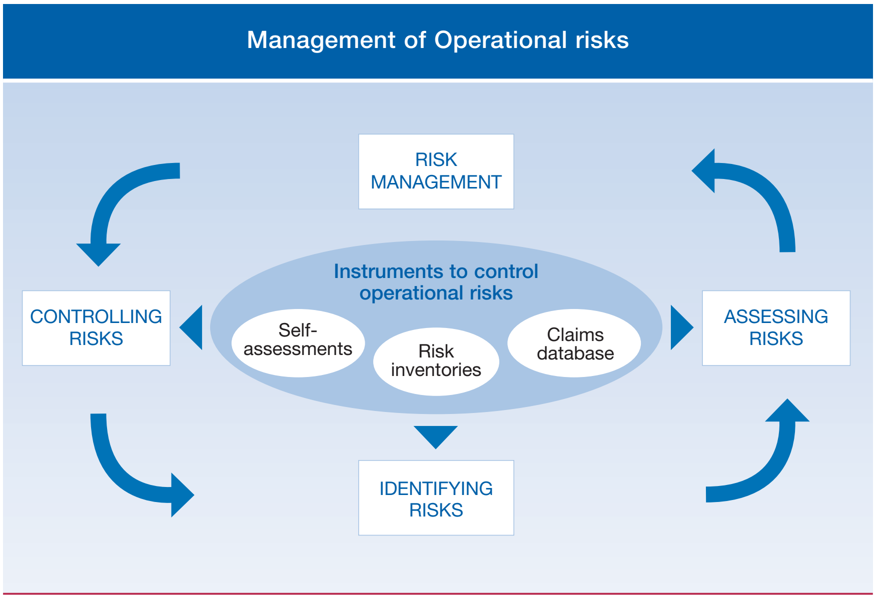
It is the objective of the policy pursued by Aareal Bank to achieve a risk-minimising or loss-limiting effect at an early stage by employing a pro-active approach.

The bank currently uses the following 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 system of controlling tools, decentralised data capture as well as centralised and timely compilation of relevant information are ensured.

The three tools described above are used to prepare the regular risk reporting to the bank's senior management. The responsibility for implementing operative risk-reducing measures rests on the responsible persons for the bank's risk management.



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. There were cases reported in the loss database during the financial year under review, but there were no losses involving significant monetary damages.

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, assessing, and management – through to risk control.

3.5 Investment risks

Aareal Bank Group's risk exposure is largely concentrated on risks generally associated with banking, such as credit risk, market price risk, liquidity risk, and operational risk. Some Group subsidiaries, however, are exposed to a variety of other types of risk outside typical banking risk, which we include in our centralised risk management system through an Investment Risk Control concept.

3.5.1 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 equity-surrogate loans. The concept of investment risk also encompasses risks arising from contingencies vis-à-vis relevant Group entities.

3.5.2 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 Corporate Development and Risk Controlling units are jointly responsible for measuring and monitoring investment risk exposure. Corporate Development holds the functional and organisational authority regarding investment controlling. Risk Controlling is responsible for submitting a quarterly investment risk report to the bank's Management Board.

3.5.3 Risk exposure in the Consulting / Services segment

The Consulting / Services segment comprises IT Services and Consulting, plus the payments and deposit-taking businesses with the institutional housing sector. The segment also accounts for the results from commercial and technical administration services, and from the disposal of residential and commercial property.

The business focus of IT Services and Consulting is on developing and operating software solutions for the commercial housing industry. Advisory services offered in conjunction with this are designed to fulfil specific customer requirements, where products need to be tailored to customers' needs. This segment is dominated by the Group subsidiaries **Aareon AG** and **Aareal First Financial Solutions AG.** Aareal Bank AG's Institutional Housing Business is responsible for the distribution of banking products.

Represented by the **Deutsche Bau- und Grundstücks Aktiengesellschaft** subsidiary, the focus in the property management and marketing business is on the management of residential property, on consultancy and marketing services for the privatisation of residential property, and on property management services.

Aareon AG

Aareon AG's main risk groups are software development risks and organisational risks, with market, process, project, and technical risks also being relevant; these risks are very often interrelated. The process of change in the property management sector prevailed during 2007. Aareon accounts for the increasingly heterogeneous requirements of its customers, with growing needs for customisation, with its new multi-product strategy launched in the 2006 financial year. Aareon offers a range of ERP solutions to different target customer groups: Blue Eagle / SAP, GES, WohnData, and Wodis – each of them commanding a leading position in its respective sector. Market response to this product strategy has been positive.

Aareon AG's ERP solutions and integrated services are being developed further, with a focus on creating added value for customers. The risk arising from developing software is in the potential inability to complete such developments within budgeted costs, with the required quality, and within the timeframe anticipated by the market. Recognising this risk, development work is generally executed within the scope of the Aareon Project Management model, which meets internationally accepted standards on the uniform and professional approach to the project process. This process model reduces software development risks. Control and management bodies specifically established to contain residual risks inherent in the ongoing development of Blue Eagle remain in place; members of the Management Board have assumed personal responsibility in these bodies. The "Blue Eagle 2008" project has reached initial milestone on schedule, with changes to the product structure being implemented.

Software development is also exposed to the risk of being unable to consider all customer requirements in the respective next release. The industry standard of implementing requirements within the framework of customer projects will be deployed in future, to reduce this risk and to enable Aareon to satisfy a large number of individual customer requests.

The risk of potential claims for damages from software implementation projects is being mitigated via a re-launched complaints management system designed to restore the satisfaction of customers having submitted a complaint through the swift and qualified rectification. Dealing with customer complaints at an early stage can help to rectify erroneous developments, preventing associated damages. Provisions have been recognised as a precautionary measure.

To minimise qualitative risks, Aareon regularly conducts surveys regarding its customers' requirements. In addition, extensive quality assurance measures are being carried out before new releases are implemented. A standardised, anonymous customer survey which is conducted on an annual basis is the key indicator of customer acceptance of the company's products. This allows Aareon to recognise the market requirements, and to take them into consideration at an early stage in product development.

The strategic changes implemented in 2006, with the "WoWi+" project and the launch of the multi-product strategy involved the risk that the company structure would no longer be in line with its new strategic orientation. Aareon countered this risk by introducing a new structural organisation oriented upon product lines. Reflecting these changes, reporting lines were based on product lines for the first time in the 2007 financial year. At the same time, internal communications have been intensified to contain any risks which might arise as a result of staff having difficulties with restructuring measures implemented. The goal is to convince staff members of the benefits of the company's strategic realignment. Sufficient provisions have been recognised for any staff-related measures which may be required under the four-point action plan to achieve Aareon Group's corporate goals.

Requirements for internal organisational development were recognised and implemented within the scope of related projects.

An extensive priority-setting process (involving senior management) is deployed to counter the risk of being unable to fulfil all internal requirements.

Foreign participations were reviewed in detail during the year under review, within the framework of the WoWi+ optimisation programme. As a result, the Blue Eagle / SAP business is being pursued on a more selective basis in some countries, and was discontinued in certain cases. The Management Committee for the international business will continue to conduct regular reviews of the entities in the United Kingdom, Italy, France, and Switzerland.

Individual customer projects represent a major component of Aareon's business. Such projects are exposed to risks in terms of time and costs, and of quality, should the company fail to meet customer expectations. Aareon reduces these risks by consistently applying its project management standards, which enable the company to also implement larger and more complex projects for its customers. Forward-looking staff deployment planning helps to reduce personnel expense risk.

Risk exposure from potential major disasters are minimised, through well-documented and regularly-rehearsed practical countermeasures, to the extent that downtimes are kept at tolerable levels – thus avoiding material damages to the customer's or service provider's business. To date, aside from unavoidable problems and short interruptions, no disasters occurred which would have interrupted service performance for a longer period of time. However, there is no way to generally exclude emergencies or disasters, which involve the risk of breaching standards agreed upon in service level agreements (SLAs). Backup locations have been retained for this type of disruption; these temporary sites allow to resume the performance of services, in line with contractual agreements, after a defined transfer period.

Furthermore, the company has implemented extensive data backup processes, allowing to restore the data, in full or in part, for a selected timeframe. Aareon has addressed the issue of liability risk by taking out property damage / liability insurance with limited scope and cover provided. This policy provides cover in the event of Aareon being judged liable to a third party for damage incurred in its capacity as a provider of IT services.

Overall, there were no risks which would have jeopardised the continued existence, or which would have had a material impact on the net assets, financial position, and results of operations of Aareon AG or its subsidiaries.

Aareal First Financial Solutions AG

Aareal First Financial Solutions AG develops innovative products and services for account maintenance and payments for the housing sector and operates the respective systems. The material risks resulting from this business consist of operational risks regarding the further development and the operation of systems, as well as an indirect market risk, which is due in particular to the close relationship with Aareal Bank, that is responsible for the distribution of banking products.

The risk arising from developing software with respect to the initial and continued development of BK 01 software solutions largely relates to the potential inability to complete such developments with the required quality, within the planned timeframe, or within budgeted costs. Internally, Aareal First Financial Solutions AG counters such risks by deploying a uniform development process and regular management reporting. This is complemented by a uniform, high-quality licensing process established vis-à-vis development cooperation partners; this is designed to satisfy our quality requirements on a sustained basis, and to ensure a high degree of transparency. Development partnerships that do not comply with these stringent quality requirements will not be extended, or will be terminated.

As the ongoing development of the BK@1 software solution (as the successor to the ZKF tool underlying BK 01® solutions) is based on Release 5.21 that is already in production, it does not involve any material risks. Besides the further development of BK@1 to implement functional requirements (such as SEPA) and technical objectives (optimising performance), the focus in the current financial year will be on finalising the migration of accounts from ZKF to BK@1; the migration process will be rolled out in several stages, by branches.

Risk exposure resulting from the operation of the the BK@1 software solution is sufficiently covered through the operational processes installed; these are based on the tried-and-tested ITIL standards. No serious faults, which would have resulted in an interruption of production or other serious damages, have occurred during the first three years of production.

The parallel operation of the legacy ZKF accounting system generally involves operational risk. To reduce this risk requires migrating an existing system (with exclusive connectivity to date) to BK@1, the new accounting system. Thanks to the early identification of this risk item, and appropriate action taken, initial customer account could already be successfully migrated. The residual risk will be gradually reduced further through continued migration. From today's perspective, it will be possible to discontinue parallel operations ahead of schedule, by the end of 2008.

The company's Management Board applies a standardised project risk management methodology, whereby risks are assessed monthly on a qualitative level, in order to identify any risks at an early stage and take appropriate counter-measures. Monthly project status reports are assessed by the management bodies identified within the framework of Aareal First Financial Solutions' project management system. This allows for continuous monitoring, facilitating swift counteraction if necessary.

A standardised procedure for the management of operational risks has been implemented. The results of regular risk inventory surveys and self-assessments regarding operational risks yielded no indication of risks or threats which are material or would jeopardise the continued existence of the business.

The market risk regarding utilisation of BK 01® solutions was mitigated by developing interfaces to third-party systems, such as SAP or platforms developed by other software providers to the commercial housing sector, alongside connectivity to Aareon's systems. The market presence of BK 01 solutions was successfully expanded into the utility sector via a pilot customer; this process will be expedited. Additional customers could be acquired during the current year. There are currently no plans to explore other sectors for BK 01.

Deutsche Bau- und Grundstücks AG

Deutsche Bau- und Grundstücks AG (BauGrund) looks back on a track record covering about eight decades in the property management sector. The business focus is on commercial services, but also on technical and infrastructure services in property management and real estate asset management; predominantly for residential property, but also for commercial and special property. BauGrund manages properties on behalf of the German federal government, local authorities and institutional investors, as well as for private investors including home owners' associations.

The company's key risk factors are property market developments, particularly regarding residential property, which in turn influence the behaviour of BauGrund's private, institutional, and public-sector clients. The preference by property investors to hold their investments for a short term only prevailed during 2007 – accordingly, this also resulted in property management and sales agreements being terminated at short notice, upon disposal. BauGrund counters this trend through a highly-diversified order book, in terms of counterparties and contractual terms.

BauGrund launched the six-point BOS+ (BauGrund Optimisation System) project in 2007, comprising the following items:

- Business growth, acquiring new clients
- Establishing a modern company structure and corporate culture
- Reducing the complexity of the BauGrund Group
- Cutting back unprofitable contracts

- Continuous enhancements to efficiency and quality
- Strengthening confidence and trust, inside the company and externally

Individual measures were already successfully implemented. The company's material risks are related to the planned business expansion, and the acquisition of new clients. The company needs to achieve its ambitious targets in order to generate the requisite return on equity over the medium term.

3.6 Other risks

3.6.1 Definition

Aareal Bank uses the category of "other risks" to aggregate those types of risk that cannot be quantified exactly: primarily, this includes reputational and strategic risks. Reputational risk is defined as the risk of events that negatively affect the bank's reputation with investors, analysts, or clients. Strategic risk is typically associated with the threat of incorrect assumptions regarding market developments, burdening a bank's performance as a result.

3.6.2 Risk measurement and monitoring

Other risks are predominantly managed and monitored through qualitative measures. A Group-wide Code of Conduct sets the framework regarding integrity and professional conduct for all activities. The Code provides a standard that is binding for all employees of the Aareal Bank Group – regardless of position, and hence, including members of the Management Board or supervisory bodies. Accordingly, the Code defines the fundamental standards for the conduct of each individual employee. Each employee or member of an executive body is personally responsible for complying with the Code of Conduct. The Aareal Bank Group ensures compliance with these standards, employing its internal facilities and organisational units (including, in particular, Internal Audit and Compliance / Anti-Money Laundering / Data Protection). Managers are responsible for raising staff awareness within their area of responsibility.

Aareal Bank's Management Board is responsible for managing strategic risk; it co-ordinates its actions with the Supervisory Board. The Management Board is supported in this task by Corporate Development, for instance, via the continuous monitoring of trends which may be relevant to business policy.

Outlook

Development of the environment

The economic framework for the year 2008 deteriorated significantly in the latter months of last year. Although many of the central banks cut interest rates since the outbreak of the sub-prime crisis affecting financial markets, the weakening effects of restrictive monetary policy pursued in recent years are now unfolding. The extent of the anticipated rise in commodity prices, and in particular the fallout from the sub-prime crisis, plus the accompanying burden on the banking system, are more decisive for the future economic cycle.

The crisis on financial markets intensified considerably at the start of 2008, and is now increasingly impacting indirect market participants, over and above directly affected market participants. High levels of write-downs (in some instances) on their sub-prime loans and on other structured finance products have impacted on the shareholders' equity of the banks in question and hence restricted their lending opportunities. Consequently, loans have become more expensive, which has eroded the investment activities of companies, thus leading to an economic slowdown.

Global growth is likely to slow down to between 3.0 % and 3.3 % in 2008. Momentum in global trading is also expected to ease. The inflationary problems that have concerned many countries since the end of 2007 should be defused during 2008, so that the inflationary trend remains under control. Financial markets will remain volatile for a long time yet, as the mortgage and financial market crisis is by no means over.

Global economic development for 2009 depends largely on the duration of the direct consequences of the crisis, and on the extent to which the real economy will be affected. Although this is still difficult to predict, we expect the financial markets crisis to influence the real economy.

We presume that the decline in investment activities in 2008 will also dampen economic development in 2009, and that economic growth in 2009 will remain in a corridor similar to that for 2008. The high write-downs that will have to be recognised by some of the banks lead us to believe that lending will also be strongly restricted in 2009 compared with the first half of 2007.

Europe

In Western Europe, particularly in Germany, we assume that the slowdown in global economic growth in 2008 will be reflected in weakened export activity. The considerable strength of the euro will also pose an additional burden. Overall, growth in 2008 will be substantially lower than in the previous year, although we do not expect a threat of lasting recession.

As the devaluation of the US dollar continues to spread, we envisage the resulting strength of the euro to dampen export activity and economic growth in 2009 relative to 2007.

The approach of Western European banks to lending should remain restrained in 2008, so that we forecast tighter lending terms and conditions for investors. We expect lending conditions to remain tight in 2009 vis-à-vis the first half of 2007, since various banks will have to endure the effects of some considerable write-downs in part. On the other hand, the fact that the banks' write-down requirements are likely to become more transparent during 2008 supports the argument for a slight easing in lending conditions. Despite good profitability, the aforementioned scenario will curb the investment activities of companies and thus diminish the economic expectations of both companies and consumers. The good employment environment on the other hand is positive.

In view of the relatively high inflation in the euro zone, the burdens from the financial and liquidity crisis, and an anticipated economic slowdown, European monetary policy is currently in a difficult situation. It therefore remains to be seen whether the European Central Bank will continue to change interest rates against this background.

We believe that the UK will be affected more by the sub-prime crisis than the euro zone overall. The Bank of England's key rate cut of 6 December 2007 was followed by another 0.25 % point cut on 7 February 2008. As we see it, further reductions are in the pipeline.

Economic growth in 2008 and 2009 in the CEE states will be lower than 2007, as a consequence of anticipated developments in the US and Western Europe. Nonetheless, growth in most of the countries will be considerably higher than the level for Western Europe. The growth momentum seen in the CEE countries for the past few years could therefore remain intact.

North America

The US was affected in particular by the mortgage and financial crisis, so that restrictive lending and a reduction in investment activity is expected for 2008. Furthermore, private consumption is expected to fall as a result of the drop in the asset value of residential properties and lower US consumer confidence. This economic scenario involves the risk of a recessionary trend. Since September 2007, the Federal Reserve has taken measures to try and counter this by means of several rate cuts. The US government also passed a USD 160 billion economic stimulus package that includes tax rebates to private households as well as tax incentives.

Given that the economic slowdown in the US should lead to further rate cuts, we are forecasting considerably weaker growth for the year 2008 as a whole, with a recessionary trend. Due to lower investment activity in 2008 and tighter lending conditions, we expect that economic growth in 2009 will be significantly lower than in 2007. Transparency in relation to the write-down requirements of the banks could boost investor and consumer confidence again, and lead to a slight economic recovery in 2009 over the year 2008.

The importance of the trading relationships with the US (NAFTA) will impact indirectly on Canada and Mexico, albeit not to the same extent as the United States.

Asia / Pacific

Asia's emerging markets are not immune to a weakening of the global economy – particularly if the US, as the world's largest consumer market by a wide margin, were to enter into a longer-term period of weakness. Growth should remain strong in the region during 2008 and 2008, supported by continued high growth momentum, increasing domestic demand and close economic ties within the region. Relatively strong correlation to developments in the US and Europe will lead to a slight economic slowdown here in 2008 and 2009.

China will remain the top performer in terms of economic growth in the next two financial years. High growth and continuous inflation will require the Chinese central bank to hike key interest rates further. In contrast, growth in Japan will remain very low, as in recent years.

International property markets

The deteriorating economic outlook that is emerging for 2008 will impact by varying degrees on property markets, particularly on commercial property.

Europe

Falling returns on investment in commercial property in Western Europe were halted back in the second half of 2007. Yields have risen again – in part – since then. We expect this scenario will continue into 2008 and that returns will stabilise in 2009. The UK, and London in particular, will be affected most by the increased returns, as yields there have already reached a particularly low level. We also expect rising yields in 2008, followed by stability in 2009, in continental European locations such as for example, the urban areas of Spain, where yields are very low. High-quality property in excellent locations will be affected to a lesser extent by the rise in yields.

We believe that the yield differential between top-class property and properties with locational disadvantages will widen further. The rise in yields should impact less on

Western European regions such as Scandinavia and the Benelux countries.

All in all, the volume of commercial property transactions concluded in Western Europe should be lower in 2008 compared with 2007. Despite low economic growth, we forecast largely stable rents in the good locations of Western Europe against the background of a stable employment situation.

The negative effects on construction investment in Germany from the abolition of the Eigenheimzulage home-ownership subsidies that came into effect on 1 January 2006 is gradually tapering off. We therefore expect residential construction investment and the price trend to be stable in 2008 and 2009.

Compared with 2007, returns on commercial property in the Central and Eastern European countries should be stable to slowly falling in 2008 and 2009. There is still a yield differential between the emerging markets, specifically Russia or Romania, and the Western European markets.

We forecast largely stable rents in Central and Eastern Europe for 2008 and 2009. Rents for office space in Moscow are currently very high. Due to low vacancy ratios for high-quality space, rental levels should remain constant over the next two years. On the other hand, the levels currently commanded in the established locations of Warsaw and Prague are considerably lower.

North America

Demand for office space by tenants is generally influenced by the economic situation of the companies. We therefore expect lower demand for office space in the US during 2008 and 2009, compared with 2007. Rents for office space should therefore stagnate on average, or even fall in some cases. However, office space in top-class locations will always be in demand, which is why rental prices there will outperform office space in peripheral locations or of lesser quality.

Weaker private consumption feeds through in the form of higher vacancies and pressure on rental prices of retail property. This segment is also affected above all in peripheral locations.

Yields on commercial property investments in the US that had fallen over many years reached their low mid-2007 and started to rise again in the second half of the year. We expect a rise in yields in 2008, as well as a lower volume of commercial property transactions than in 2007. The forecasted rise in returns on investments could fade in 2009, to be followed by stable yields.

Residential construction investment should continue to fall initially, as it has done at the end of 2007. We also expect residential property prices to fall on average, although major regional differences are unlikely. It is not clear how long this trend is likely to continue: however, it could come to an end if investors regain a high measure of confidence in the economy in 2009.

Asia / Pacific

Property returns in the Asian emerging markets should fall in 2008 followed by a further slight fall and stagnation in 2009. Nevertheless, they will be considerably higher than in North America and Western Europe during these years. Despite strong construction activity, such as in Beijing or Shanghai, we assume that demand for new space in particular is so strong that rents in China will remain largely stable during the forecast period. We are also forecasting stable or slightly rising yields for 2008 and 2009 in other important Asian centres, such as Tokyo, Seoul or Singapore.

German housing and property management sector

The German property management sector is stable. The challenges of recent years, especially the rise in service and maintenance costs, have seen the sector adjust to the changed market environment and successfully carve out new directions. The issue of process optimisation to enhance efficiency will remain on the agenda in 2008 and 2009 owing to relentless cost pressures.

Ever since the international capital market has focused on the German property market as an investment opportunity, the institutional housing sector has become more heterogeneous. The corresponding changes in the ownership structure on the German housing market will be maintained. Following the spate of large-volume residential property transactions in the first quarter of last year, investor trading activities eased off in the wake of the credit markets turbulence. The significance of opportunistic buyers has diminished on the investment market. We are forecasting a higher level of domestic investor interest, and strategically-focused international investors with conservative return targets in 2008 and 2009.

Investment activities in property management companies are likely to rise further, mainly due to the coming into force of the new energy saving regulation (EnEV) in October 2007. The trend of rising energy costs is set to continue, thus contributing to the drive amongst property management companies towards optimising existing properties.

The objective of enhancing the attractiveness of let residential properties and approaching target client groups is gaining importance again. In order to reach these goals, the housing companies will have to increasingly provide supplementary services in conjunction with the rental properties.

The increased heterogeneity of customer requirements in the institutional housing business will continue to play an important role for the providers of IT services to the property management business in developing more complex and differentiated solutions. The demand for automated IT systems and optimisation of payment systems (or internal processes) will rise further in the years ahead.

Although we will generally see an increase in the number of providers in the IT market for professional property management, the rate at which companies will change to new software providers should remain low.

Corporate development

Structured Property Financing

The environment forecasted for 2008 and 2008 will be influenced mainly by the property financing business. This will present Aareal Bank with opportunities as well as risks. In the light of our three-continent strategy in particular, and accompanying regional diversification of our business model, we believe that the opportunities will outweigh the risks.

We presume that the situation on the capital market in 2008 will make it impossible (except for some individual cases) or very difficult to place loans with third parties. As we see it, being able to carry loans on the bank's balance sheet will therefore become a key competitive advantage.

New developments are evident within the scope of the business activities of the property investors, which are being stepped up as a result of the sub-prime crisis and its consequences: international property investors are concentrating increasingly on long-term commitments. Property is being regarded again as a non-current asset class. This should lead to a rise in quality and to an improvement in the risk / return ratio of the financings. We view the return to a more attractive pricing of risks and to higher equity stakes in the financings as positive for the future performance of the property financing business.

Given that the sub-prime crisis has hardly impacted on the Asian markets to date, they should continue to offer good opportunities for Aareal Bank.

The threat of a sustained recession in the US could represent risks for the development of the structured property finance business. This could lead to economic weakness worldwide. The subsequent drop in transaction volumes on the property markets could impair the financing business.

Asset-covered bonds are expected to trade in a stable range on the capital markets in 2008. We intend to exploit this opportunity by further increasing the share of asset-covered bonds in our refinancing mix.
It is difficult at this point in time to estimate the future performance of the margins of unsecured notes. A significant rise in the

price range for senior unsecured bonds would increase Aareal Bank's refinancing costs overall. However, we are very confident that rising margins in the lending business can more than compensate for higher refinancing costs.

Our securities portfolios could suffer further temporary negative effects in 2008 as a result of securities being marked to market.

Including all opportunities and risks, Aareal Bank adjusted its company strategy in line with future business development. Owing to the anticipated market environment, projections assume that there will be only very limited exit opportunities available – or possibly none at all – by way of syndication and securitisation in 2008.

We expect a reduction in the level of prepayments of structured property financings, and hence a drop in net commission income.

We plan to further increase the volume of risk-weighted assets held in 2008. Net interest income will benefit from the rise in risk-weighted assets and margins.

Consulting / Services

Aareal Bank Group has successfully adjusted to the changing environment on the German property market. As an experienced and stable partner for the property management sector, we are well positioned in the market together with our subsidiaries Aareon AG and Aareal First Financial Solutions AG and the bank's Institutional Housing Business.

We develop our products and services for the institutional housing sector with the needs of our clients in mind. The two Blue Eagle / SAP® releases 5.0 und 5.1 are scheduled for 2008. We view the SAP®-based Blue Eagle as a target system for property management companies with complex requirements. The investment phase for Blue Eagle / SAP® has already been concluded. We anticipate a significant rise in the number of residential units managed through Blue Eagle in the 2008 and 2009 financial years. Sales in the Consulting segment should therefore rise considerably.

We will largely retain market share in relation to our existing products GES and WohnData. We expect a slight decline in the product result of our GES solution for SMEs in 2008, since some clients are expected to migrate to Blue Eagle / SAP®.

The IT product Wodis, which is integrated in Aareon AG's service together with other available integrated services, has been very well received by the market.

The integrated services offer our clients added value by increasing efficiency as well as being key features that distinguish us from our competitors. The emphasis in 2008 will lie on penetrating our existing client base further. The product result should increase significantly, with the Mareon solutions probably making the greatest contribution.

The process optimisation procedures for electronic mass payment services offered by the bank's Institutional Housing Business will continue to generate stable deposits for Aareal Bank's refinancing activities. This will be guaranteed by constantly developing the technical components of the procedure through a direct exchange of views with the clients.

The bank will concentrate increasingly next year on the acquisition of new clients and on taking greater advantage of the existing client base by realising cross-selling effects.

Cooperation with the leading providers of software to the institutional housing sector and commercial property managers, as well as the energy companies offers the bank the potential to acquire new clients. Aareal Bank is also planning to introduce additional payment transaction products that will further enhance market penetration over and above the user-group of the integrated payment transaction systems BK 01 and BK XL. Cross-selling opportunities provide access to more than 2,200 clients, for example in the management of key money or processing of all recurring payments in the area of operating costs.

The contribution of the bank's Institutional Housing Business to Group results will benefit in the years ahead from this extensive range of services, and above all from the excellent positioning in payment transactions. Costs are expected to remain stable.

In summary, the profit contribution of the Consulting / Services segment to the overall results of Aareal Bank Group is expected to rise significantly in 2008. This will be driven mainly by rising turnover, whilst costs will remain stable.

Aareal Bank Group

On the basis of the aforementioned environment in the two business segments, Structured Property Financing and Consulting / Services, Aareal Bank will face opportunities as well as risks in the 2008 financial year.

Although the current market situation makes it difficult to deliver concrete forecasts, we are generally confident that the opportunities available to Aareal Bank Group will outweigh the risks. The effects of appropriate pricing of credit risks and corresponding improvements in margin for the financing business will be positive. Additionally, the successful regional diversification within the scope of the three-continent strategy will enable us to offset any possible negative developments in the individual markets.

Assuming that there will be no further serious distortions in the financial markets, we will match last year's good operative results in 2008 – or even improve on them, given the right market environment.

Positive performance in the Consulting / Services segment is expected to continue. We affirm the target already announced of a pre-tax profit of € 50 to 60 million in this segment by the end of 2009.

On the basis of Group planning, where we made very conservative assumptions owing to the forecasting difficulty presented by current market developments, we are confident of achieving our announced target figure of a return on equity after taxes of 13 %. In keeping with the more difficult environment in the banking sector, we have extended the planning horizon for achieving this unchanged objective from 2009 to year-end 2010. The ability to achieve this target will depend on a recovery in financial markets by 2009 at the latest.

Disclosure pursuant to section 315 No. 4 of the HGB

Compensation system

The Executive Committee of the Supervisory Board determines the structure and amount of remuneration for members of the Management Board. The Committee sets salaries and other remuneration components for members of the Management Board.

Aareal Bank AG has entered into fixed-term service contracts with the members of its Management Board.

In addition to fixed salary components, which are paid in twelve identical monthly instalments, the members of the Management Board receive a variable remuneration, which is made up of a bonus and a long-term component in the form of phantom shares (long-term component 1) that must be held for three years, after which they can be exercised in the three following years. The members of the Management Board receive an additional long-term component that entitles them to exercise allocated phantom shares, of which a quarter are allocated in the year of allocation and in the three following years, and provided the member of the Management Board has not terminated his service contract at the time of exercise (long-term component 2).

The basis for this variable remuneration component is a target system, largely based on net income (of the Group) as reported under International Financial Reporting Standards (IFRS), as well as qualitative and quantitative targets, which are redefined annually.

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 resolution passed at the Annual General Meeting of 23 May 2006 determined the current remuneration that was adjusted in line with the remuneration system of the Supervisory Board. According to this new system, Supervisory Board members' remuneration for the 2007 financial year will for the first time be for the full financial year.

The total remuneration of the Supervisory Board will comprise a fixed and a variable remuneration component, comparable to the remuneration package of the Management Board. The variable remuneration is performance-related and comprises a short-term and a long-term component.

Please refer to the Notes to the Consolidated Financial Statements (Remuneration Report) on page 209 for further details about the remuneration system for members of the Management Board and the Supervisory Board of Aareal Bank AG as well as on the existing change of control regulations.

Shareholders' equity

As at 31 December 2007, Aareal Holding Verwaltungsgesellschaft mbH, Düsseldorf and Hermes Focus Asset Management Europe Limited, London held 37.23 % and 10.225 % respectively of the voting shares of the subscribed capital of Aareal Bank AG. Any further direct or indirect shareholdings in the bank's capital that exceed 10 % of the voting rights were unknown.

Further explanations with regard to Aareal Bank AG's shareholder equity can be found in the Notes to the Consolidated Financial Statements (Notes to the Balance Sheet) from page 178.

Appointment and removal of Management Board members

Pursuant to the wording of the Memorandum and Articles of Association, as recorded on 22 June 2007 in the Commercial Register with the Local Court of Wiesbaden, the Supervisory Board shall appoint the members of the Management Board and determine their number. The Supervisory Board shall be authorised to amend the Memorandum and Articles of Association, provided that such amendments are restricted to the wording only.

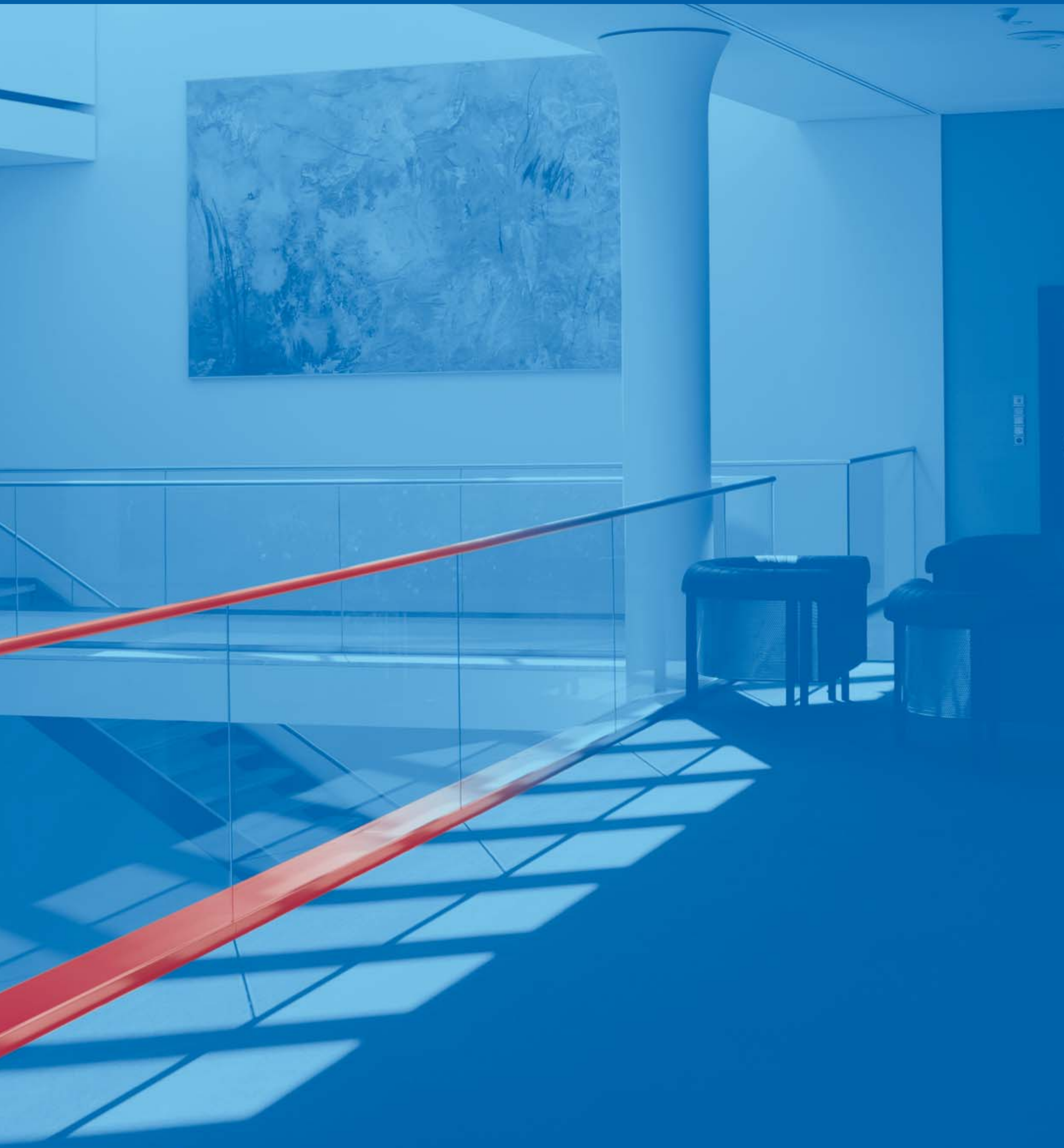
Report on material events after the reporting date

There have been no material events subsequent to the balance sheet date of 31 December 2007 that need to be disclosed at this point.

CONTENTS II

CONSOLIDATED FINANCIAL STATEMENTS

FINANCIAL



CONSOLIDATED INCOME STATEMENT

OF AAREAL BANK GROUP

	Note	1 Jan - 31 Dec 2007	1 Jan - 31 Dec 2006
		€ mn	€ mn
Interest income		1,903	1,603
Interest expenses		1,492	1,214
Net interest income	25	**411**	**389**
Provision for loan losses	26	77	89
Net interest income after net loan loss provisions		**334**	**300**
Commission income		205	228
Commission expenses		63	83
Net commission income	27	**142**	**145**
Net result on hedge accounting	28	1	9
Net trading income / expenses	29	-26	13
Results from non-trading assets	30	206	66
Results from investments accounted for using the equity method	31	68	4
Results from investment properties	32	1	-13
Administrative expenses	33	361	356
Net other operating income / expenses	34	18	-8
Impairment of goodwill	35	3	0
Operating profit from continuing operations		**380**	**160**
Income taxes	36	72	36
Results from discontinued operations	E	–	1
Consolidated net income / loss		**308**	**125**
Allocation of results			
Consolidated net income / loss attributable to minority interests		18	18
Consolidated net income / loss attributable to shareholders of Aareal Bank AG		290	107
Appropriation of profits			
Consolidated net income / loss		308	125
Consolidated net income / loss attributable to minority interests		18	18
Transfer to retained earnings		143	0
Consolidated distributable profit		**147**	**107**
		€	€
Earnings per share	37	**6.77**	**2.49**
Diluted earnings per share	37	**6.77**	**2.49**

Earnings per share are determined by dividing the earnings attributable to ordinary shareholders of Aareal Bank AG by the weighted average of ordinary shares outstanding in the financial year.

CONSOLIDATED INCOME STATEMENT

(QUARTERLY DEVELOPMENT)

	Quarter 4 2007	Quarter 3 2007	Quarter 2 2007	Quarter 1 2007	Quarter 4 2006
	€ mn	€ mn	€ mn	€ mn	€ mn
Interest income	505	488	475	435	417
Interest expenses	396	388	371	337	325
Net interest income	**109**	**100**	**104**	**98**	**92**
Provision for loan losses	14	19	22	22	23
Net interest income after net loan loss provisions	**95**	**81**	**82**	**76**	**69**
Commission income	53	47	52	53	52
Commission expenses	16	15	16	16	18
Net commission income	**37**	**32**	**36**	**37**	**34**
Net result on hedge accounting	-3	-1	3	2	3
Net trading income / expenses	-20	-13	5	2	7
Results from non-trading assets	18	162	14	12	27
Results from investments accounted for using the equity method		63	5		
Results from investment properties	0	0	1	0	-12
Administrative expenses	88	93	91	89	88
Net other operating income / expenses	-9	-10	-2	39	-2
Impairment of goodwill	3				0
Operating profit from continuing operations	**27**	**221**	**53**	**79**	**38**
Income taxes	5	33	11	23	1
Results from discontinued operations					1
Consolidated net income / loss	**22**	**188**	**42**	**56**	**38**
Allocation of results					
Consolidated net income / loss attributable to minority interests	4	5	4	5	4
Consolidated net income / loss attributable to shareholders of Aareal Bank AG	18	183	38	51	34

CONSOLIDATED BALANCE SHEET

OF AAREAL BANK GROUP

	Note	31 Dec 2007	31 Dec 2006
Assets		**€ mn**	**€ mn**
Cash funds	38	1,051	1,331
Loans and advances to banks	39	2,245	2,691
Loans and advances to customers	40	24,985	23,341
Provision for loan losses	41	-190	-333
Positive market value of derivative hedging instruments	42	899	883
Trading assets	43	1,819	726
Non-current assets held for sale and discontinued operations	44	20	215
Non-trading assets	45	8,811	8,510
Investments accounted for using the equity method	46	92	120
Investment properties	47	10	10
Intangible assets	48	80	84
Property and equipment	49	101	93
Income tax assets	50	32	42
Deferred tax assets	51	61	175
Other assets	52	186	391
Total		**40.202**	**38,279**
Shareholders' equity and liabilities		**€ mn**	**€ mn**
Liabilities to banks	53	4,953	5,212
Liabilities to customers	54	21,790	21,346
Certificated liabilities	55	7,862	7,078
Negative market value of derivative hedging instruments	56	1,128	974
Trading liabilities	57	995	157
Obligations from disposal groups and discontinued operations	58	0	3
Provisions	59	273	286
Income tax liabilities	60	18	14
Deferred tax liabilities	61	55	128
Other liabilities	62	183	318
Subordinated equity	63	1,318	1,391
Shareholders' equity	64		
Subscribed capital		128	128
Capital reserves		511	511
Retained earnings		554	314
Reserves from transactions under common control		-26	-18
Revaluation surplus		70	86
Minority interest		243	244
Consolidated distributable profit		147	107
Total shareholders' equity		1,627	1,372
Total		**40,202**	**38,279**

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY *

					Revaluation surplus						
	Subscribed capital	Capital reserves	Retained earnings	Reserves from transactions under common control	Reserves from business combinations	AfS reserves	Hedging reserves	Currency translation reserves	Minority interest	Consolidated distributable profit	Consolidated shareholders' equity
	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn
Consolidated shareholders' equity as at 1 Jan 2007	**128**	**511**	**314**	**-18**	**0**	**89**	**-2**	**-1**	**244**	**107**	**1.372**
Changes in gains / losses recognised directly in equity						5	1	1			7
Reclassifications to income of gains / losses recognised directly in equity						-33	2				-31
Remeasurement upon business combinations					13						13
Changes in tax effects						8					8
Net result of items recognised directly in equity					**13**	**-20**	**3**	**1**			**-3**
Consolidated net income / loss										308	308
Total income					**13**	**-20**	**3**	**1**		**308**	**305**
Transfer to retained earnings			229							-229	0
Dividends paid										-21	-21
Effects from transactions under common control				-8							-8
Reclassifications			13		-13						0
Consolidated net income / loss attributable to minority interests										-18	-18
Changes in minority interest									-1		-1
Changes in reporting entity structure, and other changes			-2								-2
Consolidated shareholders' equity as at 31 Dec 2007	**128**	**511**	**554**	**-26**	**0**	**69**	**1**	**0**	**243**	**147**	**1.627**

** See note (64) in the Notes to the Consolidated Financial Statements for explanations on the consolidated shareholders' equity*

	Subscribed capital	Capital reserves	Retained earnings	Reserves from transactions under common control	Revaluation surplus: AfS reserves	Revaluation surplus: Hedging reserves	Revaluation surplus: Currency translation reserves	Minority interest	Consolidated distributable profit	Consolidated shareholders' equity
	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn
Consolidated shareholders' equity as at 1 Jan 2006	**128**	**511**	**344**	**-42**	**63**	**-6**	**-1**	**244**	**0**	**1,241**
Changes in gains / losses recognised directly in equity					47	7	0			54
Reclassifications to income of gains / losses recognised directly in equity					-13					-13
Changes in tax effects					-8	-3				-11
Net result of items recognised directly in equity					**26**	**4**	**0**			**30**
Consolidated net income / loss									125	125
Total income					**26**	**4**	**0**		**125**	**155**
Capital increase										0
Transfer to retained earnings										0
Effects from transactions under common control			-24	24						0
Consolidated net income / loss attributable to minority interests									-18	-18
Changes in minority interest										0
Changes in reporting entity structure, and other changes			-6							-6
Consolidated shareholders' equity as at 31 Dec 2006	**128**	**511**	**314**	**-18**	**89**	**-2**	**-1**	**244**	**107**	**1,372**

CONSOLIDATED STATEMENT OF CASH FLOWS*

	Cash flow from continuing operations 1 Jan - 31 Dec 2007	Cash flow from continuing operations 1 Jan - 31 Dec 2006	Cash flow of discontinued operations 1 Jan - 31 Dec 2006	Total Cash flow 1 Jan - 31 Dec 2006
	€ mn	€ mn	€ mn	€ mn
Consolidated net income / loss	**308**	**124**	**1**	**125**
Amortisation, depreciation, write-downs and write-ups on loans and advances	63	88		88
Net new loan loss provisions / (release of provisions)	16	5		5
Depreciation of (write-ups to) non-current assets	24	37	0	37
Other non-cash changes	643	-126	1	-125
Profits (losses) on the disposal of non-current assets	-197	-69	-1	-70
Other adjustments	57	-125	4	-121
Subtotal	**914**	**-66**	**5**	**-61**
Changes in loans and advances to banks	444	-1,112	-1	-1,113
Changes in loans and advances to customers	-1,923	617	0	617
Changes in trading assets	0	-3	0	-3
Changes in other assets from operating activities	465	260	-5	255
Changes in liabilities to banks	-417	-2,441	7	-2,434
Changes in liabilities to customers	164	3.030	0	3,030
Changes in certificated liabilities	722	-439		-439
Changes in trading liabilities	0	-2		-2
Changes in other liabilities from operating activities	-362	-324	-3	-327
Income taxes paid	27	5	0	5
Interest received	2,668	1,645	0	1,645
Interest paid	-2,565	-1,517	0	-1,517
Dividends received	0	0		0
Cash flow from operating activities	**137**	**-347**	**3**	**-344**

** See note (77) for explanations on the Consolidated Statement of cash flows*

	Cash flow from continuing operations 1 Jan - 31 Dec 2007	Cash flow from continuing operations 1 Jan - 31 Dec 2006	Cash flow of discontinued operations 1 Jan - 31 Dec 2006	Total Cash flow 1 Jan - 31 Dec 2006
	€ mn	**€ mn**	**€ mn**	**€ mn**
Proceeds from the disposal of non-trading assets and investments accounted for using the equity method	2,748	1,780	4	1,784
Payments for the acquisition of non-trading assets and investments accounted for using the equity method	-3,028	-1,380	-3	-1,383
Proceeds from the disposal of property and equipment, intangible assets and investment properties	194	12	1	13
Payments for the acquisition of property and equipment, intangible assets and investment properties	-218	-42	-8	-50
Effects of changes in reporting entity structure		0		0
Changes due to other investing activities	0		0	
Cash flow from investing activities	**-304**	**370**	**-6**	**364**
Proceeds from capital increase	0	0		0
Dividends paid	-21	-5	5	0
Changes in subordinated equity	-72	-165		-165
Changes due to other financing activities	-20	-17	-1	-18
Cash flow from financing activities	**-113**	**-187**	**4**	**-183**
Cash and cash equivalents as at 1 January	**1,331**	**1,494**	**0**	**1,494**
Cash flow from operating activities	137	-347	3	-344
Cash flow from investing activities	-304	370	-6	364
Cash flow from financing activities	-113	-187	4	-183
Cash and cash equivalents as at 31 December	**1,051**	**1,330**	**1**	**1,331**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOT

(A) BASIS OF ACCOUNTING

Legal framework and reporting entity structure

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.

As a listed public limited company, Aareal Bank AG has prepared its consolidated financial statements for the financial year ended on 31 December 2007 in accordance with International Financial Reporting Standards (IFRS) applicable within the European Union (EU) as at the balance sheet date, in connection with the provisions pursuant to section 315a (1) of the German Commercial Code (Handelsgesetzbuch – "HGB").
The reporting currency is the euro (EUR).

The consolidated financial statements were approved for publication by the Management Board on 26 March 2008.

All subsidiaries and joint ventures of Aareal Bank AG have been included in the consolidated financial statements as at 31 December 2007 by way of consolidation. Companies over which Aareal Bank AG may exercise a significant influence ("associated companies") are measured at equity.

In the financial year 2007, the following changes occurred in the reporting entity structure:

In 2007, Aareal Bank AG acquired a total of 35.73 % of the shares in the internet property portal Immobilien Scout GmbH, Berlin, during several transactions. The consideration amounted to € 168 million. The bank's total shareholding thus increased from 30.49 % to 66.22 %. In the 3rd quarter 2007, Aareal sold all its shares in the company at a price of € 358 million. The sales transaction resulted in income for the Group of € 153 million.

In addition to the sale of Immobilien Scout GmbH, Aareal sold a number of property companies. There was also a number of mergers within the Aareal Bank Group as well as individual purchases which are insignificant from a Group perspective.

Beside the above-mentioned effects from the sale of Immobilien Scout GmbH, the changes in reporting entity structure had no material impact on the financial position and performance of the Aareal Bank Group.

An overview of material subsidiaries as at 31 December 2007 (quoting their country of domicile and the percentage of voting rights held) is given in section (I) "List of Shareholdings" of this annual report. The full list of shareholdings has been published in the electronic Federal Gazette and is available to the public.

Accounting policies

(1) Accounting standards

Recognition and measurement is based on principles consistently applied throughout the Group. We apply accounting policies – and the presentation of financial statements – consistently, in order to ensure the comparability of financial statements over time.

Information is presented in accordance with the principle of materiality.

The bank observes the general prohibition of setting off assets against liabilities.

Income and expense are recognised on an accrual basis.

Preparing the consolidated financial statements requires estimates in some cases. Furthermore, the application of accounting policies at a Group level requires assessments. This involves scope of discretion in relation to these estimates and assessments. The basis for assumptions made in such areas is explained in the corresponding sections.

(2) 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 in which the respective entity operates ("functional currency").

The consolidated financial statements are prepared in euro, being both the functional and the Group's 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 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 revaluation surplus), or recognised in income (in net trading income).

Financial statements of consolidated subsidiaries, which are presented in currencies other than euro, are translated at the exchange rate prevailing at the reporting date. Translation differences are recognised in equity, in the revaluation surplus.

(3) Consolidation

Subsidiaries are defined as all entities where the parent company of a group has the power to govern the financial and operating policies so as to obtain benefits from it. Subsidiaries are consolidated from the point in time when the parent has assumed control (full consolidation); consolidation ends when control is no longer exercised.

Minority interests resulting from full consolidation are shown in the consolidated balance sheet, as part of equity.

Assets, liabilities, income and expenses of jointly-controlled entities are reported in the consolidated financial statements using proportionate consolidation.

First-time consolidation of entities is accounted for, applying the purchase method, in accordance with IFRS 3, whereby remeasured amounts (including hidden reserves and hidden encumbrances) must be used when recognising assets and liabilities of an entity to be consolidated. This may lead to the recognition of new assets and liabilities that were previously not reported in the balance sheet 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 immediately charged against income.

Intragroup transactions, balances, and profits on transactions between Group entities are eliminated. Accounting policies applied by subsidiaries were amended to the extent required to ensure consistent accounting throughout the Group.

Associated companies ("associates") are companies in which the Group may exercise significant influence, without exercising control. Associates are measured using the equity method. The Group's share in gains and losses of associates is recognised in the consolidated income statement from the date of acquisition and is included in the carrying amount of the equity investment.

(4) Changes in accounting policies

In the financial year 2007, the following financial reporting standards (IAS / IFRS) and interpretations (SICs and IFRICs) were published by the International Accounting Standards Board (IASB) and adopted by the EU Commission:

- IFRS 8 Operating Segments
- IFRIC Interpretation 10 Interim Financial Reporting and Impairment
- IFRIC Interpretation 11 IFRS 2 – Group and Treasury Share Transactions

IFRS 8 supersedes the previous IAS 14 Segment Reporting. IFRIC 10 provides more detailed information on the recognition of impairments in connection with interim financial reporting in accordance with IAS 34.

The financial reporting of share-based payment transactions is described in more detail by IFRIC 11.

IFRIC 10 was applied in the year under review. The application of IFRIC 10 did not have a material impact on the financial position and performance.

The Aareal Bank Group has not exercised the option for early application of the other new standards and interpretations mentioned above. The first-time adoption of these new standards and interpretations in 2008 and 2009 is not expected to have any material consequences for the presentation of the financial position and performance of the Group.

IFRS 7 Financial Instruments: Disclosures were applied for the first time in the financial year 2007. The standard includes disclosure requirements with respect to financial instruments. The application of IFRS 7 did not have a material impact on the Group's financial position and performance.

Specific accounting policies

(5) Definition and classification of financial instruments

Pursuant to IAS 32, a financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Within the Aareal Bank Group, the following line items on the balance sheet contain financial instruments that fall within the scope of IAS 39:

- Cash funds
- Loans and advances to banks
- Loans and advances to customers
- Positive market values of derivative hedges
- Trading assets
- Non-current assets held for sale and discontinued operations
- Non-trading assets
- Deferred income tax assets
- Other assets
- Liabilities to banks
- Liabilities to customers
- Certificated liabilities
- Negative market values of derivative hedges
- Trading liabilities
- Obligations from disposal groups held for sale, and from discontinued operations
- Deferred income tax liabilities

- Other liabilities
- Subordinated equity

Financial instruments (including derivative financial instruments) must be recognised if the reporting entity has become a contracting party to the contractual provisions of such financial instruments. Financial assets are derecognised upon final maturity or where material risks or opportunities under such assets have lapsed, or control over the contractual rights from such assets has expired. Financial liabilities are derecognised upon repayment.

IAS 39 requires all financial assets to be classified under one of the (measurement) categories shown below, upon recognition:

- At fair value through profit or loss
- Held to maturity (HtM)
- Loans and receivables (LaR)
- Available for sale (AfS)

The ”fair value through profit or loss“ category comprises the following sub-categories:

- Held for trading (HfT) and
- Designated as at fair value

Financial instruments are classified as held for trading if they are acquired or incurred principally for the purpose of selling or repurchasing them in the near term, or if they are derivatives not designated within the scope of a recognised hedging relationship.

Entities have the option to irrevocably designate financial instruments as ”At fair value“, irrespective of any intention to trade. The Aareal Bank Group has not exercised this ‘fair value option’.

Upon first-time recognition, financial instruments classified as ”At fair value through profit and loss“ are recognised at fair value (excluding transaction costs), and subsequently measured at fair value, with results recognised in income.

”Held to maturity“ financial instruments are financial assets with fixed or determinable payments and fixed maturity. To classify financial instruments under this category, the entity must have the positive intention and ability to hold these financial instruments to maturity. Upon first-time recognition, financial instruments classified as ”Held to maturity“ are recognised at cost (including transaction costs which can be directly attributed), and subsequently measured at amortised cost. Currently, the Aareal Bank Group has not allocated any financial instruments to this category.

The ”Loans and receivables“ category comprises non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market. Upon first-time recognition, financial instruments classified as ”Loans and receivables“ are recognised at cost (including transaction costs which can be directly attributed), and subsequently measured at amortised cost.

The ”Available for sale“ category comprises all financial assets which cannot be classified under any of the preceding categories and that are held for an unspecified period of time and may be sold if there is a need of liquidity or market conditions have changed. Upon first-time recognition, financial instruments classified as ”Available for sale“ are also recognised at fair value (including transaction costs which can be directly attributed); they are subsequently measured at fair value, with results recognised in equity.

The Aareal Bank Group reviews at any balance sheet date whether there is objective evidence of impairment for financial assets. Criteria were defined for this purpose which – if such criteria are met – trigger a review to determine whether there is objective evidence of impairment. If there is objective evidence and a negative impact on the future cash flows generated from the financial asset can be expected as a result of the loss event, impairment losses are recognised.

For debt securities held, such a criterion is a downgrade of an external credit rating to ”BBB“ or worse. The relevant criteria for equity instruments are either a price decrease by more than 20 % below the average acquisition costs or when the price of a share at the valuation date has been below the average acquisition costs for that share for more than one year.

In the event of impairment, the carrying amount of a financial asset is written down to the recoverable amount (for Loans and receivables and Held to maturity financial assets). The recoverable amount is the present value of expected future cash flows from the financial asset. Where reasons for impairment lapse subsequently, the necessary reversals of impairments (write-backs) are generally recognised in income. In case of an impairment of Available for sale financial instruments, the accumulated losses previously recognized directly in equity in the revaluation surplus are reclassified into the income statement. If the reasons for impairment cease to exist, a write-back (up to amortised cost) to be recognised in income is permitted only for debt securities. Amounts exceeding amortised cost, as well as write-backs of equity instruments, are always recognised directly in equity in the revaluation surplus.

IAS 39 requires all financial liabilities to be classified under one of the (measurement) categories shown below, upon recognition:

- At fair value through profit or loss
- Financial Liabilities measured at Amortised Cost (OL)

The ”At fair value through profit or loss“ category corresponds to the same category for financial assets. Upon first-time recognition, financial liabilities classified as ”At fair value through profit and loss“ are recognised at fair value (excluding transaction costs), and subsequently measured at fair value.

All financial liabilities not designated as ”At fair value through profit or loss“ are classified as ”Financial liabilities measured at amortised cost“. Financial liabilities classified as ”Financial liabilities measured at amortised cost“ are initially recognised at cost (less transaction costs), and subsequently measured at amortised cost.

(6) Receivables

Receivables are disclosed under loans and advances to customers, loans and advances to banks, or other assets; they are classified as ”Loans and receivables“.

Interest income on lending is deferred over the term of the loan, with accrued interest disclosed with the corresponding receivable.

Interest income is no longer recorded, if – irrespective of the legal position – the inflow of interest is no longer deemed likely.

(7) Provision for loan losses

Provision for loan losses comprises specific valuation allowances as well as portfolio-based valuation allowances.

Where it is probable that the recoverable amount falls below the book value of a loan or an advance, specific loan loss provisions are recorded. This is the case when it is probable (due to observable criteria) that not all interest and principal payments can be made as contractually agreed. The estimated recoverable amount is determined on the basis of the present values of expected future cash flows from the asset (taking into account the marketability of collateral provided). Cash flows determined in this way are discounted over the estimated marketing period. Collateral is largely provided in the form of land charges or mortgages; these are measured in line with the measurement of investment properties as described in note (13).

Portfolio-based valuation allowances are determined using historical default data for the Aareal Bank Group. The risk parameters used for calculation are primarily based on the average loan-to-value ratio of the Group’s property financing portfolio, that is determined in regular intervals.

Recognition and release of loan loss provisions are directly reflected in income. The balance of provisions for loan losses is shown in a separate valuation allowance item.

Uncollectable loans and advances are derecognised against specific provisions recognised previously, or written off directly. Payments on loans previously written off are recognised in income.

(8) Trading assets and trading liabilities

Trading assets of the Aareal Bank Group comprise positive market values of derivative financial instruments which are not part of balance sheet hedges (stand-alone derivatives), and securities held for short-term sale. The trading liabilities include negative market values from stand-alone derivatives. Financial instruments disclosed under these items are classified under the measurement category ”At fair value through profit or loss“. Measurement results, or realised gains or losses on trading assets or liabilities are reflected in net trading income, together with interest on standalone derivatives. Interest on foreign exchange forwards entered into for funding purposes are included in net interest income.

(9) Non-current assets held for sale and discontinued operations

In the financial year 2008, the Group plans to sell further properties it owns. The composition of these assets classified as “held for sale” in accordance with IFRS 5 and disposal groups still reported in the balance sheet as at 31 December 2007 is explained in more detail in notes (44) and (58).

(10) Hedge accounting

The bulk of Aareal Group’s derivatives positions have been entered into in order to hedge interest rate and currency risk exposure.

The use of derivatives as hedging instruments (and corresponding hedge accounting) involves extensive documentation requirements, and the hedge has to be tested for effectiveness on a quarterly basis at least.

Hedge accounting is based on clean fair values.

Derivatives used as hedging instruments are classified as fair value hedges or cash flow hedges.

The purpose of a fair value hedge is the protection of the market value of an underlying transaction. Measurement gains or losses on the underlying transaction of the hedged exposure are recorded together with the corresponding fair value changes of the hedging instrument, and recognised in income (in ”Net result on hedge accounting“). A fully effective hedge results in offsetting measurement gains or losses. Interest on the underlying transaction and the hedge instrument is recognised in net interest income.

The hedge 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. The effective portion of measurement gains or losses from the derivative is recorded in equity, in the revaluation surplus. The ineffective portion is recorded directly in income (in ”Net result on hedge accounting“). When the hedge ceases to exist, the amounts recorded in the revaluation surplus 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.

(11) Non-trading assets

Non-trading assets of the Aareal Bank Group include securities in the form of bonds or other debt securities, equities, and fund units. In addition, this item includes investments in companies over which Aareal Bank AG neither has economic control nor may exercise any significant influence.

All assets included in other financial assets are recognised at cost, plus attributable transaction costs.

Premiums and discounts are amortised over the term, and recognised in income.

The bonds and other debt securities reported in non-trading assets are allocated to the measurement categories ”Available for sale“ or ”Loans and receivables“. The remaining securities and equity investments are classified as ”Available for sale“.

(12) Investments accounted for using the equity method

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.

(13) Investment properties

Investment properties include land and buildings held for rental purposes or due to an expected increase in value.

Investment properties are measured annually, at fair value based on rents agreed, or on prevailing market rents less management costs specific to the property. The discounting rate is between 5 % and 6 %, depending on the type and location of the property. Reductions in vacancies, or structural vacancies, are taken into account accordingly.

Valuation is carried out by in-house experts. Changes to fair value are recognised in income (in results from investment properties).

(14) Leases

In accordance with IAS 17, leases where a material part of the 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.

The Aareal Bank Group acts both as lessor and lessee of property. All rental contracts are classified as operating leases.

Properties leased by the Group are reported under investment property and other assets.

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

(15) Intangible assets

Intangible assets (except goodwill) are carried at cost, less scheduled depreciation and write-downs.

All research costs for proprietary software are directly recognised as expenditure.

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. They are amortised on a straight-line basis, using an estimated economic life of between five and ten years.

Goodwill is defined as the excess of the cost of acquiring an entity over the fair value of the Group's interest in the net assets of the acquired entity, at the time of acquisition (positive difference). An impairment test is carried out at least once a year. Goodwill is carried at original cost less accumulated impairments. Any negative goodwill arising upon acquisition is immediately charged against income.

Where there are indications of impairment of intangible assets (as set out in IAS 36) at the reporting date, and the recoverable amount is lower than the carrying amount of the asset concerned, the asset is written down against income, 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. The Aareal Bank Group generally defines individual Group companies as cash-generating units. The recoverable amount of an asset or a cash-generating unit is the higher of fair value 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.)

(16) Property and equipment

Property and equipment is measured at cost, less scheduled depreciation and write-downs.

Land and buildings reported under property and equipment are depreciated on a straight-line basis, over a period of 50 years. Other property and equipment items are initially depreciated using the declining-balance method, subsequently reverting to straight-line depreciation, applying the following periods:

Other property and equipment	Depreciation period
Tenant's improvements	10 years
IT equipment	3-7 years
Other office furniture and equipment	5-13 years

For details on recognising impairments as defined in IAS 36, please refer to the explanations on Note (15) Intangible assets in this section.

Gains and losses upon disposal of property and equipment are recognised in income (in "Net other operating income / expenses").

(17) Deferred taxes

In accordance with IFRS, deferred taxes are recognised for all temporary or quasi-permanent measurement and recognition differences between the carrying amount of an asset or liability and its tax value. Under this approach, all differences are recognised (irrespective of their origin) if they result in future tax credits or tax charges. Deferred tax liabilities are recorded for differences which, when reversed at a later date, will result in a higher tax charge; deferred tax assets are recorded for those differences which, when reversed, will result in a tax credit.

Deferred tax assets are created on losses carried forward for tax purposes, provided that tax laws allow for the use of existing tax loss carry forwards within the next three years after the reporting date.

Existing deferred tax assets must be reviewed for impairment on a regular basis.

Deferred taxes are calculated at local tax rates, which are in force or announced as at the balance sheet date. Deferred tax assets or liabilities are adjusted to the tax rates in force or announced at the balance sheet date.

(18) Other assets

Properties reported under other assets are measured at fair value less costs to sell.

(19) Liabilities

Financial liabilities are carried at amortised cost, unless they are hedged transactions within the specifications of hedge accounting. Accrued interest is also recorded together with the respective liability.

Liabilities originated at a discount are initially recognised using the amount of consideration received, and subsequently measured at their original effective interest rate.

(20) Provisions

Provisions are set aside for commitments to third parties if utilisation is probable and the amount of the commitment can be reasonably estimated. Provisions are measured on the basis of the best possible estimate.

(21) Pension obligations

Aareal Bank Group maintains various defined benefit 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 (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.

All pension obligations which do not fulfil the criteria of defined contribution plans are classified as defined benefit plans. The amount of obligations usually depends on one or several factors, including age, length of service, and salary. For the funded pension plans maintained by the Aareal Bank Group, the amount of obligations also depends on the return on the respective fund, and on the minimum return guaranteed by the employer.

The Group's obligations under defined benefit plans are recognised as a provision in the consolidated balance sheet.

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. Projected economic and demographic developments, as well as salary and career trends, must be applied to the calculations of the provisions. The discounting factor used to determine the present value of the obligation is based on the capital market rate of corporate bonds with impeccable credit rating at the reporting date. Calculating the amount of provisions in the Group is based on actuarial opinions which are prepared by external actuaries on the basis of specific and Group-wide standardised parameters.

Provisions for pensions and similar liabilities, as recognised in the consolidated balance sheet, are based on company agreements on an employee pension scheme as well as individual agreements with the members of the company's senior management.

Accumulated actuarial gains or losses are not recognised, to the extent that they do not exceed 10 % of the present value of the defined benefit plan (corridor approach). Any amounts in excess of this 10 % threshold are recognised in the financial year following occurrence of the excess, and amortised in income over the average remaining working lives of the employees covered by the defined benefit plans.

(22) Share-based payments

The Aareal Bank Group currently maintains four share-based payment plans in accordance with IFRS 2.

Note (81) includes a detailed description of the plans and their scope as well as information on the measurement model applied and the effects of share-based payments on the Group's financial position and performance.

A provision for obligations under the four remuneration programmes has been recognised against administrative expenses, in the amount of the fair value of the relevant obligation at the reporting date.

(23) Shareholders' equity and minority interest

Pursuant to IFRS, equity instruments are such instruments which constitute a residual interest in the assets of a company after deduction of all its liabilities.

Minority interests are recorded as a separate item within shareholders' equity.

(24) Reserves from transactions under common control

The split of the DEPFA Group, which was completed during the financial year 2002, resulted in the transfer of various property financing portfolios, various participations and several properties from DEPFA Deutsche Pfandbriefbank AG to Aareal Bank Group. In turn, some participations previously held by Aareal Bank AG were transferred to DEPFA Deutsche Pfandbriefbank AG. Moreover, Aareal Bank provided individual maximum default guarantees for individual loans within the property finance portfolio of DEPFA Deutsche Pfandbriefbank AG. The transfer of said assets was decided upon whilst Aareal Bank still belonged to the DEPFA Group; it was still ongoing during the 2007 financial year.

IFRS does not provide guidance for the presentation of spin-offs.

Assets and liabilities taken over from DEPFA Deutsche Pfandbriefbank AG are stated, applying the separate reporting entity method, at the same values which DEPFA Deutsche Pfandbriefbank AG would have presented in accordance with IFRS, at the time of transfer. Any differences between cost and IFRS carrying amounts are recognised directly in equity, under reserves from transactions under common control.

(B) NOTES TO THE CONSOLIDATED INCOME STATEMENT

(25) Net interest income

	1 Jan - 31 Dec 2007 € mn	1 Jan - 31 Dec 2006 € mn
Interest income from		
Property loans	966	862
Public-sector loans	85	81
Other lending and money market operations	493	329
Fixed-income securities and debt register claims	347	319
Current dividend income	12	10
Other interest income	0	2
Total interest income	**1,903**	**1,603**
Interest expenses for		
Bonds issued	506	428
Borrowed funds	437	361
Subordinated equity	77	79
Term deposits taken	324	222
Overnight deposits taken	122	102
Other banking transactions	26	22
Total interest expenses	**1,492**	**1,214**
Total	**411**	**389**

Interest income from property loans includes income from impaired loans (so-called unwinding) in the amount of € 13 million (2006: € 19 million).

(26) Provision for loan losses

	1 Jan - 31 Dec 2007 € mn	1 Jan - 31 Dec 2006 € mn
Additions	120	151
Amounts released	125	107
Direct write-offs	84	49
Payments on loans previously written off	2	4
Total	**77**	**89**

(27) Net commission income

	1 Jan - 31 Dec 2007 € mn	1 Jan - 31 Dec 2006 € mn
Net commission income from		
Consulting and other services	107	98
Trustee loans and administered loans	14	25
Securities transactions	-1	-1
Securitisation transactions	-15	-17
Other lending and capital market transactions	22	23
Net other commission income	15	17
Total	**142**	**145**

Commissions from consulting and other services primarily include commissions for IT services.

(28) Net result on hedge accounting

This item contains the measurement gains or losses from hedges, within the context of hedge accounting. The total result from hedging instruments and their related underlying instruments of € 1 million (2006: € 9 million) includes the effects from the measurement of fair value and cash flow hedges. The total amount of risk-induced changes to fair value was determined using recognised measurement methods, based on current market parameters.

(29) Net trading income

	1 Jan - 31 Dec 2007 € mn	1 Jan - 31 Dec 2006 € mn
Results from derivative financial instruments	-3	9
Currency translation	2	1
Net income / expenses from other positions held for trading	-25	3
Total	**-26**	**13**

(30) Results from non-trading assets

	1 Jan - 31 Dec 2007 € mn	1 Jan - 31 Dec 2006 € mn
Results from securities sales	39	29
Results from the measurement of securities	0	0
Results from the disposal of participating interests	167	38
Results from the measurement of participating interests	0	-1
Total	**206**	**66**

The result from the disposal of participating interests includes the gain from deconsolidation of Immobilien Scout GmbH in the amount of € 153 million.

(31) Results from investments accounted for using the equity method

The net result from investments accounted for using the equity method amounting to € 68 million (2006: € 4 million) was mainly the result of the measurement of the stake held in Deutsche Interhotel Holding GmbH & Co KG (€ 63 million). In addition, the item includes the pro rata share in net profit for 2006 of Immobilien Scout GmbH (€ 5 million).

(32) Results from investment properties

	1 Jan - 31 Dec 2007 € mn	1 Jan - 31 Dec 2006 € mn
Rental income	3	7
Expenses for the operation of properties rented out	2	3
Expenses for the operation of properties not rented out	0	0
Results from the measurement of properties	0	-14
Results from the sale of properties	0	-3
Total	**1**	**-13**

(33) Administrative expenses

	1 Jan - 31 Dec 2007 € mn	1 Jan - 31 Dec 2006 € mn
Staff expenses	230	228
of which: for pensions	17	17
Other administrative expenses	110	105
Depreciation and amortisation of property and equipment and intangible assets	21	23
Total	**361**	**356**

Administrative expenses include research and development costs in the amount of € 2 million (2006: € 2 million).

Other administrative expenses for the financial year 2007 include the following fees paid to the auditors of the consolidated financial statements:

	1 Jan - 31 Dec 2007 € 000's	1 Jan - 31 Dec 2006 € 000's
Auditing fees	2,273	2,365
Other audit or valuation services	259	61
Tax advisory services	203	66
Other services	616	1,846
Total	**3,351**	**4,338**

(34) Net other operating income/expenses

	1 Jan - 31 Dec 2007 € mn	1 Jan - 31 Dec 2006 € mn
Income from property	10	32
Income from the release of provisions	10	10
Income from goods and services	2	2
Miscellaneous	69	27
Total other operating income	**91**	**71**
Expenses for property	11	30
Expenses for services used	0	1
Write-downs on trade receivables	4	5
Expenses for other taxes	3	2
Miscellaneous	55	41
Total other operating expenses	**73**	**79**
Total	**18**	**-8**

An agreement was reached with DEPFA Deutsche Pfandbriefbank AG with regard to off-setting the effects arising from the completed tax audit of a subsidiary. The equity investment in this company was transferred to Aareal Bank within the scope of the split of the former DePfa Group. A compensation payment of € 37 million made under said agreement was recognised as other operating income, and reported under ”Miscellaneous“.

Miscellaneous other operating expenses include research and development costs of € 5 million (2006: € 4 million) which could not be capitalised.

(35) Impairment of goodwill

Impairment of goodwill amounted to € 3 million (2006: –) in the year under review. The impairment related to the investment in Deutsche Bau- und Grundstücksaktien-gesellschaft (€ 2 million, Consulting / Services segment) and the investment in a property company (€ 1 million, Structured Property Financing segment).

(36) Income taxes

	1 Jan - 31 Dec 2007 € mn	1 Jan - 31 Dec 2006 € mn
Current income taxes	27	-3
Deferred taxes	45	39
Total	**72**	**36**

The differences between the mathematical and actual tax expense is presented in the following reconciliation:

	1 Jan - 31 Dec 2007 € mn	1 Jan - 31 Dec 2006 € mn
Income before income taxes	380	160
Applicable tax rate	39.8 %	39.8 %
Calculated income taxes	151	64
Reconciliation to reported income taxes		
Corporate income tax credit	-1	-19
Effect of different tax rates in other countries	-8	-1
Tax-free income	-75	-19
Non-deductible expenses	0	2
Taxes for previous years	-4	-3
Changes in tax rates for deferred taxes	13	–
Third party interests	-7	7
Provisions for deferred taxes	1	6
Trade income tax	-1	0
Other differences	3	-1
Reported income taxes	**72**	**36**

The tax rate used for German Group companies was 39.8 % (2006: 39.8 %). Companies subject to corporation tax only were charged a tax rate of 26.4 % (2006: 26.4 %).

The Bundesrat, the Upper House of German Parliament, approved the corporate tax reform 2008 in its session on 6 July 2007. As a result of the corporate tax reform, the applicable tax rates to be applied consistently throughout the Group from 1 January 2008 will be reduced to 31.2 % (for German Group companies) and to 15.8 % (for German Group companies only subject to corporation tax).

On the basis of the resolution of the Bundesrat of 6 July 2007, existing deferred taxes were measured using the new tax rates, if their realisation occurs after 1 January 2008.

(37) Earnings per share

	1 Jan - 31 Dec 2007	1 Jan - 31 Dec 2006
Consolidated net income / loss attributable to equity holders of Aareal Bank AG (€ mn)	290	107
Average number of shares outstanding	42,755,159	42,755,159
Earnings per share (€)	**6.77**	**2.49**

Earnings per share are determined by dividing the earnings attributable to ordinary shareholders by the weighted average of ordinary shares outstanding in the financial year.

For Aareal Bank Group, diluted earnings per share corresponds to undiluted earnings per share, as no convertible instruments were issued.

(C) NOTES TO THE CONSOLIDATED BALANCE SHEET

(38) Cash funds

	31 Dec 2007 € mn	31 Dec 2006 € mn
Cash on hand	1	1
Balances with central banks	1,050	1,330
Total	**1,051**	**1,331**

(39) Loans and advances to banks

	31 Dec 2007 € mn	31 Dec 2006 € mn
Term deposits and current account balances	431	659
Public-sector loans	333	354
Receivables from securities repurchase transactions	1,377	1,397
Other receivables	104	281
Total	**2,245**	**2,691**

(40) Loans and advances to customers

	31 Dec 2007 € mn	31 Dec 2006 € mn
Property loans	22,550	20,682
Public-sector loans	1,738	1,735
Other receivables	697	924
Total	**24,985**	**23,341**

Additional property loans in a volume of € 176 million were transferred from the DEPFA Group to the Aareal Bank Group during the financial year 2007, as a result of the split of the former DEPFA Group.

Moreover, Aareal Bank is obliged to gradually assume the remaining property loans on the books of DEPFA Deutsche Pfandbriefbank AG as at 31 December 2007 in the event of certain contractually agreed conditions.

Part of the risks in property loan portfolios are placed on the international capital markets through securitisation transactions.

The exposure to credit risks collateralised by synthetic securitisation transactions related to property finance under management amounts to € 3,059 million as at 31 December 2007 (2006: € 4,493 million). Synthetic securitisation does not result in a derecognition of the receivables concerned.

These synthetic securitisations included interest sub-participation agreements for the First Loss Pieces sold in an aggregate amount of € 138 million (2006: € 138 million), as well as the assumption of first losses up to € 21 million (2006: € 21 million).

(41) Provision for loan losses

	Specific loan loss provisions		Valuation allowances at a portfolio level		Total	
	2007 € mn	2006 € mn	2007 € mn	2006 € mn	2007 € mn	2006 € mn
Balance at 1 January	**304**	**1,113**	**29**	**27**	**333**	**1,140**
Additions / transfers	86	127	11	2	97	129
Drawdowns	110	846			110	846
Amounts released	130	90			130	90
Balance at 31 December	**150**	**304**	**40**	**29**	**190**	**333**

Provision for loan losses is entirely related to loans and advances to customers. They are classified as ”Loans and receivables“.

(42) Positive market value of derivative hedging instruments

	31 Dec 2007 € mn	31 Dec 2006 € mn
Positive market value of fair value hedges	316	388
Positive market value of cash flow hedges	1	2
Pro rata interest receivable	582	493
Total	**899**	**883**

(43) Trading assets

	31 Dec 2007 € mn	31 Dec 2006 € mn
Debt and other fixed-income securities	1,390	498
Positive market value of standalone derivatives	429	225
Other assets held for trading	–	3
Total	**1,819**	**726**

The standalone derivatives reported are mainly used to hedge the economic credit and interest rate risk exposure.

(44) Non-current assets held for sale and discontinued operations

Aareal Bank AG intends to sell further properties in the financial year 2008.

The assets involved in these transactions were classified as held for sale on 31 December 2007, and accounted for in accordance with IFRS 5. The necessary measurement did not have any effect on earnings (2006: negative effect of € 3 million). The assets are allocated to the Structured Property Financing segment.

(45) Non-trading assets

	31 Dec 2007 € mn	31 Dec 2006 € mn
Debt securities and other fixed-income securities		
Bonds and debentures of public-sector issuers	5,709	5,844
Bonds and debentures of other issuers	2,504	2,183
Money market instruments from public-sector issuers	–	0
Equities and other non-fixed income securities	594	478
Interests in affiliated companies	–	–
Other investments	4	5
Total	**8,811**	**8,510**

Carrying amounts of negotiable non-trading assets:

	Listed		Unlisted	
	31 Dec 2007 € mn	31 Dec 2006 € mn	31 Dec 2007 € mn	31 Dec 2006 € mn
Debt and other fixed-income securities	7,056	7,029	1,156	998
Equities and other non-fixed income securities (available for sale)	238	226	253	112
Total	**7,294**	**7,255**	**1,409**	**1,110**

(46) Investments accounted for using the equity method

As in the previous year, there were no unrecognised pro-rata losses incurred from companies accounted for at equity during the financial year. There were no accumulated, unrecognised losses at the 2007 and 2006 reporting dates. The share of the Aareal Bank Group in gains and losses of associates taken into account in 2007 totalled € 68 million (2006: € 3 million).

Material companies accounted for at equity as at 31 December 2007 had total assets of € 491 million (2006: € 503 million) and total liabilities of € 384 million (2006: € 69 million).

At-equity accounting was based on the most recent available financial statements prepared under local GAAP.

(47) Investment properties

Investment properties, as shown in the balance sheet, developed as follows:

	2007 € mn	2006 € mn
Carrying amount as at 1 January	**10**	**89**
Additions	–	0
Disposals	–	3
Effect of classification as held for sale (in accordance with IFRS 5)	–	-62
Net losses from fair value measurement	–	14
Carrying amount as at 31 December	**10**	**10**

(48) Intangible assets

	31 Dec 2007 € mn	31 Dec 2006 € mn
Goodwill	29	32
Software developed in-house	37	37
Other intangible assets	14	15
Total	**80**	**84**

The amount shown for software developed in-house includes € 14 million (2006: € 16 million) for the electronic payments system BK@1; the software is amortised over a remaining term of seven years. The same item also includes € 10 million (2006: € 7 million) for the property management software suite Blue Eagle; the software is amortised over an average remaining term of eight years.

Intangible assets developed as follows:

	2007				2006			
	Software developed in-house € mn	Goodwill € mn	Other intangible assets € mn	Total € mn	Software developed in-house € mn	Goodwill € mn	Other intangible assets € mn	Total € mn
Cost								
Balance at 1 January	**57**	**91**	**35**	**183**	**57**	**90**	**30**	**177**
Additions	7	114	80	201	6	10	11	27
Transfers		-7	12	5				0
Disposals	4	114	77	195	6	9	6	21
Balance at 31 December	**60**	**84**	**50**	**194**	**57**	**91**	**35**	**183**
Amortisation and impairment								
Balance at 1 January	**20**	**59**	**20**	**99**	**18**	**68**	**21**	**107**
Amortisation and impairment	7	3	5	15	7		4	11
of which: impairment losses		3		3				0
Write-ups				0				0
Transfers		-7	12	5				0
Disposals	4	0	1	5	5	9	5	19
Balance at 31 December	**23**	**55**	**36**	**114**	**20**	**59**	**20**	**99**
Carrying amount as at 1 January	**37**	**32**	**15**	**84**	**39**	**22**	**9**	**70**
Carrying amount as at 31 December	**37**	**29**	**14**	**80**	**37**	**32**	**15**	**84**

(49) Property and equipment

	31 Dec 2007 € mn	31 Dec 2006 € mn
Land and buildings and construction in progress	84	77
Office furniture and equipment	17	16
Total	**101**	**93**

Property and equipment:

	2007				2006			
	Land and buildings € mn	Office furniture and equipment € mn	Construction in progress € mn	Total € mn	Land and buildings € mn	Office furniture and equipment € mn	Construction in progress € mn	Total € mn
Cost								
Balance at 1 January	**77**	**82**	**6**	**165**	**79**	**92**	**9**	**180**
Additions	0	8	10	18	2	8	6	16
Transfers		5		5				0
Disposals	2	17		19	4	18	9	31
Balance at 31 December	**75**	**78**	**16**	**169**	**77**	**82**	**6**	**165**
Depreciation and impairment								
Balance at 1 January	**6**	**66**	**0**	**72**	**6**	**73**	**8**	**87**
Depreciation and impairment	2	7		9	2	9		11
of which: impairment losses				0				0
Write-ups				0				0
Transfers		5		5				0
Disposals	1	17		18	2	16	8	26
Balance at 31 December	**7**	**61**	**0**	**68**	**6**	**66**	**0**	**72**
Carrying amount as at 1 January	**71**	**16**	**6**	**93**	**73**	**19**	**1**	**93**
Carrying amount as at 31 December	**68**	**17**	**16**	**101**	**71**	**16**	**6**	**93**

(50) Income tax assets

Income tax assets of € 32 million as at 31 December 2007 (2006: € 42 million) include € 24 million (2006: € 24 million) expected to be realised after a period exceeding twelve months.

(51) 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 € 465 million (2006: € 461 million).

Deferred tax assets were recognised in relation to the following balance sheet items:

	31 Dec 2007 € mn	31 Dec 2006 € mn
Loans and advances to banks / to customers	8	7
Trading assets and trading liabilities	0	0
Non-trading assets	1	23
Investments accounted for at equity	0	0
Investment property	–	1
Intangible assets	–	–
Further assets / liabilities	168	172
Liabilities to banks / to customers, and certificated liabilities	269	300
Provisions	13	18
Minority interest	3	3
Tax loss carryforwards	64	112
Tax loss carryforwards	**526**	**636**

Deferred tax assets not recognised totalled € 21 million (2006: € 28 million). They entirely relate to unrecognised tax loss carry forwards the realisation of which is no longer expected.

Deferred tax assets as at 31 December 2007 include € 37 million (2006: € 112 million) expected to be realised after a period exceeding twelve months.

(52) Other assets

	31 Dec 2007 € mn	31 Dec 2006 € mn
Property	44	16
Trade receivables	34	128
Miscellaneous	108	247
Total	**186**	**391**

(53) Liabilities to banks

	31 Dec 2007 € mn	31 Dec 2006 € mn
Payable on demand	203	557
Term deposits	1,223	1,116
Promissory note loans borrowed	1,366	2,124
Liabilities from securities repurchase transactions and open-market operations	1,546	1,004
Registered mortgage bonds	398	340
Other	217	71
Total	**4,953**	**5,212**

(54) Liabilities to customers

	31 Dec 2007 € mn	31 Dec 2006 € mn
Payable on demand	3,570	5,129
Term deposits	5,547	4,578
Promissory note loans borrowed	8,472	7,784
Registered mortgage bonds	4,199	3,819
Other	2	36
Total	**21,790**	**21,346**

(55) Certificated liabilities

	31 Dec 2007 € mn	31 Dec 2006 € mn
Medium-term notes	2,765	2,151
Bearer mortgage bonds	3,233	1,830
Other debt securities	1,864	3,097
Total	**7,862**	**7,078**

New issues of certificated liabilities during 2007 totalled € 2,488 million (2006: € 1,826 million). The amounts reported include accrued interest.

(56) Negative market value of derivative hedging instruments

	31 Dec 2007 € mn	31 Dec 2006 € mn
Negative market value of fair value hedges	728	592
Negative market value of cash flow hedges	–	3
Pro rata interest payable	400	379
Total	**1,128**	**974**

(57) Trading liabilities

	31 Dec 2007 € mn	31 Dec 2006 € mn
Negative market value of standalone derivatives	170	157
Other liabilities held for trading	825	–
Total	**995**	**157**

(58) Obligations from disposal groups held for sale and discontinued operations

Obligations from disposal groups held for sale and discontinued operations relate to the following main categories:

	31 Dec 2007 € mn	31 Dec 2006 € mn
Deferred tax liabilities	–	–
Provisions	–	2
Other liabilities	0	1
Total	**0**	**3**

(59) Provisions

	31 Dec 2007 € mn	31 Dec 2006 € mn
Provisions for pensions and similar obligations	108	103
Other provisions	165	183
Total	**273**	**286**

Provisions for pensions and similar obligations

The provisions for pensions result mainly from retirement benefit plans maintained at Aareal Bank AG and Aareon AG.

There are currently five different retirement benefit plans within Aareal Bank AG, of which four plans have been closed (and no longer admit employees). All of these plans are defined benefit plans (as defined in IAS 19), under which the bank guarantees the amount of benefits to beneficiaries, subject to certain conditions. The various types of benefits are backed by reinsurance cover to a certain extent; some are funded. Depending on the type of retirement plan, the amount of benefits depends on various factors, including eligible salary, period of employment, benefits from the statutory pension insurance fund as well as on returns generated where external funding is involved.

There are currently six different retirement benefit plans within Aareon AG. All plans have been closed, and no longer admit employees. These plans are also defined benefit plans, as defined in IAS 19. Depending on the type of retirement plan, the amount of benefits also depends on various factors, including eligible salary, period of employment, benefits from the statutory pension insurance fund as well as on benefits from direct insurance plans.

The determination of the amount of provisions for pensions is based on the following actuarial assumptions:

	31 Dec 2007	**31 Dec 2006**
Calculation method	Projected unit credit method	Projected unit credit method
Calculation basis	Actuarial tables 2005 G issued by K. Heubeck	Actuarial tables 2005 G issued by K. Heubeck
Actuarial assumptions (%)		
Interest rate used for valuation	5.50	4.50
Development of salaries	2.25 to 3.25	2.25
Pension increase	2.00	2.00
Rate of inflation	2.00	2.00
Staff turnover rate	3.00 to 4.00	3.00 to 4.00

Pension liabilities developed as follows in the 2007 financial year:

	2007 € mn	2006 € mn
Present value of pension liabilities as at 1 January	**136**	**136**
Actuarial losses as at 1 January	33	40
Reported provision for pensions as at 1 January	**103**	**96**
Service cost	4	4
Interest expenses	6	6
Recognised actuarial losses	1	2
Pension payments made	6	5
Reported provision for pensions as at 31 December	**108**	**103**
Actuarial losses as at 31 December	9	33
Present value of pension liabilities as at 31 December	**117**	**136**

The present value of pension obligations developed as follows:

	31 Dec 2007 € mn	31 Dec 2006 € mn	31 Dec 2005 € mn	31 Dec 2004 € mn	31 Dec 2003 € mn
Present value of pension liabilities	117	136	136	112	93

Expenses incurred under pension obligations during the financial year are shown in administrative expenses. Of the pension liabilities reported as at 31 December 2007, an amount of € 5 million (2006: € 8 million) is funded. The related fund assets amounted to € 10 million as at 31 December 2007 (2006: € 9 million), and were reported under non-trading assets.

Provisions for pensions carried at 31 December 2007 include € 102 million (2006: € 98 million) expected to be realised after a period exceeding twelve months.

Other provisions

Other provisions developed as follows:

	Restructuring provisions € mn	Provisions for staff costs and other administrative costs € mn	Provisions in the lending business € mn	Other provisions € mn	Total € mn
Carrying amount as at 1 Jan 2007	**5**	**76**	**59**	**43**	**183**
Additions	0	49	23	24	96
Charge-offs	3	41	30	17	91
Amounts released	1	7	7	8	23
Reclassifications		-4	1	3	0
Carrying amount as at 31 Dec 2007	**1**	**73**	**46**	**45**	**165**

	Restructuring provisions € mn	Provisions for staff costs and other administrative costs € mn	Provisions in the lending business € mn	Other provisions € mn	Total € mn
Carrying amount as at 1 Jan 2006	**4**	**68**	**69**	**37**	**178**
Additions	5	50	22	31	108
Charge-offs	0	36	15	11	62
Amounts released	0	5	17	5	27
Effect of changes in reporting entity structure		0		-13	-13
Reclassifications	-4	-1		4	-1
Carrying amount as at 31 Dec 2006	**5**	**76**	**59**	**43**	**183**

Provisions for staff expenses and other administrative costs include provisions set aside for bonuses and for anniversary bonuses.

An amount of € 25 million (2006: € 51 million) in provisions related to the capital guarantees for DEPFA Deutsche Pfandbriefbank AG was recognised as at the balance sheet date.

Other provisions include provisions for interest rate guarantees related to the property loan portfolio held by DEPFA Deutsche Pfandbriefbank AG.

Provisions existing at the reporting date are expected to be realised within a twelve-month period following the reporting date, with the exception of provisions for the lending business.

(60) Income tax liabilities

Income tax liabilities of € 18 million as at 31 December 2007 (2006: € 14 million) include € 13 million (2006: € 12 million) expected to be realised after a period exceeding twelve months.

(61) 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 € 465 million (2006: € 461 million).

Deferred tax liabilities were recognised in relation to the following balance sheet items:

	31 Dec 2007 € mn	31 Dec 2006 € mn
Loans and advances to banks / to customers	42	37
Positive and negative market values from derivative hedging instruments	53	56
Trading assets and trading liabilities	65	67
Non-trading assets	191	249
Investments accounted for at equity	–	0
Investment property	–	14
Intangible assets	10	11
Property and equipment	12	4
Other assets / liabilities	145	151
Liabilities to banks / to customers, and certificated liabilities	–	0
Provisions	–	0
Minority interest	2	–
Deferred tax liabilities	**520**	**589**

An amount of € 17 million (2006: € 26 million) related to deferred taxes on measurement differences between the tax balance sheet and the consolidated accounts was directly recognised in the revaluation surplus. Deferred tax liabilities as at 31 December 2007 include € 48 million (2006: € 51 million) expected to be realised after a period exceeding twelve months.

(62) Other liabilities

	31 Dec 2007 € mn	31 Dec 2006 € mn
Liabilities from outstanding invoices	30	7
Deferred income	24	25
Liabilities from other taxes	22	13
Trade payables	11	14
Other liabilities	96	259
Other liabilities	**183**	**318**

(63) Subordinated equity

	31 Dec 2007 € mn	31 Dec 2006 € mn
Subordinated liabilities	603	667
Profit-participation certificates	483	504
Contributions by silent partners	232	220
Total	**1,318**	**1,391**

Subordinated liabilities

Subordinated funds raised in accordance with section 10 (5a) of the KWG 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 themselves subordinated. This also applies to those subordinated funds raised that are not specified in detail.

As at the balance sheet date, the bank had no knowledge of any individual items exceeding 10 % of total subordinated liabilities.

Interest expenses for total subordinated liabilities during 2007 totalled € 32 million (2006: € 34 million). Interest was paid on subordinated liabilities at an average rate of 5.40 % (2006: 5.06 %).

Profit-participation certificates

Profit-participation certificates issued comply with the provisions of section 10 (5) of the German Banking Act (Kreditwesengesetz – "KWG") and include the following profit-participation certificates issued by Aareal Bank AG:

	Nominal amount € mn	Issue currency	Interest rate (% p.a.)	Maturity
Bearer profit-participation certificates				
	150.0	EUR	6.750	2002 - 2011
	100.0	EUR	6.375	2002 - 2011
	60.0	EUR	6.125	2003 - 2013
	310.0			
Registered profit-participation certificates				
	10.2	DEM	6.800	1996 - 2007
	5.0	EUR	7.010	2002 - 2012
	10.0	EUR	7.010	2002 - 2012
	5.0	EUR	7.010	2002 - 2012
	10.0	EUR	7.010	2002 - 2012
	5.0	EUR	7.100	2002 - 2012
	10.0	EUR	7.150	2002 - 2012
	5.0	EUR	7.030	2002 - 2012
	5.0	EUR	7.220	2002 - 2016
	5.0	EUR	7.220	2002 - 2016
	5.0	EUR	6.080	2003 - 2013
	20.0	EUR	6.120	2003 - 2013
	5.0	EUR	6.310	2003 - 2017
	10.0	EUR	5.750	2004 - 2014
	2.0	EUR	5.470	2004 - 2014
	5.0	EUR	5.480	2004 - 2014
	5.0	EUR	5.380	2004 - 2016
	20.0	EUR	5.950	2004 - 2016
	6.0	EUR	5.830	2005 - 2017
	148.2			

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. Where a distribution during the term of the profit-participation certificates would cause a net loss, said interest claim would be reduced, 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.

An amount of € 30 million (2006: € 32 million) in interest expenses were incurred with respect to profit-participation certificates issued.

Contributions by silent partners

Contributions by silent partners to Aareal Bank Group totalled € 220 million (2006: € 220 million). These contributions comply with the requirements for liable capital pursuant to section 10 (4) of the KWG. The contributions by silent partners are used as core capital for regulatory purposes (2006: € 220 million) in their full amount.

Total expenditure for silent partnership contributions totalled € 15 million (2006: € 13 million) in the year under review.

(64) Consolidated shareholders' equity

Subscribed capital

Aareal Bank AG's subscribed capital amounted to € 128 million as at the reporting date (2006: € 128 million). It is divided into 42,755,159 notional 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 was no change in the number of shares issued in the year under review.

Treasury shares

The Company has been authorised by the Annual General Meeting held on 30 May 2007 to purchase and sell treasury shares, pursuant to section 71 (1) no. 7 of the AktG, until 29 November 2008. The volume of shares acquired for this purpose must not exceed 5 % of the bank's share capital at the end of any day. The lowest price at which a share may be acquired is determined by the closing price of the shares in Xetra (or a comparable successor system) on the trading day prior to such purchase less 10 %. The highest price shall not exceed such average closing price plus 10 %.

The Company was authorised at the same Annual General Meeting in accordance with Section 71 (1) No. 8 of the AktG to purchase own shares not exceeding 10 % of the bank's share capital for other purposes than securities trading until 29 November 2008. Shares may be acquired via the stock exchange or by means of a public offer to buy, directed at all shareholders. Neither the purchase price, excluding ancillary costs, (if the acquisition takes place via the stock market) nor the offering price, excluding ancillary costs, (in case of a public offer to buy) may exceed or fall below the average closing price of the bank's shares in Xetra (or a comparable successor system) during the three trading days prior to the purchase or the public announcement of the purchase offer by more than ten per cent (10 %).

Said authorities were not utilised. No treasury shares were held at the end of the year under review.

Authorised capital

The Annual General Meeting held on 15 June 2005 resolved to approve a new authorised capital. The Management Board is authorised to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 58,300,000 (Authorised Capital) by issuance of new bearer shares for contribution in cash or in kind (where such contribution may represent the full contribution, or part thereof), subject to the approval of the Supervisory Board; this authority will expire on 14 June 2010. 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:

In the event of a capital increase against cash contributions, provided that the issue price is not significantly below the prevailing stock exchange price. However, this authorisation shall be subject to the proviso that the aggregate value of shares issued to the exclusion of shareholders' subscription rights, in accordance with section 186 (3) sentence 4 of the AktG, shall not exceed ten per cent (10 %) of the issued share capital at the time of exercising said authorisation. 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 ten per cent (10 %) of the issued capital. Said ten-per-cent threshold shall also include shares which were issued (or 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 (4) sentence 4 of the AktG, which are outstanding at the time of exercising said authorisation.

For fractional amounts arising from the determination of the applicable subscription ratio.

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 upon exercising their conversion or option rights or upon performance of a conversion obligation, if any, thus protecting such holders against dilution.

For an amount of up to € 4 million, to offer employees (of the company or its affiliated companies) shares for subscription.

Where the new shares will be issued against contributions in kind.

Exercising said authorisations, and with the approval of the Supervisory Board, the Management Board resolved on 6 November 2005 to increase the Company's issued share capital by € 11,660,496 (equivalent to 10 % of the issued share capital prior to the increase) to € 128,265,477, by issuing 3,886,832 bearer shares against cash contributions, at an issue price of € 25.75. Excluding shareholders' pre-emptive subscription rights, Aareal Holding Verwaltungsgesellschaft mbH, Bayerische Beamtenversicherung and Neue Bayerische Beamten Lebensversicherung AG were admitted to subscribe and acquire the new shares. The capital increase was carried out, and entered in the Commercial Register on 21 November 2005.

Following this increase, the remaining authorised capital amounts to € 46,639,504. This authorisation will expire on 14 June 2010.

Conditional capital

The share capital is subject to a conditional capital increase of up to € 30 million by means of issuing 10 million new no-par value bearer shares. Such conditional capital increase serves to enable the company to service convertible bonds and / or bonds with warrants on the basis of the authorisation resolution of the Annual General Meeting held on 23 May 2006. Said resolution authorised the Management Board, subject to the consent of the Supervisory Board, to issue, on one or more occasions until 22 May 2011, convertible bonds and / or bonds cum warrants with a limited or an unlimited term in an aggregate nominal amount of € 600 million and to grant option and / or conversion rights to bearers or holders of bonds with regard to no-par value bearer shares of the Company, equivalent to a share in the equity capital of up to € 30 million. The issuance of bonds may be effected against contributions in kind for the purpose of acquiring companies, interests in companies or divisions of companies.

The bonds may be issued in euro as well as in any other currency – with the corresponding equivalent value – which is the legal tender of, for example, an OECD member state. They may also be issued via an indirect or a direct subsidiary of the Company; in this case, the Management Board is authorised, subject to the consent of the Supervisory Board, to issue a guarantee with regard to the bonds on behalf of the Company or to grant to the bondholders conversion or option rights to new no-par value bearer shares of the Company.

The conditional capital increase will be executed only to the extent that holders of conversion or option rights exercise such rights or any conversion obligation from such convertible bonds and / or bonds with warrants are performed, and to the extent that treasury shares are not utilised to service such convertible bonds and / or bonds with warrants. The new shares will 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 or option rights or the performance of conversion obligations.

No convertible bonds or warrants were in issue as at the balance sheet date.

Capital reserve

The capital reserves contain premiums received upon the issuance of shares.

Retained earnings

Retained earnings are comprised of statutory reserves (pursuant to section 150 of the AktG) of € 5 million (2006: € 5 million) and of other retained earnings of € 549 million (2006: € 309 million).

Changes in retained earnings have been reflected in the consolidated statement of changes in shareholders' equity.

Reserves from transactions under common control

Any differences between cost of assets agreed upon within the scope of the split of the former DePfa Group and the notional IFRS carrying amounts of assets earmarked for transfer are recognised directly in equity, in the reserves from transactions under common control.

Revaluation surplus

The revaluation surplus includes unrealised gains and losses from changes in the market value of available-for-sale securities, effective portions from cash flow hedges as well as currency translation adjustments.

Minority interest

€ 250 million (2006: € 250 million) in preference shares issued by a subsidiary were outstanding at the end of the financial year. These shares are repaid at their nominal value and carry an exclusive right to termination for the issuer.

Interest expenses on these preference shares amounted to € 18 million (2006: € 18 million).

Dividend

At the Annual General Meeting, it will be proposed to pay a dividend of € 0.50 per share (2006: € 0.50 per share).

(D) REPORTING ON FINANCIAL INSTRUMENTS

A detailed description of the system in place at Aareal Bank AG to measure, limit, and manage risks throughout the Aareal Bank Group is presented in the Risk Report. Information on the description and the extent of the risks resulting from financial instruments in accordance with IFRS 7 is also included in the risk report, with the exception of the notes to contractually agreed maturities of financial instruments.

(65) Fair value of financial instruments

The fair value is the amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arm's length transaction. To that extent, it is equivalent to the amount that will be paid for an asset in a "regular way" transaction between two parties that are independent from one another.

Listed financial instruments (such as futures, equities, bonds, or other debt securities) are generally measured on the basis of valid market prices. In cases where securities are not listed, they are measured on the basis of current market parameters, using generally accepted valuation methods, in particular on the basis of present values. Options are measured using generally accepted option price models.

Contingent liabilities and loan commitments are taken into account at their carrying amount.

The following table is a comparison of the carrying amounts and the fair values of the financial instruments by measurement categories in accordance with IAS 39:

	31 Dec 2007 Carrying amount € bn	31 Dec 2007 Fair value € bn	31 Dec 2006 Carrying amount € bn	31 Dec 2006 Fair value € bn
Cash on hand and balances with central banks	**1.1**	**1.1**	**1.3**	**1.3**
Loans and advances to banks (LaR)	2.2	2.2	2.7	2.7
Loans and advances to customers (LaR)	24.8	25.1	23.0	23.2
Non-trading assets (LaR)	1.0	1.1	1.0	1.0
Other assets (LaR)	0.1	0.1	0.3	0.3
Total Loans and receivables	**28.1**	**28.5**	**27.0**	**27.2**
Non-trading assets Available for sale	**7.8**	**7.8**	**7.5**	**7.5**
Positive market value of derivative hedging instruments	**0.9**	**0.9**	**0.9**	**0.9**
Assets held for trading	**1.8**	**1.8**	**0.7**	**0.7**
Liabilities to banks (ol)	5.0	5.0	5.2	5.2
Liabilities to customers (ol)	21.8	21.8	21.3	21.4
Securitised securities (ol)	7.9	7.9	7.1	7.2
Other liabilities (ol)	0.1	0.1	0.3	0.3
Subordinated equity (ol)	1.3	1.3	1.4	1.4
Total liabilities measured at amortised cost	**36.1**	**36.1**	**35.3**	**35.5**
Negative market value of derivative hedging instruments	**1.1**	**1.1**	**1.0**	**1.0**
Liabilities Held for trading	**1.0**	**1.0**	**0.2**	**0.2**
Financial guarantee contracts	**0.7**	**0.7**	**0.7**	**0.7**
Irrevocable loan commitments	**4.6**	**4.7**	**2.8**	**2.8**

(66) Net results of financial instruments by category

The following overview shows the net gains or net losses from financial instruments in accordance with the classification of financial assets and financial liabilities (from which the results are generated) in the measurement categories in accordance with IAS 39:

	1 Jan - 31 Dec 2007 € mn	1 Jan - 31 Dec 2006 € mn
Result from Loans and receivables	-118	-259
Result from financial instruments Held for trading	-28	13
Result from financial instruments Available for sale	-187	-259
of which: directly recognised in equity	5	47
Result from derivative hedging instruments	-204	-162
Result from Liabilities measured at amortised cost	480	661

The amount reclassified from equity into the income statement in the year under review is € 33 million (2006: € 13 million).

The net results include measurement gains and losses, realised gains / losses on disposal, subsequent recoveries on loans and advances previously written off as well as results from currency translation of all financial instruments of the individual category. The result from financial instruments held for trading also includes interest and dividends as well as commissions from held-for-trading financial instruments.

The net result from derivatives that are part of hedges is included in the result from derivative hedging instruments, while the result from hedged items is reported under the result from the relevant measurement category.

(67) Impairment losses

The following overview shows the impairment losses recognised for financial instruments by classes of financial instruments during the year under review:

	1 Jan - 31 Dec 2007 € mn	1 Jan - 31 Dec 2006 € mn
Loans and advances to customers (LaR)	184	178
Non-trading assets (AfS)	0	1
Other assets (LaR)	4	6
Total	**188**	**185**

(68) Transfer of financial assets without derecognition

Aareal Bank Group has entered into securities repurchase agreements as borrower. Within the scope of such agreements, securities were transferred to lenders without resulting in a derecognition of the securities since the Aareal Bank Group retains the substantial risks and rewards from the securities. The risks to which the Aareal Bank Group is still exposed comprise the default risk, the interest rate risk and other price risks.

Liabilities to banks include obligations resulting from genuine repurchase agreements in an amount of € 196 million (2006: € 104 million).

The following table shows the carrying amounts, as at the balance sheet date, of the securities that are part of repurchase agreements:

	31 Dec 2007 € mn	31 Dec 2006 € mn
Bonds and notes (LaR)	–	–
Bonds and notes (AfS)	175	102
Total	**175**	**102**

(69) Assets provided or accepted as collateral

Assets provided as collateral

The 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 balance sheet items in which they are reported.

	31 Dec 2007 € mn	31 Dec 2006 € mn
Loans and advances to banks	135	167
Loans and advances to customers	499	516
Non-trading assets	2,534	2,028
Total	**3,168**	**2,711**

The carrying amount of financial assets pledged as collateral where the protection buyer has the right to sell or re-pledge the assets is € 175 million (2006: € 102 million). They are recognised in the balance sheet item ”Non-trading assets“.

Assets accepted as collateral

The Aareal Bank Group has accepted financial and non-financial assets as collateral. These assets may be sold or pledged without the collateral owner being in default. The fair value of such collateral totalled € 1,616 million (2006: € 1,357 million) as at the balance sheet date.

Of these collateral accepted, securities with a fair value of € 63 million (2006: € 0 million) had already re-sold or re-pledged.

There is a redemption obligation for securities in the amount of € 63 million (2006: € 0 million).

Collateral is provided and accepted predominantly on the basis of standardised agreements on securities repurchase transactions and on the collateralisation of forward transactions. In addition, the securities are collateralised by securitisation transactions to secure credit-linked notes issued by the Aareal Bank Group.

(70) Maturities of financial instruments

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

Breakdown by remaining lifetime as at 31 December 2007

	payable on demand € mn	up to 3 months € mn	3 months to 1 year € mn	1 year to 5 years € mn	more than 5 years € mn	Total € mn
Liabilities to banks	203	2,553	598	834	2,181	**6,369**
Liabilities to customers	3,570	4,815	1,701	6,107	17,089	**33,282**
Securitised liabilities	38	497	1,481	5,381	2,482	**9,879**
Subordinated equity	–	6	116	569	790	**1,481**

Breakdown by remaining lifetime as at 31 December 2006

	payable on demand € mn	up to 3 months € mn	3 months to 1 year € mn	1 year to 5 years € mn	more than 5 years € mn	Total € mn
Liabilities to banks	643	2,706	540	1,720	1,093	**6,702**
Liabilities to customers	5,224	9,239	933	2,220	14,987	**32,603**
Securitised liabilities	–	577	1,032	5,388	1,898	**8,895**
Subordinated equity		30	30	484	1,019	**1,563**

(71) Derivative financial instruments

The Aareal Bank Group enters into derivative financial instruments in order to hedge credit and market risks and for refinancing purposes. Derivatives designated for hedging purposes and meet the hedge accounting criteria are reported in the balance sheet as derivative hedging instruments.

Derivatives classified as ”Held for Trading“ are reported as Assets or liabilities held for trading. They are also mainly used to hedge the economic credit and interest rate risk exposure. Spot and forward foreign exchange transactions are almost exclusively used for refinancing purposes. Credit derivatives are used both to hedge the Aareal Bank Group’s existing credit risk exposure and to assume credit risks for the purpose of portfolio diversification.

Counterparty risks in derivative transactions are monitored by means of counterparty limits, provision of collateral and a uniform lending policy. Limits are set in accordance with the counterparty classification in internally-defined credit classes as well as ratings of Fitch IBCA, Moody’s and Standard & Poor’s. Collateral is generally provided in the form of cash collateral, which is released to the pledger as soon as the purpose of collateralisation ceases to exist.

Derivative transactions are generally entered into on the basis of the German Master Agreement for Financial Derivatives, or the ISDA Master Agreements only. Such master agreements provide for the netting of claims and liabilities in the event of insolvency or counterparty default, and thus further reduce counterparty risk.

Fair value hedges

Fair value hedges are entered into by the Aareal Bank Group in order to hedge interest rate and currency risks inherent in securities, mortgage loans, promissory loan notes, money market instruments, registered mortgage bonds, certificated liabilities, and subordinated equity. Instruments used for fair value hedges comprise interest rate swaps as well as cross-currency swaps.

The following gains and losses resultes from fair value hedges in the year under review:

	1 Jan-31 Dec 2007 € mn	1 Jan-31 Dec 2006 € mn
Result from hedging transactions	-206	-162
Result from hedged items	208	171
Total	**2**	**9**

Cash flow hedges

Cash flow hedges are used within the Aareal Bank Group exclusively to hedge future cash flows from securities, mortgage loans, and certificated liabilities.

The cash flows of hedged items subject to cash flow hedges will impact earnings of the Aareal Bank Group in the following reporting periods:

Cash flows from hedged items Cash flow hedges as at 31 December 2007

	up to 3 months € mn	3 months to 1 year € mn	1 year to 5 years € mn	more than 5 years € mn	Total € mn
Cash flows from hedged assets	–	–	–	–	**0**
Cash flows from hedged liabilities	1	2	4	0	**7**

Cash flows from hedged items Cash flow hedges as at 31 December 2006

	up to 3 months € mn	3 months to 1 year € mn	1 year to 5 years € mn	more than 5 years € mn	Total € mn
Cash flows from hedged assets	1	2	3	–	**6**
Cash flows from hedged liabilities	3	7	6	1	**17**

In 2007, gains and losses determined as the effective portion of the hedge from derivatives included in cash flow hedges were recognised directly in equity at an amount of € 0 million (2006: € 7 million).

The amount from cash flow hedges transferred from equity to the income statement in the year under review can be allocated to the following income statement items:

	1 Jan-31 Dec 2007 € mn	1 Jan-31 Dec 2006 € mn
Net interest income	-1	0
Net result on hedge accounting	-1	-1
Total	**-2**	**-1**

In the year under review a negative amount of € 1 million (2006: negative amount of € 1 million) was recognised directly in the income statement due to inefficiencies of cash flow hedges.

The following table shows positive and negative market values (including pro-rata interest) of derivative financial instruments:

	Fair value at 31 Dec 2007		Fair value at 31 Dec 2006	
	positive € mn	negative € mn	positive € mn	negative € mn
Standalone derivatives				
Interest rate instruments				
OTC products				
Interest rate swaps	131	125	126	104
Swaptions	–	–	0	0
Caps, floors	14	14	9	9
FRAs	5	5	0	0
Total interest rate instruments	**150**	**144**	**135**	**113**
Currency-related instruments				
OTC products				
Spot and forward foreign exchange transactions	84	7	32	13
Cross-currency interest rate swaps	165	–	–	–
Total currency-related instruments	**249**	**7**	**32**	**13**

	Fair value at 31 Dec 2007		Fair value at 31 Dec 2006	
	positive € mn	negative € mn	positive € mn	negative € mn
Other forward transactions				
OTC products				
Credit default swaps [1]	14	5	30	0
Credit-linked notes [1]	–	2	–	6
Other forward transactions	6	3	7	5
Exchange-listed contracts				
Futures	–	0	1	0
Options on futures	–	–	–	0
Total other forward transactions	**20**	**10**	**38**	**11**
Total stand-alone derivatives	**419**	**161**	**205**	**137**
Derivatives from fair value hedges				
Interest rate instruments				
OTC products				
Interest rate swaps	853	1.127	813	955
Swaptions	0	1	0	1
Total interest rate instruments	**853**	**1,128**	**813**	**956**
Currency-related instruments				
OTC products				
Spot and forward foreign exchange transactions	2	–	–	0
Cross-currency interest rate swaps	43	0	68	15
Total currency-related instruments	**45**	**0**	**68**	**15**
Total derivatives from fair value hedges	**898**	**1,128**	**881**	**971**
Derivatives from cash flow hedges				
Interest rate instruments				
OTC products				
Interest rate swaps	1	0	2	3
Total interest rate instruments	**1**	**0**	**2**	**3**
Total derivatives from cash flow hedges	**1**	**0**	**2**	**3**
Total	**1,318**	**1,289**	**1,088**	**1,111**

[1] excluding financial guarantees

Derivatives have been entered into with the following counterparties:

	Fair value at 31 Dec 2007		Fair value at 31 Dec 2006	
	positive € mn	negative € mn	positive € mn	negative € mn
OECD banks	1,278	1,224	1,079	1,062
Companies and private individuals	40	65	9	49
Total	**1,318**	**1,289**	**1,088**	**1,111**

The following two overviews show the future, undiscounted cash flows of derivative financial instruments with a positive fair value separately from those with a negative fair value as at the balance sheet date.

	Derivatives with positive fair value					
	up to 3 months € mn	3 months to 1 year € mn	1 year to 5 years € mn	more than 5 years € mn	Total at 31 Dec 2007 € mn	Total at 31 Dec 2006 € mn
Interest rate instruments						
OTC products						
Interest rate swaps	88	26	107	616	837	800
Forward rate agreements	–	–	5	–	5	0
Swaptions	–	–	–	–	–	
Caps, floors	0	0	8	5	14	9
Total interest rate instruments	**88**	**26**	**120**	**621**	**856**	**809**
Currency-related instruments						
OTC products						
Spot and forward foreign exchange transactions	84	1	0	–	85	32
Cross-currency interest rate swaps	37	51	131	161	380	153
Total currency-related instruments	**121**	**52**	**131**	**161**	**465**	**185**
Other forward transactions						
OTC products						
Credit default swaps	0	0	2	2	4	9
Equity options	–	5	–	–	5	3
Exchange-listed contracts						
Futures	–	–	–	–	–	1
Options on futures	–	–	–	–	–	
Total other forward transactions	**0**	**5**	**2**	**2**	**9**	**13**
Total	**209**	**83**	**253**	**784**	**1,330**	**1,007**

	Derivatives with negative fair value					
	up to 3 months € mn	3 months to 1 year € mn	1 year to 5 years € mn	more than 5 years € mn	Total at 31 Dec 2007 € mn	Total at 31 Dec 2006 € mn
Interest rate instruments						
OTC products						
Interest rate swaps	91	56	263	-29	381	324
Forward rate agreements	–	–	5	–	5	0
Swaptions	–	–	1	0	1	1
Caps, floors	0	0	8	5	14	9
Total interest rate instruments	**91**	**56**	**277**	**-24**	**401**	**334**
Currency-related instruments						
OTC products						
Spot and forward foreign exchange transactions	6	1	1	–	8	15
Cross-currency interest rate swaps	–	–	–	–	–	–
Total currency-related instruments	**6**	**1**	**1**	**0**	**8**	**15**
Other forward transactions						
OTC products						
Credit default swaps	-1	-2	-8	-7	-18	–
Equity options	1	–	–	–	1	2
Exchange-listed contracts						
Futures	–	–	–	–	–	–
Options on futures	–	–	–	–	–	–
Total other forward transactions	**0**	**-2**	**-8**	**-7**	**-17**	**2**
Total	**97**	**55**	**270**	**-31**	**392**	**351**

(E) SEGMENT REPORTING

Segment reporting in accordance with IAS 14 makes a distinction between the primary and the secondary reporting format. The primary reporting fomat of the Aareal Bank Group shows the relevant results and balances by operating business segments in line with the Group's internal organisational and reporting structure. The secondary reporting format is structured by geographical markets.

Segmentation by operating units

The Aareal Bank Group operates in two business segments:

- Structured Property Financing
- Consulting / Services [1]

[1] Please refer to the Group Management Report (page 80) for an industrial enterprise classification of segment results

Structured Property Financing brings together all domestic and international property financing activities. These include structured commercial property finance, portfolio financing and related advisory services.

The Consulting / Services segment offers a range of different services for managing residential property portfolios and processing payment flows for the institutional housing sector.

The information provided for bank-internal management of the business segments represents the basis of the figures disclosed in the segment report. Income and expenses within the Aareal Bank Group are predominantly attributable to transactions with third parties, and are directly attributed to the corresponding business segment. Transactions between business segments are performed in line with prevailing market conditions and allocated to the relevant segment. All results and balances are reconciled with the figures determined for the Group in accordance with IFRS. The financial performance of business segments is measured using operating profit and net income, and using the financial indicators return on equity (RoE) and cost / income ratio. RoE, which indicates a segment's profitability, is calculated as the ratio of net income or loss and the portion of shareholders' equity allocated to that segment. The cost / income ratio – determined as the ratio of input to output of resources – is used as an indicator for segment efficiency.

Segmentation by geographical market

The geographical segmentation uses a regional breakdown into "Germany" and "International", based on the registered office of the respective Group company or branch office. Organisational units centralised at head office are classified according to their regional responsibility. Segment reporting by geographical market is generally based on the same methodology as for the formation of operating business segments.

Segment reporting by operating unit

	Structured Property Financing		Consulting / Services		Consolidation / Reconciliation / Other		Aareal Bank Group	
	€ mn		€ mn		€ mn		€ mn	
	2007	2006	2007	2006	2007	2006	2007	2006
Net interest income	347	340	0	0	64	49	411	389
Provision for loan losses	77	89					77	89
Net interest income after net loan loss provisions	**270**	**251**	**0**	**0**	**64**	**49**	**334**	**300**
Net commission income	24	33	186	167	-68	-55	142	145
Net result on hedge accounting	1	9					1	9
Net trading income / expenses	-26	13					-26	13
Results from non-trading assets	52	52	154	14			206	66
Results from investments accounted for using the equity method	63	1	5	3			68	4
Results from investment properties	1	-13			0		1	-13
Administrative expenses	212	199	154	164	-5	-7	361	356
Net other operating income / expenses	25	-8	-6	1	-1	-1	18	-8
Impairment of goodwill	1		2	0			3	0
Operating profit from continuing operations	**197**	**139**	**183**	**21**	**0**	**0**	**380**	**160**
Income taxes	61	31	11	5			72	36
Results from discontinued operations						1		1
Consolidated net income / loss	**136**	**108**	**172**	**16**	**0**	**1**	**308**	**125**
Allocation of results								
Consolidated net income / loss attributable to minority interests	16	16	2	2			18	18
Consolidated net income / loss attributable to equity holders of Aareal Bank AG	120	92	170	14	0	1	290	107
Allocated equity	926	765	67	86	163	130	1,156	981
Cost / income ratio (%)	49.7	54.1	47.7	89.1			48.6	63.5
RoE after taxes (%)	12.9	12.0	252.2	16.3			25.0	10.9
Employees (average)	**1,100**	**1,129**	**1,446**	**1,541**		**42**	**2,546**	**2,712**

Segment reporting by operating unit (quarterly comparison)

	Structured Property Financing		Consulting / Services		Consolidation / Reconciliation / Other		Aareal Bank Group	
	€ mn		€ mn		€ mn		€ mn	
	Quarter 4 2007	Quarter 4 2006	Quarter 4 2007	Quarter 4 2006	Quarter 4 2007	Quarter 4 2006	Quarter 4 2007	Quarter 4 2006
Net interest income	91	78	0	0	18	14	109	92
Provision for loan losses	14	23					14	23
Net interest income after net loan loss provisions	**77**	**55**	**0**	**0**	**18**	**14**	**95**	**69**
Net commission income	4	3	53	47	-20	-16	37	34
Net result on hedge accounting	-3	3					-3	3
Net trading income / expenses	-20	7					-20	7
Results from non-trading assets	18	29	0	-2			18	27
Results from investments accounted for using the equity method								
Results from investment properties	0	-12			0		0	-12
Administrative expenses	48	53	42	37	-2	-2	88	88
Net other operating income / expenses	-7	1	-2	-3	0	0	-9	-2
Impairment of goodwill	1		2	0			3	0
Operating profit from continuing operations	**20**	**33**	**7**	**5**	**0**	**0**	**27**	**38**
Income taxes	3	1	2	0			5	1
Results from discontinued operations						1		1
Consolidated net income / loss	**17**	**32**	**5**	**5**	**0**	**1**	**22**	**38**
Allocation of results								
Consolidated net income / loss attributable to minority interests	4	4	0	0			4	4
Consolidated net income / loss attributable to equity holders of Aareal Bank AG	13	28	5	5	0	1	18	34
Allocated equity	926	765	67	86	163	130	1,156	981
Cost / income ratio (%)	67.6	52.9	83.4	86.8			72.6	61.5
RoE after taxes (%)	5.8	14.6	27.1	23.7			6.1	13.7

Balance sheet data by operating unit

	Structured Property Financing		Consulting / Services		Consolidation / Reconciliation / Other		Aareal Bank Group	
	€ mn		€ mn		€ mn		€ mn	
	2007	2006	2007	2006	2007	2006	2007	2006
Cash funds	1,051	1,331	0	0			1,051	1,331
Loans and advances to banks	2,240	2,689	35	27	-30	-25	2,245	2,691
Loans and advances to customers	20,218	18,542	4,579	4,467	-2	-1	24,795	23,008
Trading assets	1,819	726		0			1,819	726
Non-trading assets	8,960	8,705	90	50	-239	-245	8,811	8,510
Investments accounted for using the equity method	91	118	1	2			92	120
Further assets	1,233	1,694	134	166	-10	-9	1,357	1,851
Segment assets	**35,612**	**33,805**	**4,839**	**4,712**	**-281**	**-280**	**40,170**	**38,237**
Liabilities to banks	4,896	5,155	58	58	-1	-1	4,953	5,212
Liabilities to customers	17,290	16,954	4,531	4,417	-31	-25	21,790	21,346
Securitised liabilities	7,862	7,078					7,862	7,078
Trading liabilities	995	157					995	157
Further liabilities	3,135	3,281	84	79	-262	-260	2,957	3,100
Segment liabilities	**34,178**	**32,625**	**4,673**	**4,554**	**-294**	**-286**	**38,557**	**36,893**
Shareholders' equity	1,452	1,210	162	156	13	6	1,627	1,372
Segment investments	15	12	204	31			219	43
Segment depreciation / amortisation	7	10	14	13			21	23
Impairments / reversals of impairments	-5	-26					-5	-26

Segmentation by geographical market

	Germany		International		Consolidation / Reconciliation / Other		Aareal Bank Group	
	€ mn		€ mn		€ mn		€ mn	
	2007	2006	2007	2006	2007	2006	2007	2006
Net interest income	147	156	264	233			411	389
Provision for loan losses	72	88	5	1			77	89
Net interest income after net loan loss provisions	**75**	**68**	**259**	**232**			**334**	**300**
Net commission income	122	130	20	15			142	145
Net result on hedge accounting	1	13	0	-4			1	9
Net trading income / expenses	-17	18	-9	-5			-26	13
Results from non-trading assets	198	56	8	10			206	66
Results from investments accounted for using the equity method	68	4		0			68	4
Results from investment properties	1	-13	0	0			1	-13
Administrative expenses	270	272	91	84			361	356
Net other operating income / expenses	17	-9	1	1			18	-8
Impairment of goodwill	2	0	1				3	0
Operating profit from continuing operations	**193**	**-5**	**187**	**165**			**380**	**160**
Allocated equity	379	350	614	501	163	130	1,156	981
Cost / income ratio (%)	56.0	80.9	32.7	33.8			48.6	63.5
RoE before taxes (%)	50.9	-1.5	30.4	32.9			32.8	16.3
Employees (average)	**1,958**	**2,076**	**588**	**594**		**42**	**2,546**	**2,712**
Segment assets	**19,201**	**20,418**	**20,969**	**17,819**			**40,170**	**38,237**

Notes to discontinued operations

	2007 € mn	2006 € mn
Net interest income	–	0
Provision for loan losses	–	–
Net interest income after net loan loss provisions	**–**	**0**
Net commission income	–	9
Net result from hedge accounting	–	–
Net trading income / expenses	–	–
Results from non-trading assets	–	1
Results from investments accounted for using the equity method	–	2
Results from investment properties	–	–
Administrative expenses	–	11
Net other operating income / expenses	–	0
Impairment of goodwill	–	–
Income taxes	–	0
Results from discontinued operations	**–**	**1**

Assets related to discontinued operations as at 31 December	–	–
Liabilities related to discontinued operations as at 31 December	–	–

(F) OTHER EXPLANATORY NOTES

(72) Assets and liabilities in foreign currency

The euro equivalent of the aggregate amount of assets denominated in foreign currency as at the reporting date amounted to € 9,716 million (2006: € 8,091 million); the euro equivalent of aggregate liabilities denominated in foreign currency amounted to € 9,687 million (2006: € 8,090 million). Amounts in material foreign currencies may be broken down in the following amounts:

	31 Dec 2007 € mn	31 Dec 2006 € mn
Foreign currency assets		
USD	2,861	1,661
GBP	2,547	1,795
Foreign currency liabilities		
USD	2,849	1,671
GBP	2,546	1,797

(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.

The following table gives an overview of subordinated assets of the Aareal Bank Group:

	31 Dec 2007 € mn	31 Dec 2006 € mn
Loans and advances to banks	3	5
Loans and advances to customers	80	83
Total	**83**	**88**

(74) Leases

The Aareal Bank Group acts both as lessor and lessee. The rental contracts are primarily classified as operating leases.

Maturity of minimum lease payments under operating leases

	31 Dec 2007 € mn	31 Dec 2006 € mn
Aareal Bank Group as lessee		
up to one year	12	13
longer than one year, and up to five years	31	20
longer than five years	15	3
Total minimum lease payments	**58**	**36**
Aareal Bank Group as lessor		
up to one year	2	7
longer than one year, and up to five years	5	9
longer than five years	2	
Total minimum lease payments	**9**	**16**

Of the properties subject to the operating lease, one property with a carrying amount of € 10 million (2006: € 10 million) is classified as an investment property in accordance with IAS 40 and measured at fair value.

€ 14 million (2006: € 8 million) in lease payments was recognised as expense in the financial year.

(75) Trust business

Aareal Bank Group's trust business at the reporting date is analysed below:

	31 Dec 2007 € mn	31 Dec 2006 € mn
Trust assets		
Loans and advances to customers	1,417	1,339
Non-trading assets	2	2
Total trust assets	**1,419**	**1,341**
Trust liabilities		
Liabilities to banks	498	601
Liabilities to customers	921	740
Total trust liabilities	**1,419**	**1,341**

(76) Contingent liabilities and irrevocable loan commitments

	31 Dec 2007 € mn	31 Dec 2006 € mn
Contingent liabilities on guarantees and indemnity agreements	733	662
Irrevocable loan commitments	4,600	2,780

Contingent liabilities on guarantees include € 82 million (2006: € 165 million) in capital guarantees extended by Aareal Bank to DEPFA Deutsche Pfandbriefbank AG (within the scope of splitting the former DEPFA Group), for the purpose of providing cover against risks of default with respect to the property loan portfolio held by DEPFA Deutsche Pfandbriefbank AG. € 25 million (2006: € 51 million) in provisions related to these capital guarantees was recognised as at 31 December 2007. Disclosures in accordance with IAS 37.86 and IAS 37.89 are waived for reasons of practicability in accordance with IAS 37.91.

(77) Consolidated Statement of Cash Flows

Aareal Bank Group's consolidated 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 consolidated income statement. Cash flows from investing activities include proceeds and payments from the disposal and acquisition of property and equipment and non-trading assets. Cash flows from financing activities include cash flows from transactions with providers of equity capital, as well as from borrowings raised or repaid.

In 2007, Aareal Bank AG acquired a total of 35.73 % of the shares in the internet property portal Immobilien Scout GmbH, Berlin, during several transactions. The consideration amounted to € 168 million. The bank's total shareholding thus increased from 30.49 % to 66.22 %. In the 3rd quarter 2007, Aareal sold all shares in the company at a price of € 358 million. All purchase price payments were paid in cash. In the consolidated cash flow statement, purchase prices paid are reflected in the cash flow from investing activities.

The sale of the shareholdings resulted in the derecognition of the following material assets and liabilities:

Item	€ mn
Intangible assets	188
Other assets	22
Deferred tax liabilities	29
Other liabilities	12

At the time of disposal, the sold company did not hold material cash or cash equivalents.

(78) Capital disclosures in accordance with IAS 1.124 A

Qualitative disclosures

The consolidated equity capital in accordance with the German Banking Act (KWG) represents the basis of capital management. This calculation basis is used to prepare a monthly projection including the changes of equity components and the risk-weighted assets as well as the resulting equity ratios which are subject to monthly reporting within the framework of management reporting.

Equity capital consists of liable capital (core (tier I) capital and supplementary (tier II) capital) as well as tier III capital. At the Aareal Bank Group equity capital is identical with liable capital. The main managed component of the core capital is the reserve component. The amounts planned to be transferred to reserves are determined within the scope of new business and earnings projections. Significant components of supplementary capital that are also part of capital management are liabilities from profit participation certificates as well as subordinated liabilities.

The Aareal Group is subject to the capital adequacy requirements of the KWG. The Group utilised the option to determine its risk exposures until 31 December 2007 pursuant to the provisions of the KWG (Grundsatz I) instead of in accordance with the German Solvability Ordinance, which went into force on 1 January 2007. Accordingly, the Group has to have capital in an adequate volume, and risk-weighted assets must be backed in an amount of at least 8% by liable capital. The compliance with the capital requirements has to be reported to the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin – German Financial Supervisory Authority) on a quarterly basis. Capital requirements were complied with at any time during the reporting period.

The objective of capital management is to meet the targeted equity ratios, which are significantly above the regulatory minimum requirements. Capital management is an integral part of overall Group planning.

[1] after adoption of Aareal Bank AG's financial statements for 2007. The inclusion of retained earnings transferred as part of Aareal Bank AG's liable equity capital as at 31 December 2007 is subject to approval by the Annual General Meeting.

Quantitative disclosures

	31 Dec 2007 [1] € mn	31 Dec 2006 € mn
Core capital ratio (Tier I)		
Paid-in capital	253	198
Reserves	1,543	1,352
Contributions by silent partners	220	220
Carrying amounts of investments	-580	-614
Tier I model	250	250
Other	74	65
Total core capital	**1,760**	**1,471**
Supplementary capital (Tier II)		
Profit-participation rights	428	428
Subordinated liabilities	528	553
Other	-14	-16
Total supplementary capital	**942**	**965**
Liable equity capital pursuant to Section 10a of the KWG	**2,702**	**2,436**
Qualifying tier III capital	0	0
Qualifying equity capital	**2,702**	**2,436**
Risk-weighted assets	**22,050**	**18,044**
of which: Assets exposed to market risk	88	225
Regulatory indicators in accordance with the German Banking Act (KWG)	**%**	**%**
Core capital ratio	8.0	8.3
Total capital ratio	12.3	13.5

(79) New property financing business

	1 Jan-31 Dec 2007 € mn	1 Jan-31 Dec 2006 € mn
Commercial property financing	10,700	8,317
of which: international	9,934	7,621
Property financing for commercial housing	1,014	1,633
of which: international	551	727
Total	**11,714**	**9,950**

(80) Related party disclosures in accordance with IAS 24

Throughout the financial year 2007, the bank has reported purchases and sales subject to reporting requirements under No. 6.6 of the German Corporate Governance Code, as well as under section 15a of the German Securities Trading Act (WpHG) to BaFin, the German financial services regulatory agency, without delay, and also published such details on its website. Furthermore, Aareal Bank AG has undertaken in its Code to disclose on its website, without delay, each reported purchase or sale by members of the Management Board or the Supervisory Board.

The following list provides an overview of existing loans to related parties:

	31 Dec 2007 € mn	31 Dec 2006 € mn
Management Board	–	–
Supervisory Board	3.3	3.5
Other related parties	2.6	2.8
Total	**5.9**	**6.3**

Loans extended generally have a term between ten and 15 years, and bear interest at (nominal) rates between 3.05 % and 7.64 %. Collateral was provided in line with usual market practice.

(81) Remuneration report

Remuneration for members of the Management Board

The Executive Committee of the Supervisory Board determines the structure and amount of remuneration for members of the Management Board. The Committee sets salaries and other remuneration components for members of the Management Board.

Aareal Bank AG has entered into fixed-term service contracts with the members of its Management Board. In addition to fixed salary components, which are paid in twelve identical monthly instalments, the members of the Management Board receive a bonus in form of a variable remuneration and are granted phantom shares as a long-term remuneration (Long-term Component I), which may be exercised after a waiting period of three years in the three years following such waiting period. The members of the Management Board receive another long-term remuneration component in the form of an entitlement to exercise allocated phantom shares (Long-term Component II). This entitlement is allocated in four equal amounts to the year of the granting of phantom shares and the three following years. A prerequisite for the entitlement is that the employment contract has not been terminated by the relevant Board member as at the exercise date.

The basis for this variable remuneration component is a target system, largely based on net income (of the Group) as reported under International Financial Reporting Standards (IFRS), as well as qualitative and quantitative targets, which are re-defined annually.

The cash payment of the members of the Management Board amounts to

	1 Jan-31 Dec 2007 €	1 Jan-31 Dec 2006 €
Fixed remuneration	1,520,000.00	1,520,000.00
Variable remuneration / bonus	2,145,000.00	2,145,000.00
Other remuneration	376,120.70	99,948.19
Total	**4,041,120.70**	**3,764,948.19**

The breakdown of the amounts stated above amongst the members of the Management Board is shown below:

	Year	Fixed remuneration (€)	Cash bonus (€)	Other (€) [1]	Total (€)
Dr. Wolf Schumacher	2007	500,000.00	900,000.00	44,493.93	1,444,493.93
	2006	500,000.00	900,000.00	24,144.03	1,424,144.03
Norbert Kickum	2007	300,000.00	435,000.00	238,287.73 [2]	973,287.73
	2006	300,000.00	435,000.00	22,036.35	757,036.35
Hermann J. Merkens	2007	420,000.00	375,000.00	53,163.31	848,163.31
	2006	420,000.00	375,000.00	31,753.05	826,753.05
Thomas Ortmanns	2007	300,000.00	435,000.00	40,175.73	775,175.73
	2006	300,000.00	435,000.00	22,014.76	757,014.76
Total	**2007**				**4,041,120.70**
	2006				**3,764,948.19**

As part of the long-term remuneration component, the Management Board received 149,928.72 phantom shares at a price of € 31.30 with a value of € 4,692,768.84 as at 31 December 2007. The breakdown of the phantom shares amongst the members of the Management Board is shown below:

	Year	Long-term component I		Long-term component II		Total		Value as at 31 Dec 2007 (€)
		Value at award date (€)	Number	Value at award date (€)	Number [3) 4)]	Number	Value at award date (€)	
Dr. Wolf Schumacher	2007	735,000.00	23,482.43 [3]	500,000.00	14,838.41	38,320.84	1,235,000.00	1,199,442.32
	2006	450,000.00	12,332.15			12,332.15	450,000.00	385,996.30
Norbert Kickum	2007	720,000.00	23,003.19 [3]	500,000.00	14,838.41	37,841.60	1,220,000.00	1,184,442.15
	2006	435,000.00	11,921.07			11,921.07	435,000.00	373,129.49
Hermann J. Merkens	2007	660,000.00	21,086.26 [3]	500,000.00	14,838.41	35,924.67	1,160,000.00	1,124,442.22
	2006	375,000.00	10,276.79			10,276.79	375,000.00	321,663.53
Thomas Ortmanns	2007	720,000.00	23,003.19 [3]	500,000.00	14,838.41	37,841.60	1,220,000.00	1,184,442.15
	2006	435,000.00	11,921.07			11,921.07	435,000.00	373,129.49

[1] Other remuneration includes payments (in particular for company cars) in the amount of € 53,772.86 (2006: € 54,429.13) as well as benefits related to social security contributions totalling € 43,084.32 (2006: € 45,519.06). Figures for 2007 also include payments for theoretical dividends on phantom shares.

[2] This amount includes a payment of € 195,532.96 that was paid upon the exercise of a part of the phantom shares.

[3] This corresponds to a value of phantom shares that will be translated into phantom shares at the award date in accordance with the regulations of the plans for share-based payments, i.e. after the publication of the annual financial statements 2007 as adopted by the Supervisory Board. The number of phantom shares was translated in this context assuming a share price of € 31.30 as at 31 December 2007.

[4] A total of 6,851.19 phantom shares were already allocated in 2007 at a share price of € 36.49 in accordance with the applicable regulations.

This results in the following total amount of phantom shares held by the individual members of the Management Board:

	Phantom shares held at 31 Dec 2006		exercised in 2007	Phantom shares held at 31 Dec 2007	
	Number	Value as at 31 Dec 2006 (€) [1)]	Number	Number	Value as at 31 Dec 2007 (€) [2)]
Dr. Wolf Schumacher	16,828.55	593,542.96	0.00	55,149.39	1,726,175.91
Norbert Kickum	11,921.07	420,456.14	6,851.19	42,911.48	1,343,129.32
Hermann J. Merkens	17,171.27	605,630.69	0.00	53,095.94	1,661,902.92
Thomas Ortmanns	11,921.07	420,456.14	0.00	49,762.67	1,557,571.57

1) Share price: € 35.27;   2) Share price: € 31.30

Mr. Schörnig resigned from the Management Board effective 30 September 2007. In addition to the fixed remuneration paid until that date in the amount of € 225,000 (2006: € 300,000), Mr. Schörnig received a compensation for the remuneration claims for the remaining term of his contract totalling € 2,700,000. In addition, he received an amount of € 271,581.17 due to the exercise of 6,851.19 allocated phantom shares. The phantom shares allocated to Mr. Schörnig during his service period, but not yet exercised (20,614.12) may be exercised until 30 September 2008. The phantom shares awarded to Mr. Schörnig have a value of € 645,221.96 at a price of € 31.30 as at 31 December 2007.

Additional pension provisions were recognised in an amount of € 643,690.05 (2006: € 242,915.00). The total of pension provisions for active and former members of the Management Board and their surviving dependants amount to € 8,951,446.00 (2006: € 7,910,647.00). Members of the Management Board who joined the Company before 1 January 2005 are entitled to receive contractual pension payments before they reach the age of 65 when they have served for a period of five years, in case the bank rejects an extension of their service contract. Payments from other employment relationships and other pension plans, if any, are taken into account.

Payments to former Management Board members of Aareal Bank AG and their surviving dependants totalled € 571,790.11 (2006: € 490,151.64).

The agreements concluded with members of the Management Board do not include any express obligation to make severance payments in case of an early termination of employment relationships. However, severance payments may be included in individual termination agreements.

In the case of a change of control and a resulting loss of membership in the Management Board, the members affected receive, in settlement of their total remuneration, their fixed remuneration as well as a contractually agreed compensation for the variable remuneration, paid in monthly instalments during the remaining term of the agreements. In addition, the members of the Management Board receive a lump-sum payment of up to 75 % of their annual fixed remuneration.

If, in case of a change of control, members of the Management Board resign from office or are not willing to extend their office in spite of an offer on the part of the Company, the respective member of the Management Board receives, in settlement of the total remuneration, an amount not exceeding 50 % of the relevant fixed remuneration and the contractually agreed compensation for the variable remuneration. In addition, the relevant member of the Management Board receives a lump-sum payment of up to 50 % of the annual fixed remuneration.

Remuneration for members of the Supervisory Board

The remuneration of the Supervisory Board is specified in Section 9 of the Memorandum and Articles of Association of Aareal Bank AG. The resolution adopted by the Annual General Meeting on 23 May 2006, which resulted in a change of the remuneration system of the Supervisory Board, currently applies. For the financial year 2007, the remuneration for the members of the Supervisory Board for the full financial year is based on the new methodology for the first time.

The total remuneration of the Supervisory Board comprises a fixed and a variable remuneration component comparable to the remuneration package of the Management Board. The variable remuneration is performance-related and comprises a short-term and a long-term component.

The fixed remuneration is € 20,000.00 p.a. for each Supervisory Board member. The Chairman of the Supervisory Board shall receive twice the amount, while the deputy shall receive one and a half times as much as a normal member. The fixed remuneration shall be increased by € 10,000.00 p.a. for each membership in a Supervisory Board committee (with the exception of the Committee for Urgent Decisions, which is a part of the Credit and Market Risk Committee). The fixed remuneration shall be increased instead by € 20,000.00 p.a. for Chairmanship of a Supervisory Board committee (also with the exception of the Committee for Urgent Decisions, which is a part of the Credit and Market Risk Committee). The fixed remuneration component of a Supervisory Board member, including the remuneration for the Chairmanship of a Supervisory Board committee, forms a basis for assessing the performance-related remuneration.

The performance-related remuneration only comes into effect if a dividend is paid for the financial year in question that exceeds € 0.20 per share.

The short-term performance-related remuneration currently amounts to 12.5 % of the individual assessment basis for each full € 50 million of the consolidated net income attributable to shareholders of Aareal Bank AG as reported in the Group income statement. However, it may not exceed 50 % of the individual assessment basis.

The long-term performance-related remuneration of a Supervisory Board member amounts to 12.5 % of the individual assessment basis for each 10 % increase in the consolidated net income attributable to shareholders of Aareal Bank AG (as reported in the consolidated income statement) over the unweighted average of the consolidated net income attributable to shareholders of Aareal Bank AG for the three previous full financial years. The long-term profit-oriented remuneration is not paid if the average value is negative. On this basis, the members of the Supervisory Board are not entitled to a long-term performance-related remuneration for the 2007 financial year. The maximum long-term performance-related remuneration is capped at 50 % of the individual assessment basis, so that the aggregate variable remuneration may amount to a maximum of 100 % of the fixed remuneration component.

The fixed remuneration is due at the end of each financial year. The variable remuneration component is due after the Annual General Meeting in which a resolution is passed on the appropriation of net income for the relevant financial year. The bank reimburses the VAT amounts to be paid on the remuneration.

In accordance with the presented methodology, the members of the Supervisory Board receive a fixed remuneration for the financial year 2007 in the amount of € 559,300.00 (2006: € 621,971.58) and, provided that the Annual General Meeting approves the proposal of the Management on the appropriation of net income, a variable remuneration of € 202,300.00 (2006: € 63,710.55).

	Fixed remuneration Total €	Variable remuneration Total €	Total remuneration €
Hans W. Reich, Chairman	107,100.00	47,600.00	154,700.00
Erwin Flieger, Deputy Chairman	59,500.00	17,850.00	77,350.00
York-Detlef Bülow, Deputy Chairman	59,500.00	17,850.00	77,350.00
Tamara Birke	35,700.00	11,900.00	47,600.00
Thomas Hawel	23,800.00	11,900.00	35,700.00
Helmut Wagner	23,800.00	11,900.00	35,700.00
Christian Graf von Bassewitz	47,600.00	11,900.00	59,500.00
Manfred Behrens	23,800.00	11,900.00	35,700.00
Joachim Neupel	59,500.00	23,800.00	83,300.00
Dr. Herbert Lohneiß	35,700.00	11,900.00	47,600.00
Prof. Dr. Stephan Schüller	47,600.00	11,900.00	59,500.00
Wolf R. Thiel	35,700.00	11,900.00	47,600.00
Total	**559,300.00**	**202,300.00**	**761,600.00**

The individual amount of the remuneration for the Supervisory Board is shown in the table above. The variable remuneration was recognised under the assumption that the Annual General Meeting approves the Management's proposal on the distribution of earnings.

The figures in the table include the reimbursement for VAT (19%).

The members of the Supervisory Board did not provide any consulting or agency services, or other personal services in 2007. Therefore, no additional remuneration was paid.

Remuneration for key executives

The definition of executives in key positions within Aareal Bank Group generally includes members of management or supervisory bodies, plus first-level managers (heads of divisions).

Total remuneration of executives in key positions is analysed as follows:

	1 Jan-31 Dec 2007 € 000's	1 Jan-31 Dec 2006 € 000's
Salaries and other short-term benefits	20,069	17,914
Severance pay	5,378	1,460
Post-employment benefits	2,007	1,476
Other long-term benefits	839	753
Share-based remuneration	4,902	3,141
Total	**33,195**	**24,744**

Share-based remuneration

a) Description of the share plans:

The members of the Management Board were granted phantom shares in the years 2006 and 2007, and executive staff (leitende Angestellte) was granted "virtual shares" in the years 2005, 2006 and 2007, both as variable remuneration components.

The relevant share plans are subject to slightly different regulations with respect to term and exercise criteria.

Phantom share plan for members of the Management Board for 2006 and 2007/ Long-term component I

In the years 2006 and 2007, the members of the Management Board were granted phantom shares in accordance with the following regulations:

- The beneficiaries receive a remuneration denominated in euro which will be converted into an equivalent number of phantom shares. For the 2006 share plan, the basis for conversion is the average price of the Aareal Bank AG share on the seven trading days following the Annual General Meeting (subscription price). For the 2007 share plan, the conversion is based on the weighted average price during the five (Xetra) trading days after the publication of the annual financial statements adopted by the Supervisory Board.

- The phantom shares are subject to a holding period of three years in which they may not be exercised.

- There are no exercise hurdles in form of a minimum stock appreciation target or other market or performance-related criteria.

- Phantom shares that have not been exercised carry full dividend rights, i.e. the beneficiaries receive for each phantom share not yet exercised a cash payment equivalent to the amount of the approved dividend.

- Under the 2006 share plan, phantom shares may be exercised during the three years following the holding period once per year one day after the relevant subscription period.

- Under the 2007 share plan, phantom shares may be exercised during the three years following the holding period four times per year within five days after the publication of the quarterly report.

Phantom share plan for members of the Management Board for 2007/ Long-term component II

The following regulations apply for phantom shares of the long-term component II additionally awarded to members of the Management Board in the year 2007:

- The beneficiaries receive a remuneration denominated in euro which will be converted into an equivalent number of phantom shares. The basis for conversion is the average price of the Aareal Bank AG share on the five trading days following the publication of the annual report (subscription price).

- Phantom shares may be exercised within five business days after the publication of a quarterly report in the years 2007 to 2010, with one quarter of the shares qualifying for exercise in each year. A prerequisite for exercise is that the employment contract has not been terminated by the relevant Board member as at the exercise date.

- Phantom shares not exercised in a particular year are available for exercise in the subsequent year.

- There are no exercise hurdles in form of a minimum stock appreciation target or other market or performance-related criteria.

- Phantom shares that have not been exercised carry full dividend rights, i. e. the beneficiaries receive for each virtual share not yet exercised a cash payment equivalent to the amount of the approved dividend.

Share plan for executive staff (virtual shares): 2005, 2006 and 2007

In the years 2005, 2006 and 2007, executive staff was granted virtual shares in accordance with the following regulations:

- The beneficiaries receive a remuneration denominated in euro which will be converted into an equivalent number of virtual shares. The basis for conversion is the average price of the Aareal Bank AG share on the date of publication of the annual report and the four subsequent trading days (subscription price).

- The shares resulting from such a grant are automatically exercised in the three years following the year of grant, with one third being exercised in each year.

- In case of a termination of the employment contract, the portion of the virtual shares that have not been exercised expires.

- The basis for exercise is the average price of the Aareal Bank AG share on the date of publication of the annual report and the four subsequent trading days.

- There are no exercise hurdles in form of a minimum stock appreciation target or other market or performance-related criteria.

- Virtual shares that have not been exercised carry full dividend rights, i.e. the beneficiaries receive for each virtual share not yet exercised a cash payment equivalent to the amount of the approved dividend.

b) Size and measurement of phantom share plans:

The number of phantom shares outstanding for active and former members of the Management Board has changed as follows:

	Quantity (number) 2007	Quantity (number) 2006
Balance at 1 January	**78,456.08**	**20,083.93**
granted (+)	156,779.90	58,372.15
expired (-)	0	0
exercised (-)	13,702.38	0
Balance at 31 December	**221,533.60**	**78,456.08**
of which: exercisable	35,968.55	0

The phantom shares granted in the year under review have a weighted average fair value of € 7,245,246.60 (2006: € 768,012.16).

The weighted average share price of the phantom shares exercised in the year under review amounted to € 34.99.

No phantom shares were exercised in the previous year.

The phantom shares outstanding as at 31 December 2007 have a limited contract term. The weighted average contract term of these phantom shares amounts to 1,534 days (2006: 1,909 days).

c) Valuation model and valuation assumptions

Valuation model

The share plans of Aareal Bank AG are of a "semi-american" type: an option may be exercised during a pre-determined exercise period at predetermined dates, subject to a holding period, if applicable. The exercise period varies according to plan. For example, the exercise period for the 2006 and 2007 plans for the Management Board amounts to three years following a holding period of three years.

According to the conditions of the phantom share plans of Aareal Bank AG a dividend will be paid for each phantom share, irrespective of whether the option has been exercised or not. This means that an earlier exercise does not result in a separate claim for dividend payment. Therefore, there is no reason for an earlier exercise of an option due to dividend payments. As can be demonstrated, it may always make sense to hold an option until the end of the exercise period. Therefore, the phantom share of the Aareal Bank AG must be valued like a European option on equities with no dividend, and hence the Black-Scholes valuation model may be used.

Valuation assumptions

The following probabilities for elementary events are used for the calculation of the probabilities of the occurrence of the exercise events:

- Death or invalidity: 0.2 % p.a. (members of the Management Board) and 0.175 % p.a. (executive staff)

- Termination of contract by employee: 3 % p.a. (members of the Management Board) and 5.5 % p.a. (executive staff)

- Termination of contract by employer (due to operational requirements or change of ownership): 1 % p.a. (members of the Management Board) and 0.5 % p.a. (executive staff)

The vesting of the rights is based on the individual share plans. It has been assumed, in the event of death or invalidity, that the outstanding option rights may be exercised immediately and in the full amount, irrespective of the extent of the rights earned until that date.

Options are valued using the Black-Scholes model. The relevant indicators for the valuation are (+: value of the option increases when the relevant indicator increases)

- the price of the Aareal Bank share on the valuation date (+)
- the exercise price of the phantom or virtual share on the exercise date (-)
- the term to exercise date (+)
- the volatility of the change (in percent) of the price of the Aareal Bank share (+)
- the risk-free interest rate for a safe investment until the exercise date (+)

The Xetra closing price of the Aareal Bank share is determined on the valuation date. The exercise price for each share plan is nil since the beneficiary receives the full equivalent of a share upon exercise. No dividend payments arise on the phantom or virtual shares upon exercise since dividend payments are made irrespective of any exercise. The term of an option in the event tree is always the maximum time as contractually agreed until the exercise event. The exercise events ”death / invalidity“ or ”termination“ are always assumed to occur in the middle of future periods. The expected volatility (standard deviation) of the percentage change of the price of the Aareal Bank share (return) is calculated using the standard deviation of the daily historical returns over a rolling reference period of 200 days, with the values being additionally smoothed subsequently. The yield curve for risk-free German zero-coupon government bonds, as published by daily the Deutsche Bundesbank applicable at the valuation date, will be used to discount future payments.

The tables on the following pages summarise the assumptions impacting valuation.

Parameters for share-based payment Executive staff	L 2005 Valuation	L 2006 Valuation	L 2007 Valuation
Valuation date	**11 Dec 2007**	**11 Dec 2007**	**11 Dec 2007**
(I) Grant			
Grant date	7 Mar 2005	20 Mar 2006	26 Mar 2007
Aareal Bank AG			
Number of phantom shares granted	36,046	22,348	28,141
Number of beneficiaries	39	32	34
Aareal First Financial Solutions AG			
Number of phantom shares granted	744	526	819
Number of beneficiaries	1	1	1
Aareal Estate AG			
Number of phantom shares granted	558	198	0
Number of beneficiaries	1	1	0
Aareal Valuation GmbH			
Number of phantom shares granted	–	–	273
Number of beneficiaries	–	–	1
Maximum contract term (years)	3	3	3
Vesting period (years)	3	3	3
Exercise period (years)	0	0	0
Expected maximum contract term at grant date (years)	3	3	3
Vested rights	after 1 year 1/3 each	after 1 year 1/3 each	after 1 year 1/3 each
Share price at grant date (closing)	27.41 €	38.24 €	37.08 €
Share price upon exercise	0	0	0
Dividend entitlement for phantom shares	no	no	no
(II) Valuation			
Valuation date	11 Dec 2007	11 Dec 2007	11 Dec 2007
Aareal Bank AG			
Number of phantom shares outstanding	11,798	14,460	27,459
Number of beneficiaries	34	28	33
Payment to beneficiaries in the past period	0	0	0
Aareal First Financial Solutions AG			
Number of phantom shares outstanding	744	526	819
Number of beneficiaries	1	1	1
Payment to beneficiaries in the past period	0	0	0

Parameters for share-based payment Executive staff	L 2005 Valuation	L 2006 Valuation	L 2007 Valuation
Aareal Estate AG			
Number of phantom shares outstanding	558	198	0
Number of beneficiaries	1	1	0
Payment to beneficiaries in the past period	0	0	0
Aareal Valuation GmbH			
Number of phantom shares outstanding	–	–	273
Number of beneficiaries	–	–	1
Payment to beneficiaries in the past period	–	–	0
Share price at valuation date (closing)	29.46 €	29.46 €	29.46 €
Standard deviation of current income, annualised, rounded	30.0 %	30.0 %	30.0 %
Risk-free interest rate at valuation date (%)			
Overnight deposits	3.86 %	3.86 %	3.86 %
Remaining term > 1 year	4.08 %	4.08 %	4.08 %
Remaining term > 2 years	4.00 %	4.00 %	4.00 %
Remaining term > 3 years	3.99 %	3.99 %	3.99 %
Valuation model	B / S	B / S	B / S
(III) Probabilities p. a.			
Death and invalidity	0.000 %	0.175 %	0.175 %
Termination by employer (change of ownership / operational requirements)	0.000 %	0.500 %	0.500 %
Termination by employee	0.000 %	5.500 %	5.500 %

Parameters for share-based payment Management Board	V 2006 Valuation	V 2007 Valuation	V 2007-S Valuation
Valuation date	**11 Dec 2007**	**11 Dec 2007**	**11 Dec 2007**
(I) Grant			
Grant date	20 Mar 2006	26 Mar 2007	26 Mar 2007
Number of phantom shares granted	20,486	58,372	137,023
Number of beneficiaries	3	5	5
Maximum contract term (years)	6	6	6
Vesting period (years)	3	3	4
Exercise period (years)	3	3	n/a Ann 2 Y
Expected maximum contract term at grant date (years)	6	6	6
Vested rights	after 3 Y	after 3 Y	1/4 per year each
Share price at grant date (closing)	38.24 €	37.08 €	37.08 €
Share price upon exercise	0	0	0
Dividend entitlement for phantom shares	no	no	no
(II) Valuation			
Valuation date	11 Dec 2007	11 Dec 2007	11 Dec 2007
Number of phantom shares outstanding	20,486	58,372	108,767.04
Number of beneficiaries	3	5	4
Payment to beneficiaries in the past period	0.00	0.00	195,532.96
Share price at valuation date (closing)	29.46 €	29.46 €	29.46 €
Standard deviation of current income, annualised, rounded	30.0 %	30.0 %	30.0 %
Risk-free interest rate at valuation date (%)			
Overnight deposits	3.86 %	3.86 %	3.86 %
Remaining term > 1 year	4.08 %	4.08 %	4.08 %
Remaining term > 2 years	4.00 %	4.00 %	4.00 %
Remaining term > 3 years	3.99 %	3.99 %	3.99 %
Remaining term > 4 years	4.03 %	4.03 %	4.03 %
Remaining term > 5 years	4.09 %	4.09 %	4.09 %
Remaining term > 6 years	4.15 %	4.15 %	4.15 %
Valuation model	B/S	B/S	B/S
(III) Probabilities p.a.			
Death and invalidity	0.000 %	0.200 %	0.200 %
Termination by employer (change of ownership/operational requirements)	1.000 %	1.000 %	1.000 %
Termination by employee	3.000 %	3.000 %	3.000 %

d) Effects on financial position and performance

The total amount expensed for share-based payments was € 2.276 million (2006: € 2.488 million) during the financial year 2007. The expense was covered in full by provisions recognised in the previous years. The liability from share-based payments amounts to € 2.211 million (2006: € 0.926 million) as at 31 December 2007.

(82) Events after the balance sheet date

No material events (adjusting events in accordance with IAS 10.21) occurred after the balance sheet date.

(83) List of Offices Held – Corporate Governance Report

The List of Offices Held, which has been deposited with the Commercial Register at the Wiesbaden District Court, includes all offices held in German and foreign companies. Like the Corporate Governance Report, the list is available, free of charge, from Aareal Bank AG in Wiesbaden, or in the internet on http://www.aareal-bank.com.

(84) Contingencies

By means of letters of comfort, Aareal Bank AG ensures that Deutsche Structured Finance GmbH, Frankfurt, DSF Beteiligungsgesellschaft mbH, Frankfurt, and Aareal Bank Capital Funding LLC, Wilmington, are able to fulfil their contractual obligations.

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.

Due to its participating interest in Liquiditäts-Konsortialbank GmbH, Frankfurt / Main, in the nominal amount of € 1.0 million, Aareal Bank AG has call commitments of up to € 6.0 million. In addition, Aareal Bank AG has a pro-rata principal liability in the event of non-fulfilment of call commitments by other co-shareholders, who hold aggregate interests of € 63.0 million.

(85) Notice pursuant to section 21 (1) of the WpHG

On 16 January 2008, Fidelity Investment Trust, Boston, Massachusetts, USA, notified us according to section 21 (1) of the German Securities Trading Act (Wertpapierhandelsgesetz, WpHG) that, on the basis of shares held, its share of voting rights in Aareal Bank AG, Wiesbaden, Germany, ISIN: DE0005408116, WKN: 540811, exceeded the threshold of 3 % of total voting rights on 6 August 2007 and now amounts to 3.08 % (corresponding to 1,315,235 voting rights).

On 1 November 2007, Fidelity International, Tadworth, United Kingdom, notified us of the following:

"As a result of an internal merger reorganisation effective from 1st October 2007, FMR LLC. (a Delaware limited liability company with its principal place of business in Boston, USA) became the successor entity to FMR Corp. and has assumed all its rights and obligations. We therefore notify you that on 1st October 2007 FMR LLC. held 3.29 % of the voting rights (voting rights arising of 1,404,640 shares in Aareal Bank AG) and therefore exceeded the threshold of 3 %. All of the voting rights of FMR LLC. are attributed to it pursuant to sec. 22 para. 1. sent 1 no. 6 and sent. 2 of the German Securities Trade Act."

Correction of the notification of 18 September 2007: On 14 September 2007, Julius Bär Holding AG, Zurich, Switzerland, notified us of the following:

"Notification pursuant to section 21 (1) of the WpHG
We herewith notify you in accordance with section 21 (1) of the WpHG that our share of voting rights in Aareal Bank AG, Paulinenstrasse 15, 65189 Wiesbaden, Germany, fell below the threshold of 3 % on 11 September 2007 and amounted to 2.99 % at that time (exact number of voting rights: 1,277,706 shares), both in terms of the total number of voting rights of the issuer and in terms of all shares equipped with voting rights of one and the same class. The voting rights are fully attributable to us via Julius Baer Investment Management LLC, New York, USA, pursuant to section 22 (1) sentence 1 No. 6 of the WpHG in conjunction with section 22 (1) sentence 2 of the WpHG."

Underlying notification of Julius Baer Investment Management LLC, New York, USA:

"We herewith notify you in accordance with section 21 (1) of the WpHG that our share of voting rights in Aareal Bank AG, Paulinenstrasse 15, 65189 Wiesbaden, Germany, fell below the threshold of 3 % on 11 September 2007 and amounted to 2.99 % at that time (exact number of voting rights: 1,277,706 shares), both in terms of the total number of voting rights of the issuer and in terms of all shares equipped with voting rights of one and the same class. The voting rights are fully attributable to us pursuant to section 22 (1) sentence 1 No. 6 of the WpHG."

In September 2007, Aareal Bank AG published the notification of Julius Baer Investment Management LLC:

"We herewith notify you in accordance with section 21 (1) of the WpHG that our share of voting rights in Aareal Bank AG, Paulinenstrasse 15, 65189 Wiesbaden, Germany, fell below the threshold of 3 % on 11 September 2007 and amounted to 2.99 % at that time (exact number of voting rights: 1,277,706 shares), both in terms of the total number of voting rights of the issuer and in terms of all shares equipped with voting rights of one and the same class. The voting rights are fully attributable to us via Julius Baer Investment Management LLC, 330 Madison Avenue, NY 10017 New York, USA, pursuant to section 22 (1) sentence 1 No. 6 of the WpHG in conjunction with section 22 (1) sentence 2 of the WpHG."

Underlying notification of Julius Baer Investment Management LLC, New York, USA:

"We herewith notify you in accordance with section 21 (1) of the WpHG that our share of voting rights in Aareal Bank AG, Paulinenstrasse 15, 65189 Wiesbaden, Germany, fell below the threshold of 3 % on 11 September 2007 and amounted to 2.99 % at that time (exact number of voting rights: 1,277,706 shares), both in terms of the total number of voting rights of the issuer and in terms of all shares equipped with voting rights of one and the same class. The voting rights are fully attributable to us pursuant to section 22 (1) sentence 1 No. 6 of the WpHG."

On 14 September 2007, Julius Baer Americas Inc., USA, notified us of the following:

"Notification pursuant to section 21 (1) of the WpHG
We herewith notify you in accordance with section 21 (1) of the WpHG that our share of voting rights in Aareal Bank AG, Paulinenstrasse 15, 65189 Wiesbaden, Germany, fell below the threshold of 3 % on 11 September 2007 and amounted to 2.99 % at that time (exact number of voting rights: 1,277,706 shares), both in terms of the total number of voting rights of the issuer and in terms of all shares equipped with voting rights of one and the same class. The voting rights are fully attributable to us via Julius Baer Investment Management LLC, 330 Madison Avenue, NY 10017 New York, USA, pursuant to section 22 (1) sentence 1 No. 6 of the WpHG in conjunction with section 22 (1) sentence 2 of the WpHG."

On 3 August 2007, BT Pension Scheme, London, United Kingdom, notified us of the following:

"Notification pursuant to § 21, 22 WpHG: Aareal Bank AG (Sedol No. 7380062)
We hereby give notice, pursuant to § 21 para. 1 of the WpHG, that on 2nd August 2007 the voting interest held by Hermes Focus Asset Management Europe Limited, Lloyds Chambers, 1 Portsoken Street, London E1 8HZ U. K. in Aareal Bank AG, Paulinenstraße 15, 65189 Wiesbaden, Germany, increased above the threshold of 3 % and amounted to 10.225 %, i.e. 4,371,792 voting rights at this day.

9.596 % of the voting shares are held by Hermes Focus Asset Management Europe Limited. These are attributable to the BT Pension Scheme in accordance with § 22 para. 1 sent. 1 No. 7 of the WpHG.

As the majority of shares in Hermes Focus Asset Management Europe Limited is owned by BT Pension Scheme, the following notification is also necessary:

We hereby give notice, pursuant to § 21 para. 1 of the WpHG, that on 2nd August 2007 the voting interest held by BT Pension Scheme, Lloyds Chambers, 1 Portsoken Street, London E1 8HZ U. K. in Aareal Bank AG, Paulinenstrasse 15, 65189 Wiesbaden, Germany, increased above the threshold of 3 % and amounted to 10.225 %, i.e. 4,371,792 voting rights at this day. All voting rights are attributable to BT Pension Scheme in accordance with § 22 para. 1 sent. 1 no. 6 and sent. 2 of the WpHG. BT Pension Scheme is the majority shareholder of Hermes Focus Asset Management Europe Limited."

On 19 June 2007, Union Investment Privatfonds GmbH, 60329 Frankfurt, Germany, notified us according to section 21 (1) of the WpHG that, on the basis of shares held, its share of voting rights in Aareal Bank AG, Wiesbaden, Germany, ISIN: DE0005408116, WKN: 540811, fell below the threshold of 3 % of all voting rights on 19 June 2007 and now amounts to 2.91 % (corresponding to 1,244,500 voting rights).

On 23 May 2007, Union Investment Luxembourg S. A. 308, route d'Esch, L-1471 Luxembourg, Luxembourg, notified us according to section 21 (1) of the WpHG that, on the basis of shares held, its share of voting rights in Aareal Bank AG, Wiesbaden, Germany, ISIN: DE0005408116, WKN: 540811, fell below the threshold of 3 % of total voting rights on 22 May 2007 and now amounts to 1.38 % (corresponding to 588,147 voting rights).

(86) Declaration of Compliance within the meaning of section 161 of the German Stock Corporation Act (AktG)

The Management Board and the Supervisory Board issued a Declaration of Compliance as stipulated in section 161 of the AktG, and made this Declaration available to shareholders.

(87) Employees

End-of-year numbers	31 Dec 2007	31 Dec 2006
Number of employees in the banking business	1,161	1,167
Number of employees in other businesses	1,375	1,465
Total	**2,536**	**2,632**
of which: Part-time employees	359	399

The average number of Aareal Bank Group employees in 2007 is shown below:

Yearly average	1 Jan - 31 Dec 2007	1 Jan - 31 Dec 2006
Number of employees in the banking business	1,151	1,180
Number of employees in other businesses	1,395	1,532
Total	**2,546**	**2,712**
of which: Part-time employees	438	398

(88) Regulatory indicators

	31 Dec 2007	31 Dec 2006
Ratios calculated in accordance with the German Banking Act (%)		
Core capital ratio	8.0 [2]	8.3
Total capital ratio	12.3 [2]	13.5
BIS rules (%) [1]		
Core capital ratio	7.3 [2]	7.3
Total capital ratio	11.2 [2]	12.1

[1] The ratios were calculated in accordance with the definitions by the Basel Committee. No agreement regarding the determination of the ratios has been concluded with the German Federal Financial Supervisory Authority (BaFin).

[2] after confirmation of Aareal Bank AG's financial statements for 2007. The inclusion of retained earnings transferred as part of Aareal Bank AG's liable equity capital as at 31 December 2007 is subject to approval by the Annual General Meeting.

(G) EXECUTIVE BODIES OF AAREAL BANK AG

OFFICES HELD IN ACCORDANCE WITH SECTION 285 No. 10 OF THE GERMAN COMMERCIAL CODE (HGB) IN CONJUNCTION WITH SECTION 125 (1) SENTENCE 3 OF THE GERMAN STOCK CORPORATION ACT (AktG)

Membership in other statutory Supervisory Boards and similar offices held in other governing bodies

SUPERVISORY BOARD

Hans W. Reich, Chairman of the Supervisory Board

Chairman Public Sector Group, Citigroup (since 1 July 2007), Chairman Public Sector Group Europe, Middle East, Africa of Citigroup Global Markets Deutschland AG & Co. KGaA (until 30 June 2007)

Aareal Bank AG	Chairman of the Supervisory Board	
DEPFA BANK plc	Non-executive member of the Board of Directors	until 5 Oct 2007
HUK-COBURG Haftpflicht Unterstützungskasse kraftfahrender Beamter Deutschlands a. G. in Coburg	Member of the Supervisory Board	
HUK-COBURG-Holding AG	Member of the Supervisory Board	
ThyssenKrupp Steel AG	Member of the Supervisory Board	

Erwin Flieger, Deputy Chairman of the Supervisory Board

Chairman of the Management Boards of Bayerische Beamten Lebensversicherung a.G., of BBV Holding AG and Bayerische Beamten Versicherung AG (until 13 July 2007), Chairman of the Supervisory Boards of Bayerische Beamten Lebensversicherung Gruppe (since 13 July 2007)

Aareal Bank AG	Deputy Chairman of the Supervisory Board	
Bayerische Beamten Lebensversicherung a.G.	Chairman of the Management Board	until 13 July 2007
Bayerische Beamten Lebensversicherung a.G.	Chairman of the Supervisory Board	since 13 July 2007
Bayerische Beamten Versicherung AG	Chairman of the Management Board	until 13 July 2007
Bayerische Beamten Versicherung AG	Chairman of the Supervisory Board	since 13 July 2007
BBV Holding AG	Chairman of the Management Board	until 13 July 2007
BBV Holding AG	Chairman of the Supervisory Board	since 13 July 2007
BBV Krankenversicherung AG	Chairman of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH	Chairman of the Supervisory Board	
Neue Bayerische Beamten Lebensversicherung AG	Chairman of the Supervisory Board	

York-Detlef Bülow, Deputy Chairman of the Supervisory Board*

Aareal Bank AG

Aareal Bank AG	Deputy Chairman of the Supervisory Board

** Employee representative member of the Supervisory Board of Aareal Bank AG*

Christian Graf von Bassewitz

Banker (ret'd.)

Aareal Bank AG	Member of the Supervisory Board	
Bank für Sozialwirtschaft Aktiengesellschaft	Member of the Supervisory Board	
Deutscher Ring Krankenversicherungsverein a.G.	Member of the Supervisory Board	
OVB Holding AG	Member of the Supervisory Board	
Societaet CHORUS AG	Member of the Supervisory Board	

Manfred Behrens

Managing Director of Schweizerische Lebensversicherungs- und Rentenanstalt (Swiss Life), German branch office

Aareal Bank AG	Member of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	
Swiss Life Insurance Solutions AG	Chairman of the Supervisory Board	
Swiss Life Partner AG	Chairman of the Supervisory Board	until 30 Dec 2007

Tamara Birke *

Aareal Bank AG

Aareal Bank AG	Member of the Supervisory Board	
SIRWIN AG	Member 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	

Dr. Herbert Lohneiß

Chief Executive Officer of Siemens Financial Services GmbH (until 30 September 2007)
(until 31 March 2008 Employee of Siemens Financial Services GmbH)

Aareal Bank AG	Member of the Supervisory Board	
INNOVEST Finanzdienstleistungs AG	Member of the Supervisory Board	until 30 Sep 2007
Siemens Financial Services Inc. USA	Chairman of the Supervisory Board	until 30 Sep 2007
Siemens Kapitalanlagegesellschaft	Chairman of the Supervisory Board	
Siemens Project Venture GmbH	Member of the Shareholder Representatives Group	until 30 Sep 2007
UBS Real Estate Kapitalanlagegesellschaft mbH	Deputy Chairman of the Supervisory Board	

** Employee representative member of the Supervisory Board of Aareal Bank AG*

Joachim Neupel, Chairman of the Accounts and Audit Committee

Certified Accountant and Tax Advisor		
Aareal Bank AG	Member of the Supervisory Board	
IKB Immobilien Management GmbH	Chairman of the Supervisory Board	until 31 Aug 2007

Prof. Dr. Stephan Schüller

Spokesman of the General Partners of Bankhaus Lampe KG		
Aareal Bank AG	Member of the Supervisory Board	
BVT-Equity-Holding	Chairman of the Board of Directors	
BVT-Holding GmbH	Chairman of the Supervisory Board	
Choren Fuel Freiberg GmbH & Co KG,	Chairman of the Supervisory Board	
Choren Industries GmbH	Chairman of the Supervisory Board	
Condor/Optima Versicherungen AG	Deputy Chairman of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	
NANORESINS AG	Chairman of the Supervisory Board	
PONAXIS AG	Chairman of the Supervisory Board	
Universal-Investment-Gesellschaft mbH	Member of the Supervisory Board	
hanse chemie AG	Chairman of the Supervisory Board	since 5 Mar 2007

Wolf R. Thiel

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	Member of the Supervisory Board

Helmut Wagner*

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

** Employee representative member of the Supervisory Board of Aareal Bank AG*

MANAGEMENT BOARD

Dr. Wolf Schumacher, Chairman of the Management Board

Aareal Asset Management GmbH	Member of the Supervisory Board	until 28 Feb 2007
Aareal Estate AG	Deputy Chairman of the Supervisory Board	
Aareal Valuation GmbH	Chairman of the Supervisory Board	
Aareon AG	Member of the Supervisory Board	

Norbert Kickum, Member of the Management Board

Aareal Bank France S.A.	Member of the Board of Directors	
Aareal Financial Service Polska Sp.z o.o.	Member of the Supervisory Board	
Aareal Bank Asia Limited (formerly Aareal Financial Services (Singapore) Pte. Ltd.)	Member of the Board of Directors	
Aareal Bank Asia Limited (formerly Aareal Financial Services (Singapore) Pte. Ltd.)	CEO (Chairman)	
Aareal Financial Services USA, Inc.	Chairman of the Board of Directors	
Aareal Financial Service spol. s r.o.	Member of the Supervisory Board	
Aareon AG	Member of the Supervisory Board	since 3 Sep 2007
Deutsche Structured Finance GmbH	Member of the Advisory Board	

Hermann Josef Merkens, Member of the Management Board

Aareal Asset Management GmbH	Chairman of the Supervisory Board	until 28 Feb 2007
Aareal Estate AG	Chairman of the Supervisory Board	
Aareal Bank Asia Limited (formerly Aareal Financial Services (Singapore) Pte. Ltd.)	Member of the Board of Directors	
Aareal First Financial Solutions AG	Member of the Supervisory Board	
Aareal Immobilien Kapitalanlagegesellschaft mbH	Chairman of the Supervisory Board	until 28 Feb 2007
Aareal Property Services B.V.	Chairman of the Supervisory Board	
Aareal Valuation GmbH	Member of the Supervisory Board	
Aareon AG	Member of the Supervisory Board	
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Chairman of the Supervisory Board	

Deutsche Interhotel Holding GmbH & Co. KG	Member of the Council of Shareholders	
Deutsche Structured Finance GmbH	Member of the Advisory Board	
Immobilien Scout GmbH	Member of the Supervisory Board	19 Apr 2007 until 19 Nov 2007
RMS Risk Management Solutions GmbH	Member of the Supervisory Board	since 12 Dec 2007

Thomas Ortmanns, Member of the Management Board

Aareal First Financial Solutions AG	Chairman of the Supervisory Board	
Aareal Financial Services USA, Inc.	Member of the Board of Directors	since 30 Aug 2007
Aareal Bank France S.A.	Member of the Board of Directors	since 25 Jan 2008
Aareon AG	Chairman of the Supervisory Board	
Innovative Banking Solutions AG	Member of the Supervisory Board	

Christof M. Schörnig, Member of the Management Board (until 8 August 2007)

Aareal Asset Management GmbH	Member of the Supervisory Board	until 28 Feb 2007
Aareal Bank France S.A.	Member of the Board of Directors	until 8 Aug 2007
Aareal Bank Asia Limited (formerly Aareal Financial Services (Singapore) Pte. Ltd.)	Member of the Board of Directors	until 8 Aug 2007
Aareal Financial Services USA, Inc.	Member of the Board of Directors	until 8 Aug 2007
Aareal First Financial Solutions AG	Member of the Supervisory Board	until 8 Aug 2007
Aareon AG	Member of the Supervisory Board	until 8 Aug 2007
FPM Frankfurt Performance Management AG	Member of the Supervisory Board	
Mansart Conseil S.A.S.	Member of the Supervisory Board	until 8 Aug 2007

(H) OFFICES HELD BY EMPLOYEES

OF AAREAL BANK AG PURSUANT TO SECTION 340 a (4) No. 1 OF THE HGB

Dr. Bernd Bach, Bank Director		
ICAS Consulting und Anwendungssysteme AG	Member of the Supervisory Board	
Dr. Michael Beckers, Bank Director		
Aareal Financial Service Polska Sp.z o.o.	Member of the Supervisory Board	
Aareal Financial Service spol. s.r.o.	Member of the Supervisory Board	
Sven Eisenblätter		
Immobilien Scout GmbH	Member of the Supervisory Board	until 19 Nov 2007
Aareal Valuation GmbH	Member of the Supervisory Board	
Hartmut Eisermann, Bank Director		
Terrain-Aktiengesellschaft Herzogpark	Member of the Supervisory Board	until 31 Jul 2007
Dr. Christian Fahrner, Bank Director		
Innovative Banking Solutions AG	Deputy Chairman of the Supervisory Board	
Ralf Gandenberger, Bank Director		
Terrain-Aktiengesellschaft Herzogpark	Deputy Chairman of the Supervisory Board	
Deutsche Interhotel Holding GmbH & Co. KG	Member of the Council of Shareholders	
Uli Gilbert		
Terrain-Aktiengesellschaft Herzogpark	Member of the Supervisory Board	since 23 Aug 2007
Dagmar Knopek, Bank Director		
Aareal Financial Services USA, Inc.	Member of the Board of Directors	
Aareal Bank Asia Limited (vormals Aareal Financial Services (Singapore) Pte. Ltd.)	Member of the Management Board	
Dr. Stefan Lange, Bank Director		
Aareal Estate AG	Member of the Supervisory Board	
Aareal First Financial Solutions AG	Member of the Supervisory Board	since 27 Aug 2007
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Deputy Chairman of the Supervisory Board	
Immobilien Scout GmbH	Member of the Supervisory Board	until 19 Nov 2007
Terrain-Aktiengesellschaft Herzogpark	Chairman of the Supervisory Board	
Via Capital Ltd.	Non-executive Director	until 10 Feb 2007

Peter Mehta, Bank Director

Innovative Banking Solutions AG	Member of the Supervisory Board	

Dr. Peter Schaffner, Bank Director

Aareal Partecipazioni S.p.A.	Member of the Supervisory Board	until 30 Apr 2007

Markus Schmidt

Deutsche Bau- und Grundstücks-Aktiengesellschaft	Member of the Supervisory Board	
Immobilien Scout GmbH	Member of the Supervisory Board	19 Apr 2007 until 19 Nov 2007

Peter Schott, Bank Director

Via Capital Ltd. i.L.	Non-executive Director	until 10 Feb 2007

Christine Schulze Forsthövel, Bank Director

Aareal Bank France S.A.	President of the Board of Directors	
Aareal Financial Service Polska Sp.z o.o.	Member of the Supervisory Board	
Aareal Financial Service spol. s r.o.	Member of the Supervisory Board	
Aareal Partecipazioni S.p.A.	Member of the Board of Directors	until 30 Apr 2007
Mansart Conseil S.A.S.	Chairman of the Supervisory Board	

Martin Vest, Bank Director

Aareal Bank France S.A.	Member of the Board of Directors	

CAST OF COMMITTEES OF THE SUPERVISORY BOARD

Executive Committee

Mr. Reich	Chairman
Mr. Flieger	Deputy Chairman
Mr. Bülow	Deputy Chairman
Prof. Dr. Schüller	
Mr. Thiel	

Accounts and Audit Committee

Mr. Neupel	Chairman
Prof. Dr. Schüller	Deputy Chairman
Mr. Reich	
Graf von Bassewitz	
Mr. Bülow	

Credit and Market Risk Committee

Mr. Reich	Chairman
Dr. Lohneiß	Deputy Chairman
Graf von Bassewitz	
Mr. Flieger	
Mr. Neupel	
Mrs. Birke	

Committee for Urgent Decisions

Mr. Reich	Chairman
Dr. Lohneiß	
Graf von Bassewitz	
Mr. Flieger	
Mr. Neupel	

Wiesbaden, 29 February 2008

The Management Board

Dr. Wolf Schumacher   Norbert Kickum   Hermann J. Merkens   Thomas Ortmanns

(I) LIST OF SHAREHOLDINGS

SELECTED PARTICIPATING INTERESTS OF AAREAL BANK AG AS AT 31 DECEMBER 2007

The List of Shareholdings of Aareal Bank AG pursuant to Section 313 (2) of the HGB has been published in the electronic German Federal Gazette, and is available on the Internet (http://www.aareal-bank.com).

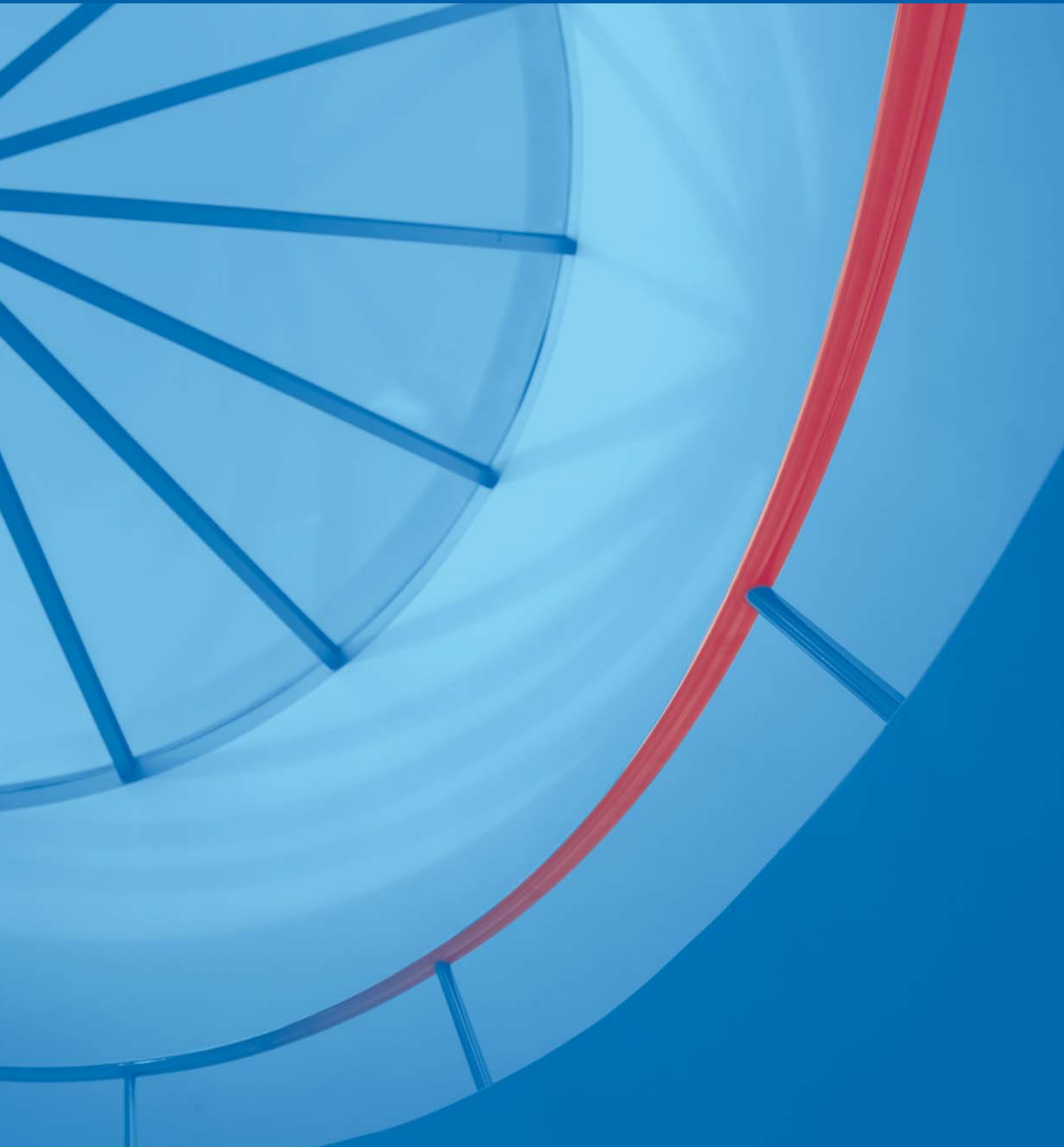
	Company name	Registered office	Interest held (% of capital)	Shareholders' equity (€ mn)	Results (€ mn)
1	Aareal Bank AG	Wiesbaden			
	I. Consolidated companies				
2	Aareal Bank Asia Limited	Singapore	100.0	3.6 mn S $	1.2 mn S $
3	Aareal Bank France S.A.	Paris	100.0	49.2	4.8
4	Aareal Estate AG	Wiesbaden	100.0	2.8	0.0 [1)5)]
5	Aareal Financial Service Polska Sp. z o.o.	Warsaw	100.0	2.2 mn PLN	0.0 mn PLN [3)]
6	Aareal-Financial Service, spol. s r.o.	Prague	100.0	29.7 mn CZK	19.9 mn CZK [3)]
7	Aareal Financial Services USA, Inc.	Wilmington	100.0	1.7 mn USD	0.3 mn USD
8	Aareal First Financial Solutions AG	Wiesbaden	100.0	3.2	0.0 [1)]
9	Aareal Valuation GmbH	Wiesbaden	100.0	0.5	0.0 [1)]
10	Aareon AG	Mainz	100.0	57.0	5.6 [5)]
11	Deutsche Bau- und Grundstücks-Aktiengesellschaft	Berlin	100.0	3.7	-0.9 [2)]
12	Deutsche Structured Finance GmbH	Frankfurt	100.0	13.0	-4.4
	II. Associated companies accounted for at equity				
13	Innovative Banking Solutions AG	Wiesbaden	49.0	1.9	0.6 [4)]

[1)] *Controlling and profit transfer agreement*
[2)] *Preliminary figures as at 31 December 2007*
[3)] *Shareholders' equity and profit / loss as at 31 December 2006*
[4)] *Financial year ending 31 March 2007*
[5)] *Indirect shareholding*

REPORT

RESPONSIBILITY STATEMENT

RESPONSIBILITY



RESPONSIBILITY STATEMENT

STATEMENT PURSUANT TO SECTION 37Y OF THE GERMAN SECURITIES TRADING ACT (WPHG) IN CONJUNCTION WITH SECTION 37W (2) NO.3 OF THE WPHG

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 management report of the group 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, 29 February 2008

The Management Board

Dr. Wolf Schumacher | Norbert Kickum | Hermann J. Merkens | Thomas Ortmanns

AUDITORS' REPORT

After the final results of our audit, we issued the following unqualified audit opinion dated 29 February 2008:

Auditors' Report

We have audited the Consolidated Financial Statements of Aareal Bank AG, Wiesbaden, comprising the Balance Sheet, Income Statement, Consolidated Statement of Changes in Shareholders' Equity, Consolidated Cash Flow Statement and Notes to the Consolidated Financial Statements for the financial year from 1 January to 31 December 2007. The preparation of the consolidated financial statements and the Group management report in accordance with the IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to section 315a (1) of the German Commercial Code (Handelsgesetzbuch – "HGB") are the responsibility of the Company's Management Board. Our responsibility is to express an opinion on the consolidated financial statements and on the Group management report, based on our audit.

We conducted our audit of the consolidated financial statements in accordance with section 317 of the German Commercial Code, observing the principles of proper auditing stipulated by the Institute of Public Auditors in Germany (IDW) as well as in accordance with the International Standards on Auditing (ISA). Those standards require that we plan and perform the audit in such a way that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements, in accordance with the applicable financial reporting framework, and in the group management report, are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group, and expectations as to possible misstatements, are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system, and the evidence supporting the disclosures in the consolidated financial statements and the Group management report, are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of the entities to be included in consolidation, the accounting policies and consolidation principles used, and significant estimates made by the Company´s Board of Managing Directors, as well as evaluating the overall presentation of the consolidated financial statements and the Group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any objections.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRS as adopted by the EU, and the additional requirements of German commercial law pursuant to section 315 a (1) of the HGB, and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The Group management report is consistent with the consolidated financial statements, gives a true and fair view of the Group's position, and suitably presents the opportunities and risks of future development.

Frankfurt / Main, 29 February 2008

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Christian Rabeling	ppa. Alexander Schack
Wirtschaftsprüfer	Wirtschaftsprüfer
(German Public Auditor)	(German Public Auditor)

CORPORATE GOVERNANCE

CORPORATE GO

CORPORATE GOVERNANCE

OF AAREAL BANK AG, WIESBADEN

Responsible corporate governance is of great importance to Aareal Bank AG, and considered the essence of prudent commercial conduct by both the Management Board and the Supervisory Board. Accordingly, Aareal Bank welcomes and supports the objectives and purposes of the German Corporate Governance Code, and regularly observes the amendments and extensions of the guidelines adopted by the German Government Commission on Corporate Governance.

Each year we review the bank's Corporate Governance Code and Memorandum and Articles of Association, as well as the internal rules of procedure for the Management Board and the Supervisory Board, regarding their compliance with the Commission's new suggestions. Our annual Declaration of Compliance gives information on the extent to which the bank complies with recommendations, and which suggestions are not being followed.

Code of Conduct

The principles of integrity and responsible conduct must be observed by all our employees across the enterprise, regardless of their functions and duties. Therefore, our internal Code of Conduct is an integral part of responsible corporate governance. We revised and extended the Code of Conduct for our staff during the 2007 financial year. The Code contains binding rules governing the legal and ethical conduct of employees vis-à-vis colleagues, clients, and business partners.

Aareal Bank's efforts in this context are also motivated by the desire to affirm and further strengthen confidence in the company.

Recommendations of the German Corporate Governance Code

The German Corporate Governance Code (the "Code"), as last amended on 14 June 2007, comprises new suggestions for responsible corporate governance, in addition to the applicable legal framework. Having reviewed the most recent amendments to the Code in detail, the bank's Management Board and Supervisory Board issued and signed their Declaration of Compliance pursuant to section 161 of the German Public Limited Companies Act (AktG) on 17 December 2007. The Declaration was published on the bank's website, and is shown after this Corporate Governance Report. In accordance with the recommendation of the Code, the Declarations of Compliance regarding the past five years are available on our website.

Aareal Bank AG complies with the German Corporate Governance Code, as last amended, to a large extent, and only diverges in a few aspects, as outlined below.

In the section on the cooperation between the Management Board and the Supervisory Board, section 3.8 of the Code recommends that a deductible be agreed where a company takes out D&O insurance cover. Aareal Bank has taken out a D&O liability insurance policy for members of the Management Board and the Supervisory Board that does not provide for a deductible. Responsible action is an integral obligation for all members of the company's executive bodies. For this reason, the members of the company's executive bodies believe that it does not require a deductible.

Item 4.2.2 in the section on the composition and remuneration of the Management Board also recommends that upon proposal by the Board, the plenary meeting of the Supervisory Board deals with the contracts for the members of the Management Board, advises on the structure of the remuneration system for the Management Board as well as reviewing it on a regular basis. In its meeting on 23 May 2006, the Supervisory Board of Aareal Bank AG passed on all issues related to the remuneration of the Management Board to the Executive Committee for independent assessment and handling. This was due to the abolishment of the separate Human Resources Committee as of this date. The procedure of delegating this duty to a committee has stood the test of time. The Executive Committee advises on a regular basis on the determination and structure of the emoluments paid to the members of the Management Board and reports to the plenary meeting of the Supervisory Board on its deliberations in this respect, and on results.

The newly-added section 5.3.3 of the Code contains a recommendation that the Supervisory Board shall form a nomination committee, composed exclusively of shareholder representatives, which proposes suitable candidates to the Supervisory Board for recommendation to the General Meeting. There is no need for Aareal Bank AG to immediately implement this recommendation, as the Supervisory Board of Aareal Bank AG in its current composition has been in office for approximately one year; therefore, there is no current need for nominating new candidates. The bank plans to conduct a review regarding market acceptance of said recommendation in 2008.

Aareal Bank AG was unable to adhere to the recommendation of the Code to elect Supervisory Board members at varied dates. The reason for this was that historically, all terms of office end on a single termination date. The recommendation could not be adhered to without breaching the principle of equal treatment of all candidates. Furthermore, grading the terms of office would represent an unnecessary increase in the bank's administrative expenditure.

The regulations laid down in item 7.1.3 in the section on accounting practises in the Code refer to the breakdown of the remuneration as of page 209.

The Management Board

The Management Board is responsible for managing the company. In doing so, it is obliged to act in the best interest of the company and undertakes to increase its sustainable enterprise value. The Management Board ensures that all provisions of law are complied with, and endeavours to achieve their compliance throughout Group companies. The Management Board develops company strategy, coordinates it with the Supervisory Board, and ensures its implementation. It ensures appropriate risk management and risk controlling throughout the company. The Management Board cooperates on the basis of trust with Aareal Bank AG's other executive bodies, and with employee representatives.

There were no conflicts of interest affecting members of the Management Board within the meaning of the Corporate Governance Code in the 2007 financial year.

Following the retirement of Christof M. Schörnig from his office as a member of the Management Board of Aareal Bank AG, Mr Schörnig's duties have been distributed amongst the remaining members of the Management Board. The Management Board believes that its remaining four members are capable of exercising the management duties previously held by Mr Schörnig in full, and with the required due care and diligence, despite the additional burden placed upon them. This Management Board resolution was passed after discussions with, and approval by the Supervisory Board.

Main components of the compensation system for members of the Management Board

The Executive Committee of the Supervisory Board determines the structure and amount of remuneration for members of the Management Board. The Committee sets fixed and variable, and any other, remuneration components for members of the Management Board. Details regarding the remuneration for members of the Management Board are provided in the Remuneration Report, which complies with all of the bank's obligations pursuant to the German Act on the Disclosure of Executive Board Remuneration (VorstOG).

The Supervisory Board

The task of the Supervisory Board is to advise regularly, and to supervise the Management Board in the management of the company. It is involved in decision-making that is of fundamental importance to the company, and cooperates closely and on the basis of trust with the Management Board.

The Supervisory Board has created committees for its work. Responsibility for individual duties has been delegated to these committees. The members of the Supervisory Board and their functions in the Supervisory Board's committees are identified in this Annual Report, after the List of Offices Held.

The Supervisory Board reports on its duties and the events of the 2007 financial year in its report on page 252 of this Annual Report. The Executive Committee prepares the plenary meetings of the Supervisory Board. The option of preparing meetings separately was neither exercised by the shareholder representatives nor by the employee representatives and is used by the Supervisory Board in exceptional cases only. No such separate preparations took place during 2007, nor were there any Supervisory Board meetings without the members of the Management Board in attendance.

In line with the recommendation of section 5.2 of the Code, the Chairman of the Supervisory Board does not chair the Accounts and Audit Committee: this position is held by Joachim Neupel, an experienced public auditor and tax advisor.

Section 5.4.2 of the Code, which forms part of the section on the composition and remuneration of the Supervisory Board, recommends that the members of the Supervisory Board do not exercise directorships or advisory tasks for important competitors of the company. The merger of DEPFA BANK plc, Dublin, with the Hypo Real Estate Group could have resulted in conflicts of interest for the Chairman of the Supervisory Board, Hans W. Reich. For this reason, Mr Reich retired from his office as a non-executive director of DEPFA BANK plc, with effect from 5 October 2007.

The members of the Supervisory Board have stated that there were no conflicts of interest (as defined in section 5.5.2 of the Corporate Governance Code) during the financial year under review.

The Supervisory Board reviews the efficiency of its own activities on a regular basis. The following considerations in particular are examined:

- Meetings (contents, duration, results)
- Information provided to the Supervisory Board by the Management Board
- Composition of the Supervisory Board
- Specific topics relevant to the committees

The results serve to further improve the work carried out by the Supervisory Board as well as enhancing the cooperation between the Supervisory Board and Management Board. The analysis showed that the Supervisory Board largely works efficiently. The Chairman of the Supervisory Board presented the results in the meeting on 17 December 2007, and discussed these with the Supervisory Board members in detail. No organisational changes to enhance efficiency were required.

The Report of the Supervisory Board on page 252 of this Annual Report provides a detailed review of the activities of the Supervisory Board and its Committees.

Remuneration system for the Supervisory Board

The remuneration structure for members of the Supervisory Board is governed by the resolution passed by the Annual General Meeting 2006. Details regarding the remuneration structure and amounts paid in 2007 are provided in the separate Remuneration Report on page 209 of this Annual Report.

Purchase or sale of the company's shares

No transactions involving the company's shares were carried out in 2007 by members of the company's executive bodies. 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.

Transactions with related parties

Related party transactions are detailed in the notes to the financial statements, on page 208 of this Annual Report.

Accounting policies

Aareal Bank AG prepares the Group's accounts in accordance with the International Financial Reporting Standards (IFRS). 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 of Aareal Bank AG and the consolidated financial statements. The external auditors submit their report on the audit of the financial statements and consolidated financial statements to the Supervisory Board. The Annual General Meeting on 30 May 2007 appointed Pricewaterhouse-Coopers Aktiengesellschaft Wirtschafts-prüfungsgesellschaft, Frankfurt / Main, as the auditors for the 2007 financial year. The Supervisory Board elected Pricewaterhouse-Coopers Aktiengesellschaft Wirtschafts-prüfungsgesellschaft, and defined the focal points of the audit. The external auditors conducted the audit in line with instructions given. The fees paid to the auditors are set out on page 156 of the notes to the financial statements.

The Supervisory Board approves the financial statements and the consolidated financial statements, and thus confirms them, provided that no objections are raised against the financial statements or the results of the audit. Details regarding the examinations carried out by the Supervisory Board, and the results of such examinations, are provided in the Report of the Supervisory Board.

Relationship to shareholders

Aareal Bank holds a General Meeting of shareholders 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 or may 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. At the Annual General Meeting, the Management Board or Supervisory Board shall comment on or answer the contributions made by shareholders.

Communication

Aareal Bank assigns great importance to extensive communications with all of the bank's stakeholders. This is also reflected in our FUTURE 2009 growth programme, where we have set ourselves the targets of actively and openly communicating with all stakeholders, taking into account the interests of all stakeholders. In this context, we make extensive use of our website to inform about current developments affecting the Group, and to provide information to all target groups at the same time.

All press releases, ad-hoc disclosures, corporate presentations, as well as annual and quarterly reports published by Aareal Bank are available on the bank's website, and may be downloaded from there. In addition, the financial calendar is regularly updated, providing information about relevant corporate events.

Aareal Bank publishes details on the financial position and performance four times annually. On these occasions, the Management Board gives a personal account of results, during press conferences and analysts' events.

We are currently not 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 the low level of acceptance of such a service amongst our shareholders would render the related technical efforts and costs excessive. Nevertheless, Aareal Bank will continue to review demand for such a service on a regular basis.

As a further step towards modern and transparent communications, the Annual General Meeting adopted an amendment to the Memorandum and Articles of Association, according to which it will be possible in future to disseminate information to holders of securities issued by Aareal Bank AG by way of electronic media.

Declaration of Compliance within the meaning of section 161 of the German Stock Corporation Act (AktG)

The Management Board and Supervisory Board of Aareal Bank AG declare, in accordance with section 161 of the AktG, that:

Aareal Bank AG has complied with the recommendations of the Government Commission "German Corporate Governance Code" (as amended on 12 June 2006 and, with effect from 14 June 2007, as amended on that date) since the last Declaration of Compliance was issued in December 2006; in each case, except for the recommendations stated below.

Item 3.8 of the Code recommends that a suitable deductible be agreed where the company takes out a D&O (directors and officers' liability insurance) policy for members of the Management Board and Supervisory Board.

Aareal Bank AG has taken out a D&O liability insurance policy for members of the Management Board and the Supervisory Board that does not provide for a deductible. Responsible action is an integral obligation for all members of Aareal Bank AG's executive bodies; for this reason it does not require a deductible.

Item 4.2.2 of the Code recommends that upon proposal by the Board, the plenary meeting of the Supervisory Board deals with with the contracts for the members of the Management Board, advises on this structure of the remuneration system for the Management Board and reviews it on a regular basis.

The Supervisory Board of Aareal Bank AG has passed on all issues related to the remuneration of the Management Board to the Executive Committee for independent assessment and handling. This procedure has stood the test of time. The Executive Committee advises on a regular basis on the determination and structure of the emoluments paid to the members of the Management Board and reports to the plenary meeting of the Supervisory Board on its deliberations in this respect.

The newly-added section 5.3.3 of the Code contains a recommendation that the Supervisory Board shall form a nomination committee, composed exclusively of shareholder representatives, which proposes suitable candidates to the Supervisory Board for recommendation to the General Meeting.

There is no need for Aareal Bank AG to immediately implement this recommendation, as the Supervisory Board of Aareal Bank AG in its current composition has been in office for approximately one year; therefore, there is no current need for nominating new candidates. The bank plans to conduct a review regarding market acceptance of said recommendation in 2008.

Aareal Bank will also comply with the recommendations of the German Corporate Governance Code (as amended on 14 June 2007) throughout the financial year 2008, with the aforementioned exceptions of sections 3.8, 4.2.2, and 5.3.3.

Aareal Bank AG has also adopted its own Corporate Governance Code as early as 1999. The bank's Code has been adapted to incorporate amendments to the German Corporate Governance Code; it goes beyond the recommendation of the Government Commission.

For further details on the Corporate Governance Principles of Aareal Bank AG, please refer to our website: http://www.aareal-bank.com/en/profile/corpgov/index.en.html.

Wiesbaden, 28 March 2008

The Management Board

Dr. Wolf Schumacher   Norbert Kickum   Hermann J. Merkens   Thomas Ortmanns

The Supervisory Board

Hans W. Reich (Chairman)

REPORT OF THE SUPERVISORY BOARD

REPORT OF THE

REPORT OF THE SUPERVISORY BOARD
OF AAREAL BANK AG, WIESBADEN

Ladies and gentlemen, dear shareholders,

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, of all issues important to the Group with regard to its situation, business development, and key financial indicators. In addition, detailed reports and explanations were given to the Supervisory Board regarding the prevailing risk situation, and on risk control and risk management measures taken. The Supervisory Board also received comprehensive reports on the development of business segments, and on operative and strategic planning. The Supervisory Board was informed about, and involved in, all important decisions. All material events were discussed and examined in detail; where required, Supervisory Board approval was given.

Between the meetings of the Supervisory Board, the Chairman of the Management Board kept me 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 myself in order to discuss key issues and important decisions personally.

Activities of the plenary meeting of the Supervisory Board

The Supervisory Board met on four scheduled occasions during the financial year under review, plus two meetings dedicated to the discussion of strategic options. Moreover, a conference call was held to discuss the enhancement of the bank's strategic options regarding its stake in Immobilien Scout GmbH.

During the scheduled meetings, the members of the Supervisory Board received reports and explanations by the members of the Management Board, and discussed these in detail. A focal point was the FUTURE 2009 growth programme: reports and extensive discussions covered the programme as well as various individual aspects and consequences. Reports on the disposal of the stake in Immobilien Scout GmbH represented a further point of attention.

As described in the Annual Report 2006, the Management Board had provided comprehensive reports on the sale of the Asset Management sub-group and other changes to the Group structure. The Management Board provided a concluding report on the preceding disposals during the first Supervisory Board meeting in 2007.

In its March meeting, the Supervisory Board concerned itself in detail with the financial statements presented for the 2006 financial year, and with the auditors' report. The relevant facts were presented in the report for the previous year.

The Management Board kept the Supervisory Board informed without delay, comprehensively and transparently, regarding the distortions on international securities markets as soon as these occurred. The Management Board provided a full account on the additional audit measures undertaken (in addition to existing comprehensive reporting) in order to gain a full image on the potential impact of the US sub-prime crisis and the resulting market distortions on Aareal Bank AG.

The comprehensive information submitted regarding the crisis affecting the US sub-prime residential mortgage market (the "sub-prime crisis") was discussed in detail during the September meeting, together with detailed explanations provided by the Management Board. This included statements by the Management Board in which it confirmed to the Supervisory Board that Aareal Bank AG has no exposure to US sub-prime loans, as it is (i) exclusively engaged in commercial property finance; and (ii) does not hold any exposures to US RMBS, CDOs, or conduit programmes. More than 90 per cent of the bank's € 625 million ABS portfolio consist of AAA-rated issues; less than € 50 million are invested in US Commercial Mortgage Backed Securities (CMBS). This investment policy is based on a conservative business policy complementing the extensive internal reporting and control mechanisms implemented.

During the same meeting, the Supervisory Board also concerned itself in detail with Mr Schörnig's retirement, and the resulting need to re-define the distribution of responsibilities amongst Management Board members. The proposed new distribution of responsibilities amongst the remaining four Management Board members was approved. The Supervisory Board believes that the distribution of responsibilities adopted will enable the Management Board to perform its duties appropriately and successfully.

Deliberations during the fourth Supervisory Board meeting, in December, focused on the company's performance, developments related to the sub-prime crisis, and on Group planning for the years 2008 to 2010. The Management Board submitted the planning and explained it in detail. Corporate governance issues were discussed as well: the Supervisory Board adopted the Declaration of Compliance, pursuant to section 161 of the AktG, for the year 2007, which was subsequently published on the bank's website. The Supervisory Board also regularly examines the efficiency of its activities in order to identify any areas requiring improvement. The examination of efficiency conducted in the 2007 financial year confirmed the previous year's good results. The results were acknowledged by the members of the Supervisory Board, and were discussed in detail. No organisational changes to enhance efficiency were required.

The Management Board regularly informed the Supervisory Board regarding the implementation of regulatory rules and regulations (including those within the Basel II framework), outlined the impact of such regulations on the bank, and discussed any changes to the regulatory framework with the Supervisory Board. The regular strategic analysis in accordance with the Minimum Requirements for Risk Management in Banks (MaRisk) was submitted and discussed.

The Chairmen of Supervisory Board committees regularly gave account of the work in the committees to the plenary meeting, answering all related questions by the plenary meeting in detail.

In addition to the four scheduled plenary meetings of the Supervisory Board, as described above, two meetings were convened exclusively to discuss the bank's strategic options. During the first of the two meetings, in January 2007, the Management Board presented the strategic options within the scope of the FUTURE 2009 growth programme to the Supervisory Board, who approved them. During the second meeting, in December, the Management Board gave an overview of market developments, and of the impact on the growth programme. This was accompanied by a presentation of the level of target achievement under the FUTURE 2009 growth programme, and a detailed discussion on its specifications for the year 2008.

No conflicts of interest of members of the Supervisory Board, as defined in No. 5.5.3 of Aareal Bank AG's Corporate Governance Code, arose during the financial year 2007. Due to the acquisition of DEPFA BANK plc by a competitor of Aareal Bank AG, my office as a member of the Board of Directors of DEPFA BANK plc might have resulted in a conflict of interest for myself. To avoid any such conflict, I did not participate in discussions, plannings, or votes related to this takeover. Furthermore, it was for this reason that I retired from office as a non-executive director of DEPFA BANK plc, with effect from 5 October 2007.

Activities of Supervisory Board committees

The Supervisory Board has established four committees in order to perform its supervisory duties in an efficient manner: the Executive Committee, the Credit and Market Risk Committee, the Committee for Urgent Decisions, and the Accounts and Audit Committee.

The Executive Committee, which advises the Management Board and prepares the resolutions of the Supervisory Board, met on four occasions. The Executive Committee's area of responsibility also includes assessing the internal condition of the Group with regard to its operative strength, efficiency and its potential for achieving set objectives. Further tasks include personnel planning and negotiating contracts with the Management Board, plus the assessment and – where necessary – approval of all issues involving loans to closely-associated persons or entities, or any other transactions to be entered into between members of the Management Board or the Supervisory Board with the company or any of its subsidiaries.

During its meetings, the Executive Committee prepared the plenary meetings of the Supervisory Board, together with proposed resolutions. In its meeting in March 2007, the Executive Committee also discussed the degree to which the Management Board had achieved set targets in the 2006 financial year, and determined the variable remuneration for the members of the Management Board on that basis. The implications of Mr Schörnig's retirement from the Management Board were discussed in detail during the meeting in September.

The Credit and Market Risk Committee convened three times. The Management Board submitted detailed reports to the committee, covering all markets in which the bank is active in the property finance business; the committee members discussed these reports and market views. The committee also dealt with the granting of loans requiring approval. The committee also noted any transactions subject to reporting requirements, and any other issues requiring the Supervisory Board's approval pursuant to the company's Memorandum and Articles of Association, or the Managing Board's internal rules of procedure. This also included the decision regarding the update of the bank's credit risk strategy, in accordance with Minimum Requirements for Risk Management in Banks (MaRisk). The committee 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 in detail, these were duly noted and approved by the members of the committee.

The Committee for Urgent Decisions is a sub-committee of the Credit and Market Risk Committee. As the Committee for Urgent decisions approves loans subject to approval requirements by way of circulation, it did not convene any meeting.

In accordance with the duties incumbent upon it pursuant to the Memorandum and Articles of Association, the Accounts and Audit Committee discussed the appointment of the external auditors, and the focal points of the audit, in the course of two meetings held during the year under review. In March 2007, the Accounts and Audit Committee received the external auditors' report on the 2006 financial year and discussed the results with the auditors. Having examined the audit reports presented and discussed these with the external auditors, the members of the committee formed their own judgement of audit results. During the autumn meeting, information was given on the progress with the audit for the 2007 financial year, and issues discussed which arose in the course of preparing the financial statements. The committee also received reports submitted by Internal Audit, and the Compliance Report, requesting and receiving detailed explanations. The updated three-year planning was also submitted and explained during the committee's autumn meeting.

In its meeting on 14 March 2008, the Accounts and Audit Committee received the external auditors' detailed report on the audit and audit results for the 2007 financial year, and extensively discussed these results with the auditors and the Management Board.

Where members of the Supervisory Board were unable to attend a meeting, they had announced their absence in advance, giving reasons. The average attendance rate at meetings of the Supervisory Board and its committees was 94 %.

Transactions of particular importance during 2007

On 21 August 2007, Aareal Bank AG signed an agreement to sell its shareholding in Immobilien Scout GmbH to a syndicate of investors led by Macquarie Bank Ltd and Publishing and Broadcasting Ltd, both based in Sydney, Australia. This transaction had been preceded by an extensive review of all investments within the framework of the realignment of Aareal Bank AG, focusing the bank on its core areas of expertise. The review had indicated that Immobilien Scout GmbH did not represent a core business of Aareal Bank AG. The Supervisory Board had been involved in this review process, with information provided by the Management Board regarding the alternative courses of action available. The Management Board had presented the planned course of action, together with the underlying rationale, in detail. The Supervisory Board had supported the plans, approving all steps necessary for implementation.

Given the complex contractual arrangements involved, the favoured alternative was to extend the bank's flexibility by acquiring the stakes held by other shareholders in Immobilien Scout GmbH. Through the acquisition of further shareholdings, Aareal Bank AG managed to significantly improve its position, thus evolving from one amongst several minority shareholders into a majority owner. The corresponding acquisitions were made upon approval by the Supervisory Board. The subsequent examination of options resulted in the decision to sell Aareal Bank AG's shareholding to the syndicate, as outlined above. Deutsche Telekom Group subsequently exercised its pre-emptive right, and an agreement was signed on this basis on 28 September 2007. The transaction was settled in full in the year 2007. Aareal Bank AG has used the proceeds from this sale to strengthen its capital base, in order to further enhance its core business.

Effective 30 July 2007, Aareal First Financial Solutions AG sold its Paco unlimited product line – an access control and automated micropayment billing system for companies managing large residential portfolios – to employees of Aareal First Financial Solutions AG, within the scope of a management buy-out. As Paco unlimited did not represent a strategic element of Aareal First Financial Solutions AG's product range, the Management Board and Supervisory Board of Aareal Bank AG were open-minded towards the concept of a management buy-out. We welcome the entrepreneurial spirit demonstrated by this venture, and wish our former staff members every success in their independent business.

Financial statements and consolidated financial statements

The Supervisory Board instructed PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt / Main, who were elected as auditors by the Annual General Meeting 2007, with the audit of the 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 Aktiengesellschaft Wirtschaftsprüfungsgesellschaft audited the financial statements prepared in accordance with the German Commercial Code (HGB) and the consolidated financial statements prepared in accordance with IFRS, the Management Report, the Group Management Report and the Report of the Supervisory Board, and certified the financial statements without qualification.

All members of the Supervisory Board received the audit reports regarding the financial statements and the consolidated financial statements, including all annexes thereto, in good time before the meeting during which the audit results were discussed, and informed themselves about the audit results on the basis of these documents. The representatives of the external auditors attended this meeting, giving a detailed account of the results of their audit and were available to answer further questions, and to provide additional information. All questions were answered to the full satisfaction of the Supervisory Board.

No objections were raised following the detailed examination of the financial statements and Management Report of Aareal Bank AG, prepared in accordance with the HGB; the consolidated financial statements prepared in accordance with IFRS; the Group Management Report; the proposal of the Management Board regarding the appropriation of profit; and of the audit report. In its meeting on 14 March 2008, the Supervisory Board approved the results of the audit. The Supervisory Board approved the financial statements and Management Report of Aareal Bank AG, prepared in accordance with the HGB, which are thus confirmed. The Supervisory Board also approved the consolidated financial statements prepared in accordance with IFRS and the Group Management Report, which are thus confirmed. Having examined and discussed it with the Management Board, the Supervisory Board has endorsed the proposal for the appropriation of profit submitted by the Management Board.

Personnel matters

The appointment of Dr Herbert Lohneiß as a member of the Supervisory Board was approved by shareholders at the Annual General Meeting held on 30 May 2007. Dr Lohneiß, who had been appointed to succeed Dr Nolting by order of the court, had agreed to also stand for election by the shareholders. The Annual General Meeting confirmed his appointment with a significant majority. To preserve the equal treatment of all members of the Supervisory Board, and to avoid additional administrative efforts, the end of Dr Lohneiß's term of office will coincide with the end of office for all other shareholder representatives who had been elected by the previous year's Annual General Meeting. The members of the Supervisory Board are delighted that Dr Lohneiß, a skilled and renowned expert in international financial markets, could be retained to join the Supervisory Board of Aareal Bank AG.

Christof M. Schörnig retired from the Management Board with effect from 8 August 2007, upon his own request. We would like to thank Mr Schörnig for his strong commitment and successful performance, and wish him every success for the future.

In conclusion, the Supervisory Board would like to thank all of the company's employees for their successful work during the 2007 financial year. In consultation with the Supervisory Board, the Management Board expressed its appreciation for the strong commitment shown by all employees in realigning the company through a special bonus paid. Without the impressive commitment and contribution of all members of staff, in a challenging situation for Aareal Bank AG, it would not have been possible to successfully conclude the realignment within a much shorter period than anticipated – which, in turn, allowed to start the FUTURE 2009 growth programme ahead of time.

Kronberg, March 2008

For the Supervisory Board

Hans W. Reich, Chairman

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FINANCIAL CALENDAR

14 May 2008	Presentation of interim report as at 31 March 2008
21 May 2008	Annual General Meeting – Kurhaus, Wiesbaden
12 August 2008	Presentation of interim report as at 30 June 2008
November 2008	Presentation of interim report as at 30 September 2008

03/2008

- *Treasury activities*
- *Countries with lending operations*
- *Real Estate Structured Finance*
- *Aareal Estate AG*
- *Aareal Valuation GmbH*
- *Institutional Housing Unit*
- *Aareal First Financial Solutions AG*
- *Aareon AG*
- *Deutsche Bau- und Grundstücks-AG*
- *Deutsche Structured Finance GmbH*

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