LOCAL EXPERTISE
MEETS GLOBAL EXCELLENCE

2008

It all adds up to experience.

Aareal Bank Group – Annual Report 2008

Aareal Bank Group

Key Group Figures

	01 Jan - 31 Dec 2008	01 Jan - 31 Dec 2007	Change	
	Euro mn	Euro mn	Euro mn	
Consolidated Income Statement				
Operating profit	117	380	-263	
Consolidated net income/loss after minority interests	60	290	-230	
Indicators				
Cost/income ratio (%) [1]	56.6	43.6		
Earnings per share (Euro)	1.41	6.77		
RoE after taxes (%)	4.5	25.0		

	31 Dec 2008	31 Dec 2007	Change	Change
	Euro mn	Euro mn	Euro mn	%
Portfolio Data				
Property finance	22,813	22,550	263	1
of which: international	18,655	16,878	1,777	11
Property finance under management [2]	23,462	23,992	-530	-2
of which: international	18,655	16,878	1,777	11
Shareholders' equity	1,429	1,627	-198	-12
Total assets	41,159	40,202	957	2
	%	%		
Regulatory Indicators				
Core capital ratio (German Banking Act/CRSA)	8.0 [3]	– [5]		
Total capital ratio (German Banking Act/CRSA)	12.0 [3]	– [5]		

	31 Dec 2008	31 Dec 2007		
Ratings				
Fitch Ratings, London				
Long-term	A -	A -		
Short-term	F2 [4]	F2		

[1] Structured Property Financing segment only

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

[3] After confirmation of Aareal Bank AG's financial statements 2008
The inclusion of retained earnings transferred as part of Aareal Bank AG's liable equity capital as at 31 December 2008 is subject to approval by the Annual General Meeting.

[4] Since 25 February 2009 "F1"

[5] The ratios were calculated for the first time in accordance with the Credit Risk Standardised Approach (CRSA) pursuant to the Solvability Ordinance as at 31 March 2008.

Group Structure

Group Structure of Aareal Bank

as at 31 December 2008

Contents

◄ Key Group Figures / Group Structure

Letter to Shareholders

Dear shareholders, business associates and Aareal Bank staff,

Aareal Bank Group has been profitable in each quarter during 2008, a year that was difficult for the entire financial sector. This underlines the viability of the bank's business model. To ensure the long-term future of our healthy business foundation, we reached agreement with the German Financial Markets Stabilisation Fund ("SoFFin") regarding a package of support measures designed to prepare the bank for the challenges ahead.

Aareal Bank Group performs well in a challenging environment

Aareal Bank Group performed well during the 2008 financial year, in a deteriorating market environment. Even though the Group could not escape the impact of the global financial markets crisis completely unscathed, it is notable that we posted a profit for each quarter since the onset of the financial markets crisis in the summer of 2007 – both at Group level and in both of our segments, Structured Property Financing and Consulting/ Services, and even for the fourth quarter of 2008, the toughest the capital markets have seen in decades.

Aareal Bank Group's sound performance is attributable to two key factors: first, the viability of its business model, built on the two strong pillars of its Structured Property Financing and Consulting/ Services segments; and second, its conservative business policy geared towards an appropriate ratio of risk and return, which has paid off during the crisis.

Aareal Bank Group posted very solid results for the 2008 financial year, in spite of the severe turmoil on financial markets and the serious economic slowdown. Profit before taxes amounted to € 117 million – adjusted for non-recurring effects, this almost matched the strong result posted for the previous year. A profit before taxes of € 11 million was achieved in the fourth quarter of 2008. We consider this result as a great success. Our sincere thanks go to our clients, for the trust they have placed in us, and to all our members of staff, for their extraordinary commitment shown throughout the past year, without which this result would not have been possible.

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

SoFFin support: Aareal Bank prepares for the future

To ensure the long-term future of our highly profitable business, we reached agreement with the German Financial Markets Stabilisation Fund ("SoFFin") regarding the key aspects of a comprehensive support package. In accordance with this agreement, SoFFin will make € 525 million in capital available to Aareal Bank, in the form of a perpetual silent participation. In addition, SoFFin will extend a guarantee facility with a total volume of up to € 4 billion to Aareal Bank for new, unsecured issues. Aareal Bank pays fair fees, both for the silent participation and the guarantee facility.

We decided to actively use the government support programme. With this agreement, Aareal Bank has prepared for any uncertainties against the background of the crisis affecting financial markets and the economy. Also, by taking advantage of the government programme, Aareal Bank will avoid being placed at a competitive disadvantage vis-à-vis any domestic and foreign banks which have already recapitalised, and which can now (with government aid) refinance themselves at lower interest rates. Taking the silent participation by SoFFin into account, we comply with the stricter capital adequacy requirements that regulators, rating agencies, and the capital markets apply to banks. At the same time, we have created a cushion to help see the bank through the difficult market phase that is expected.

The guarantee facility provided by SoFFin provides Aareal Bank with a solid base and more flexibility for refinancing, in an environment that is expected to remain difficult. Any decision as to whether or when the guarantee facility will be utilised will be made without any time pressure, and in accordance with the prevailing market conditions.

Aareal Holding will not change its current amount of shares held in Aareal Bank during the term of the silent participation. This will ensure stability of the shareholder structure and the independence of the Aareal Bank Group, with Aareal Holding as an anchor shareholder. Beyond the applicable legal provisions, SoFFin has not imposed additional conditions on the Aareal Bank Group. In particular, there will be no state influence on our corporate governance, nor will any changes be required to our proven business model built on two strong segments and a broad international diversification.

Structured Property Financing: strong rise in net interest income

In the Structured Property Financing segment, Aareal Bank continued to pursue a strict, selective new business policy that focuses on quality and return, and on financings with an attractive risk/return profile. Given the changed business environment, and recognising that the crisis affecting financial markets and the economy was deteriorating during the course of the year, we scaled back new business originated by Aareal Bank AG, from € 11.7 billion in 2007 to € 5.5 billion in the 2008 financial year. We view this volume to be appropriate in light of the difficult market situation during the year.

At € 403 million, net interest income in the Structured Property Financing segment was up by a notable 16 % compared to the previous year.

The volume of allowance for credit losses – almost unchanged from the previous year, at € 80 million – underlines the high quality of our credit portfolio. The figure comprises net allocation to allowances for specific credit losses of € 35 million, portfolio impairment allowances of € 11 million, and a further € 34 million in write-downs as additional provisioning in the current difficult market environment.

The fall in the segment result before taxes, from € 197 million to € 73 million, is primarily a result of the financial markets crisis and its impact on net trading income and results from non-trading assets which could not be offset by the sharp rise in net interest income. Moreover, 2007 results were influenced by non-recurring effects.

Consulting / Services: leading market position maintained

We further strengthened our leading market position in the Consulting / Services segment, both for our subsidiary Aareon AG and in the bank's Institutional Housing Business. Segment operating profit increased by approx. 50 % (on an adjusted basis), reaffirming the importance of Consulting / Services as a reliable, largely crisis-proof source of income for the Aareal Bank Group.

Aareon AG reported sales successes in all product lines during 2008. In the bank's Institutional Housing Business, we acquired 81 housing enterprises as new customers managing more than 110,000 residential units. The volume of deposits generated from the commercial housing sector was largely stable, despite the continuing financial markets crisis. This proves that our clients are well capable of judging the quality of our business: in any case, clients and investors alike are convinced of Aareal Bank's solidity, stability, and reliability.

Successful refinancing activities, in spite of the challenging capital markets environment

Aareal Bank Group successfully conducted the refinancing activities planned for 2008, despite the extremely challenging capital markets environment. In doing so, we successfully offset the growing restrictions in placing unsecured issues by boosting our issuance of Pfandbriefe. During the financial year under review, we also benefited from the deposits generated from the commercial housing sector: this stable and largely independent source of funding is yet another key competitive edge over those competitors that are completely dependent upon placing their refinancing issues on the capital markets.

Share price under pressure, despite solid fundamental data

In spite of solid fundamental data, the general loss of confidence in the banking sector exerted growing selling pressure on our share price – Aareal Bank's sound financial situation and its sustainable business model were almost completely ignored. As investors no longer differentiated between different banks, the Aareal Bank share price became entangled in the web of negative sector developments.

The Aareal Bank share changed from the mid-cap MDAX index to the small-cap SDAX index, with effect from 23 March 2009. The sole reason for this change, which we find very regrettable, is the bank's current market capitalisation, which is currently very low – at levels which we believe to be fundamentally unjustified.

Outlook: solid basis, ready to face challenges

The year 2009 holds significant challenges for all financial institutions. Many countries are already in recession or approaching it. The dire mood and negative outlook prevailing in numerous sectors of the economy represent a major burden for economic developments over the next 12 to 24 months. The economic decline is expected to continue throughout 2009, with any recovery in 2010 likely to be slow and gradual.

In the Structured Property Financing segment, which comprises our property finance business and our Treasury activities, we will continue to prepare for the negative influence of the distortions on capital markets and economic decline. We envisage net interest income for the current year to be burdened as a result of the lower new business generated in the Structured Property Financing segment: based on today's information, originated volumes are expected to range between € 2 billion and € 3 billion. Our main business focus will be on our existing client base, and on existing financings. Whilst the allowance for credit losses will be markedly higher than in 2008, we expect it to remain at a manageable level. Administrative expenses are expected to remain at the previous year's level, including consolidation effects. In the Consulting / Services segment, we envisage a continuation of the positive performance seen over recent years, with further earnings increases. It is not possible to give a reliable, comprehensive forecast for Group results at this time in light of the ongoing crisis affecting financial markets and the economy.

Our short-term focus is on strengthening and protecting our tried-and-tested, successful business model. Opportunities will arise on a medium to long-term horizon: for instance, we observe a re-entry of property investors with a long-term view. In the long run, this will lead to a rise in market quality and to an improvement in the risk / return ratio of the financings. We are well positioned in the credit business, as a senior lender being able to capitalise on our own sound client base. Moreover, we expect competitive pressures to abate as some competitors withdraw from the market or cut back their relevant business lines.

Aareal Bank Group is healthy, and has a coherent, viable business model. We have provided sufficient proof that we are able to overcome serious challenges such as the international financial markets crisis, and can do so using our own resources. Aareal Bank is well positioned to deal with the challenges ahead – not least thanks to the agreement with SoFFin – and has also secured a good starting point for the post-crisis period. The bank will thus remain a reliable partner for its clients, and a secure employer. We are highly confident that Aareal Bank will once again create value for its shareholders in the future.

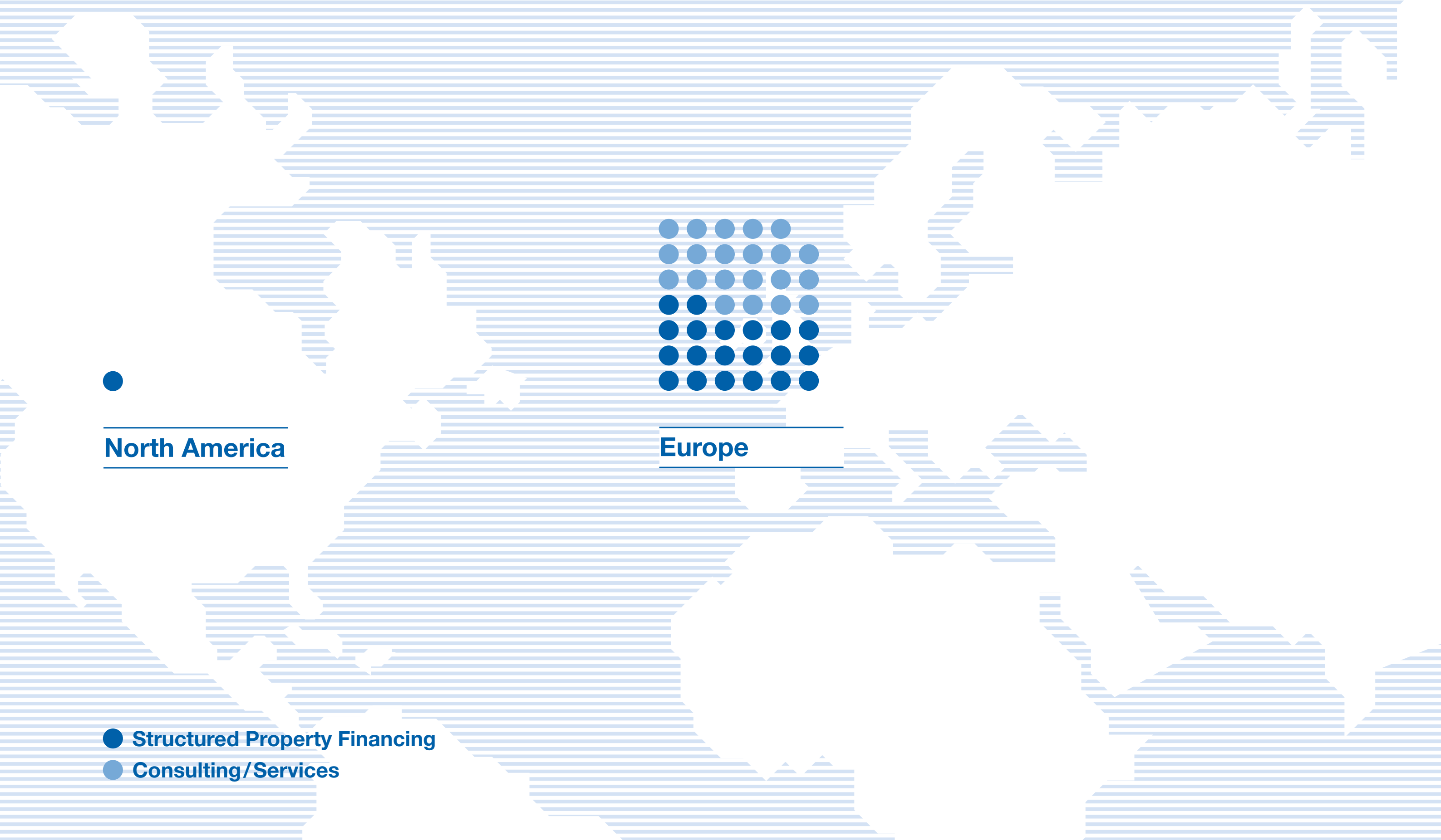
Yours sincerely

The Management Board

Dr Wolf Schumacher | Norbert Kickum | Hermann J. Merkens | Thomas Ortmanns

Profile

Aareal Bank Group – an Overview



Aareal Bank Group, headquartered in Wiesbaden, Germany, is one of the leading international specialist banks for commercial property finance and the commercial housing sector. Aareal Bank AG's shares are listed at the Frankfurt Stock Exchange.

Led by Aareal Bank AG as its parent, the Group focuses on two key business segments: the Structured Property Financing segment finances property investments in more than 25 countries on more than three continents. The Consulting/Services segment offers the institutional housing sector services and products for managing residential property portfolios and processing payment flows.

Aareal Bank Group employs people from around 40 nations. The Group's experts maintain a presence at locations in 19 countries across Europe, North America, and Asia.

Our portfolio of clients and products

The Structured Property Financing segment is at the service of national and international property investors. 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.
As well as traditional products such as mortgage loans, we also offer our clients the entire range of modern financing instruments. Our focus is senior loans secured by first-lien mortgages, where the property used as collateral generates a stable cash flow. We assign top priority 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.

Aareal Bank, Real Estate Structured Finance: Amsterdam, Berlin, Brussels, Copenhagen, Dublin, Hamburg, Helsinki, Istanbul, London, Madrid, Milan, Moscow, Munich, New York, Paris, Prague, Rome, Shanghai, Singapore, Stockholm, Warsaw, Wiesbaden, Zurich | **Aareal Valuation GmbH:** Wiesbaden | **Aareal Estate AG:** Wiesbaden

Aareal Bank, Institutional Housing Unit: Berlin, Essen, Hamburg, Leipzig, Munich, Stuttgart, Wiesbaden | **Aareon AG:** Berlin, Coventry, Dortmund, Dresden, Erfurt, Hamburg, Hannover, Hückelhoven, Leipzig, Mainz, Meudon La Foret, Munich, Oberhausen, Orléans, Rostock, Rome, Stuttgart | **Deutsche Bau- und Grundstücks-AG:** Berlin, Bonn, Moscow, Munich | **Aareal First Financial Solutions:** Wiesbaden | **Innovative Banking Solutions AG:** Wiesbaden

The key target group of the Consulting / Services segment are companies of the institutional housing sector in Germany. The client base comprises small, medium-sized and large housing enterprises, including private, cooperative, church and municipal housing companies as well as property managers and commercial property companies.

One focus is on IT support for business processes involved in property management. Furthermore, the scope of services encompasses integrated payment solutions for the commercial housing sector. Across Europe, more than 2,300 clients use systems provided by Aareal Bank Group to manage some eight million residential units, of which approx. seven million are in Germany, the Group's core market.

Our corporate history

Aareal Bank Group's history stems from two predecessors: to "Preußische Landespfandbriefanstalt", established in 1922, and to "Deutsche Wohnstättenbank AG", which was founded in 1923. Landespfandbriefanstalt emerged as one of the largest issuers of Pfandbriefe (German asset-covered bonds), focusing on long-term finance for housing construction, whilst Deutsche Wohnstättenbank subsequently developed into a data processing pioneer. Aareal Bank AG was established as a specialist provider of property finance in 2002, and was listed at the Frankfurt Stock Exchange in the same year.

Group Strategy

The Group's core areas of expertise are property finance as well as services and products for the commercial property and institutional housing sectors. This is reflected in the business model: the Structured Property Financing and Consulting / Services segments constitute the sustainable pillars of Aareal Bank Group.

Two businesses – one reliable partner

Our strategy incorporating two segments provides a major contribution to the stability of the entire Group, even during times of turbulence. The Consulting / Services segment generates a stable and continuous stream of income, and also enables Aareal Bank to tap the regular volume of deposits generated from the commercial housing sector for the purposes of refinancing. This reduces dependency on the volatile money and capital markets, creating a competitive edge.

International presence, close to the market

The Structured Property Financing segment brings together the commercial property finance and funding activities of Aareal Bank.

In the Structured Property Financing segment, we have an active presence at 23 locations on three continents: in Europe, North America, and in the Asia / Pacific region. Thus, we reduce the dependency on individual markets and regional economic fluctuation. The activities are aggregated into a network of regional sales centres (”hubs“), which we have established wherever several countries constitute an economic region, and where our clients are active throughout the respective region. We therefore concentrate our distribution activities to correlate with the business needs of our clients.

Property finance requires local expertise: depending on criteria such as building structures, usage, rental terms, tenant structure, or the neighbourhood, the valuation of each property is very specific indeed – sometimes, it may even differ according to which side of the road you are on. Experts ”on the ground“ are in the right position to properly assess the relevant factors. They know the investors and the clients, and are able to build a solid client base. In this way, the regional presence of Aareal Bank Group safeguards the bank's market proximity and flexibility, also ensuring portfolio quality.

The bank's local experts are supported by sector specialists focusing on shopping centres, hotels, and logistics properties. It is thanks to this combination of specific sector expertise and regional know-how that Aareal Bank Group is in a position to offer customised financing solutions, based on a better assessment of risks, also on account of our customers.

Aareal Bank uses various refinancing vehicles on the money and capital markets to raise the funds required for its lending business. The bank is a regular and reliable issuer of Pfandbriefe, and a member of the Association of German Pfandbrief Banks (vdp).

Well-connected solutions for the commercial housing sector

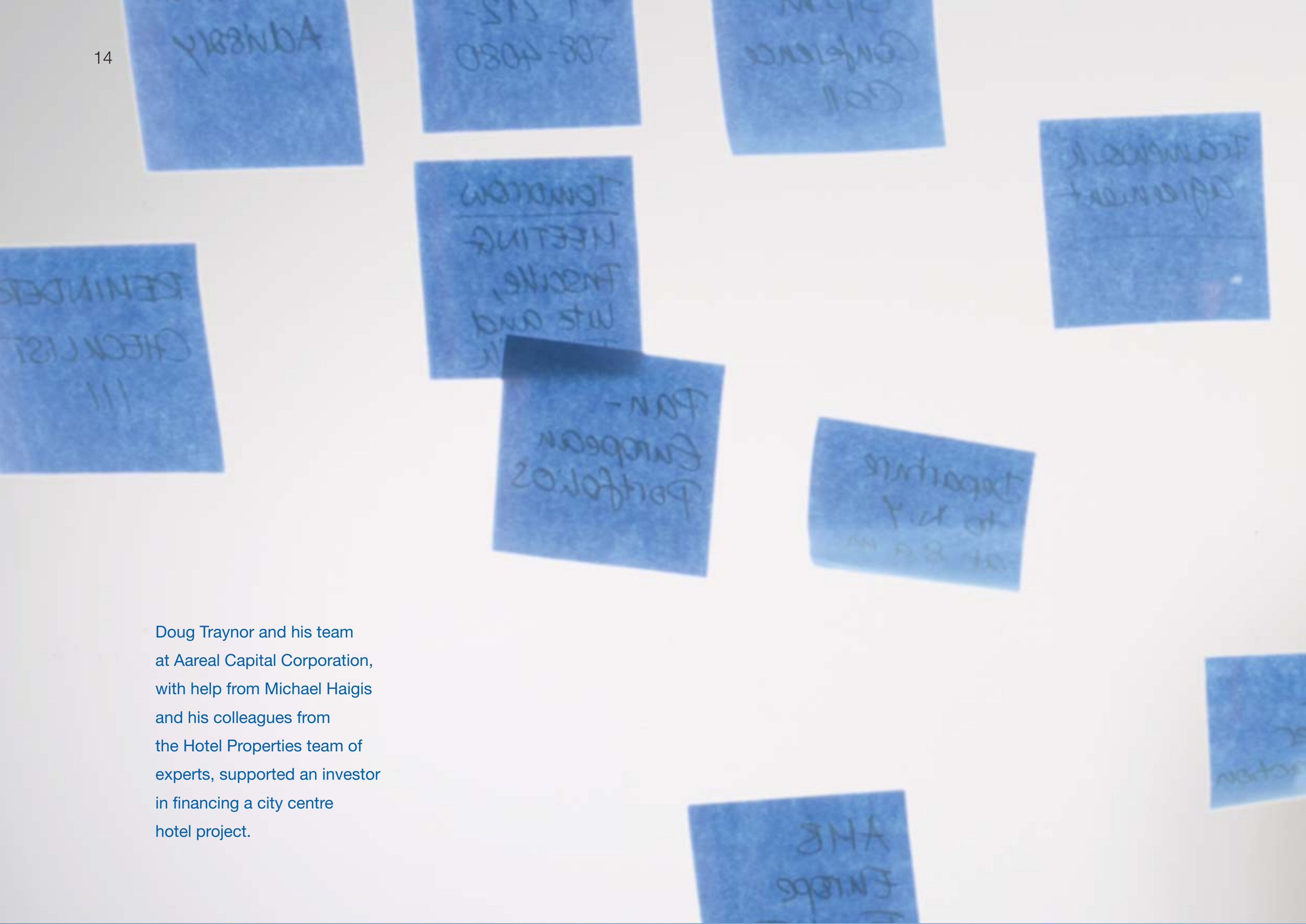
Aareal Bank Group's Consulting/Services segment is unique for a bank: it combines technical property management know-how with a range of integrated payments and advisory services to create tailor-made solutions for managing property. These solutions, in turn, create value for our clients. The segment's primary target clients are institutional housing enterprises in Germany. With an approx. 60 per cent market share, the segment enjoys an outstanding position in the commercial housing sector, making Aareal Bank the lead bank for the German institutional housing business.

Within the Group, this expertise is allocated to the bank's Institutional Housing Business and its Aareon AG subsidiary.

The bank's Institutional Housing Business provides a comprehensive range of services for managing rental income and operating costs. Clients can use a special IT platform to collect payments such as rent, ancillary costs or deposits, reconciling these payments against their internal accounts, and post them. Complex processes are thus largely automated, leading to significant savings in terms of time and cost for our clients. We use the deposits regularly generated through the payment flows processed as an integral part of our refinancing.

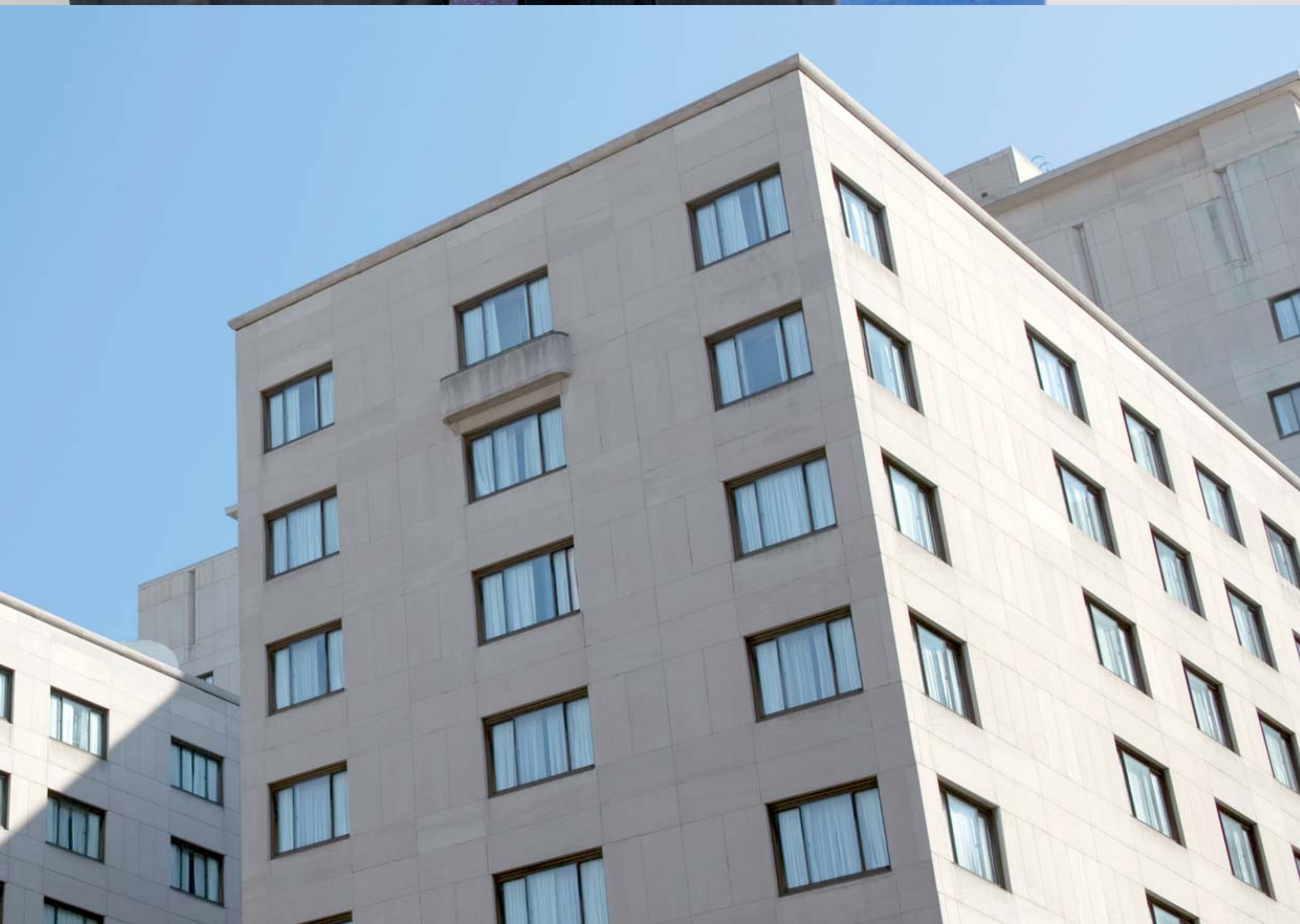
Through Aareon AG we provide IT services and products for the management, controlling and rental management of residential property portfolios. The diverse range of software products are tailored to match our clients varied systems requirements, covering the needs of small and medium-sized enterprises as well as those of large companies. For instance, the Blue Eagle software package is geared towards managing the complex data of large operations, whilst Wodis is tailored to match the according process requirements of medium-sized housing enterprises. All software solutions comply with the increasingly complex legal framework, for example, for the delivery of ancillary cost accounting to tenants. Aareon's services provide sustainable support for the operative business of property companies.

The businesses of the Group's two segments also give rise to cross-selling: 80 per cent of Aareon's clients use Aareal Bank's payments processes.



Doug Traynor and his team at Aareal Capital Corporation, with help from Michael Haigis and his colleagues from the Hotel Properties team of experts, supported an investor in financing a city centre hotel project.

The financing of **hotel projects** requires a particular degree of **quality management:** Aareal Bank Group's sector expertise and detailed **knowledge** of the local market, business and legal framework, in conjunction with the investor's **long-standing experience** paved the way for a swift closing of the transaction.



Experts from the Logistics Properties team, led by Priscille Schlosser joined forces with Lutz Brandenburg and Frederick Schönig and their Credit Management colleagues to coordinate the financing of a cross-border project.

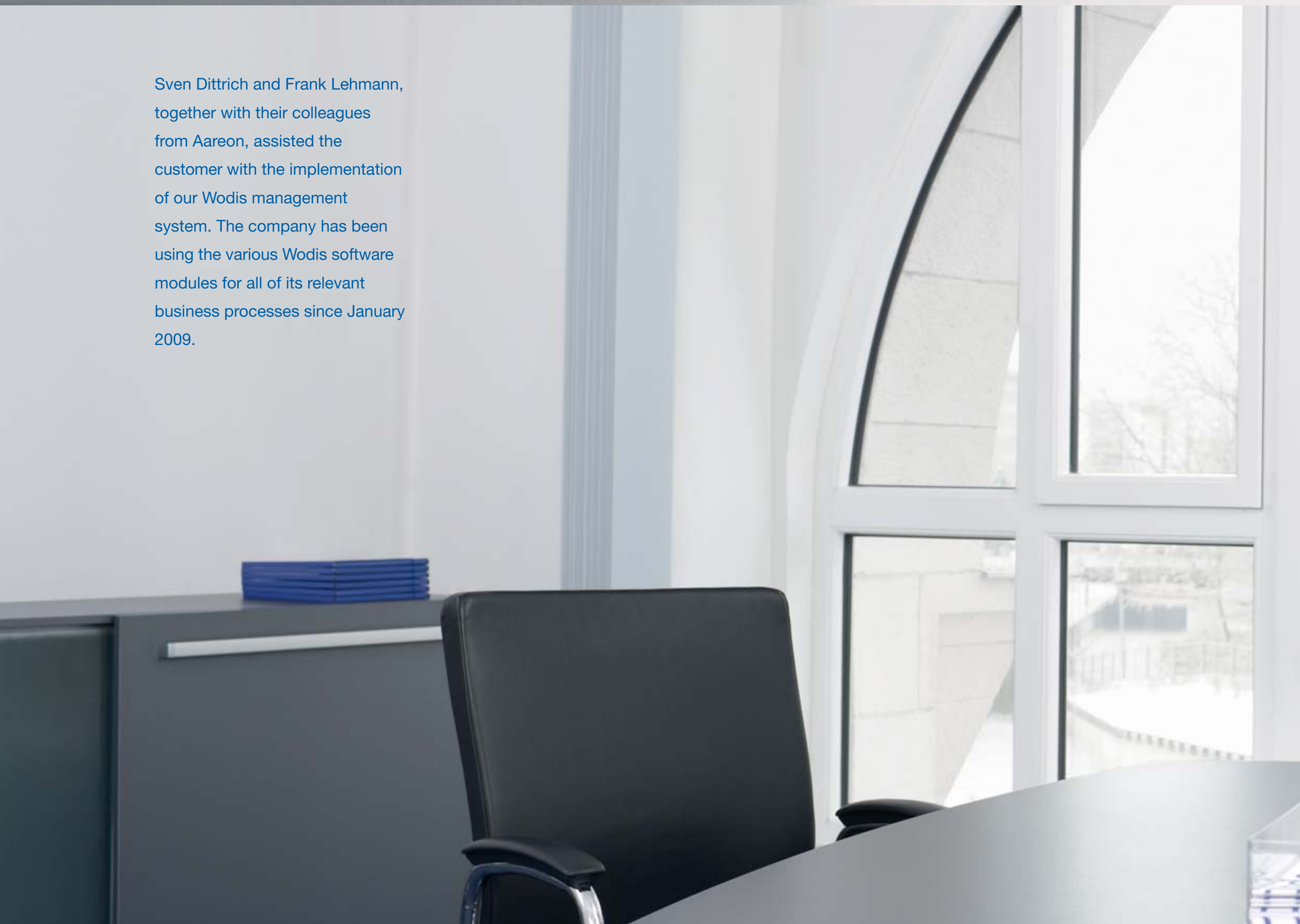
The key challenge in structuring a cross-border financing package for **various logistics centres in three countries** was to take into account the local **lending specifics.** We solved this issue together with the client by drafting a **framework agreement** which permitted efficient documentation for each **individual financing,** whilst remaining under a uniform documentation package.


3
2
1

A team led by Paul Stone from our London branch, supported by Julia Fichtner and her colleagues at Wiesbaden-based Credit Management supported this long-standing client with financing for the acquisition of this unique retail asset.

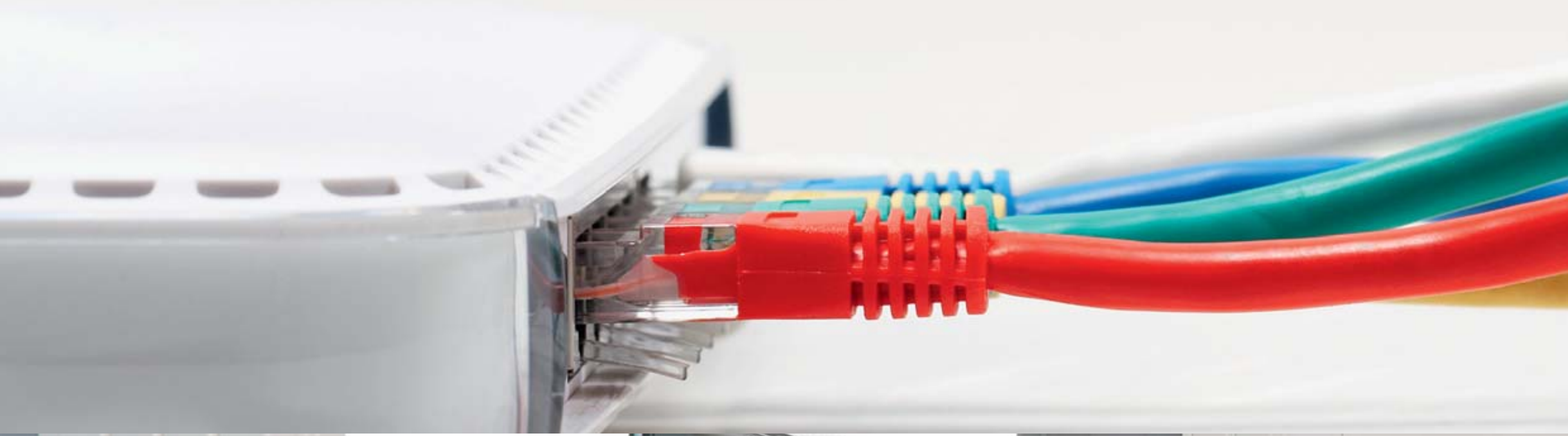
Thanks to the **long-standing relationship** with the investor, we knew that they would ensure the smooth management of this **retail asset** with its variety of tenants. What makes this property unique is the variety of high-quality shops, combined with the **special atmosphere** of a historic building – this attractive blend supported our decision to go ahead with the financing.

Our client was looking for a new software package to map his business processes. Our Wodis product offer convinced him thanks to its **strong analytical functions** and long track record, established with numerous large customers. On top of this, we brought over **five decades of experience** as a software house to the table. The fully-developed product, supported by a comprehensive services and training offer and our **local expertise** ensured that the conversion went without a hitch.



Sven Dittrich and Frank Lehmann, together with their colleagues from Aareon, assisted the customer with the implementation of our Wodis management system. The company has been using the various Wodis software modules for all of its relevant business processes since January 2009.

Aareal Bank migrated the accountings of the **BK 01 system** onto a new technology platform. To convert the data inventory in our client's existing ERP systems, our colleagues at **Aareon** leveraged the Group's know-how to develop a special **migration tool.** Accounts were imported automatically straight after installation. Everything went smoothly, thanks to our close customer relationships, **experience**, and **excellent teamwork**.



Burkhard Mohr and his fellow sales experts in our Institutional Housing Business Unit joined forces with Jörg Meimerstorf and his colleagues at Aareon to assist numerous customers – including 153 users of Wodis and WohnData – in the migration of their IT systems to Aareal Bank's new SEPA-compliant BK 01 system.

In their property management business, our clients are in need of software that would cover all their banking transactions, and one that is **easy to install** and use. We used our BK 01 expertise in payments systems to customise the streamlined package **Aareal Account** to meet the client's needs. All the customer had to do was to install the software on its system, using the CD-ROM provided – taking **less than 15 minutes** from installation to the first bank transfer.

Claudia Menge and our local experts from the Institutional Housing Business team in Munich, together with Stefan Pilkowski and his team at Aareal First Financial Solutions, supported the customer with their installation of Aareal Account, the electronic banking package.

Responsibility

Employees

Aareal Bank Group relies on employees who want to take part in shaping the company's success. As specialists for specialists, our employees work on customised solutions for our clients and thus contribute to the company's success.

Aareal Bank and its subsidiaries around the world employ about 2,500 people, 800 of which are at the Wiesbaden Head Office. The bank's international orientation is apparent in its employee structure. Our international workforce is comprised of people from 40 different nations.

We promote intercultural understanding by offering language courses, opportunities to work abroad, and partnerships with internationally oriented universities. In addition, we regularly involve our managers and experts from Europe, North America and Asia in projects extending across different locations, engaging them to regularly exchange experience with us and each other.

For us, there are two aspects to expertise: international experience combined with the knowledge of one's own domestic market and industry expertise. We also welcome industry expertise beyond the financial sector. Because specialists are indispensable in the complex nature of our business operations, employees can choose one of two equal career tracks, the expert track or the management track.

Aareal Bank is mid-sized in structure. Our level hierarchy and lack of bureaucracy in decision-making open up attractive opportunities to employees. And those just starting their careers have the opportunity to assume responsibility early on – working on partial projects in financing applications, for example. We lead people through new tasks step by step. More experienced co-workers are available to mentor them.

At Aareal Academy we develop our employees and management personnel. In addition, we participate in an exchange programme with internationally accredited universities such as European Business School (cf. page 78). At EBS, Aareal Bank have the opportunity to attend various continuing education courses at the Real Estate Management Institute (REMI).

The Structured Property Financing segment employs people from 40 nations. They contribute the detailed knowledge of their home markets and personal know-how to achieve the common goal of providing optimum service to our clients and their international businesses.

The experts in the Consulting / Services segment provide a comprehensive range of products and services to clients in the institutional housing sector, including the development and delivery of IT services. The expertise of our staff is a key contributory factor to our market leadership in Germany in this segment.

In-house, many employees share their knowledge with colleagues in other departments in seminars and presentations. By offering this wide range of training and professional development opportunities, we want to increase our competitive edge with qualified staff.

As a global company, employees with a high degree of international and inter-cultural expertise are particularly important to us. They are experts in the markets for their respective home countries, and are familiar with local conditions and potential.

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. 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 actions. 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.

The future of the property business rests on trust, solidity, expertise, and long-term client relationships. This is why we seek to establish permanent relationships with our employees. After all, the sum of their experience is the foundation for our future success.

It goes without saying that we comply with the laws and official regulations applicable in the jurisdictions in which we do business.

Joining forces to create value

Prof Dr Nico B. Rottke, Executive Director of the Real Estate Management Institutes (REMI) at European Business School (EBS), Wiesbaden, and Dr Wolf Schumacher, Chairman of the Management Board of Aareal Bank AG, discussed the cross-relationship of science and business in property management. EBS, a private university, is among the top three German business schools. Aareal Bank is the main sponsor of the Property Management Foundation Chair at REMI.

What is special about studying at EBS?

Rottke: The property management sector encompasses numerous disciplines, including law, taxes, economics, management, architecture, engineering, and many more. In contrast to the more general courses of study in Regensburg or Leipzig, we focus on the management aspects. Our graduates go beyond knowing a bit of everything: they have a very detailed knowledge of economic issues in the property management sector.

Prof Dr Nico B. Rottke (right), Executive Director of the Real Estate Management Institutes (REMI) at European Business School (EBS) with Dr Wolf Schumacher (left), Chairman of the Management Board of Aareal Bank AG, in a discussion.

"Expertise is the strongest advantage in international competition."

Real Estate Management Institute (REMI), European Business School (EBS)

International University Schloss Reichartshausen, Wiesbaden / Rheingau

What are Aareal Bank's motivations for cooperating with REMI?

Schumacher: REMI analyses the economics of the property business from a transaction perspective, focusing on investment, financing, and valuation – very much the way we do. Essentially, the course of study maps the value chain covering the property lifecycle: purchase, management, sale. This is coherent with the issues we are dealing with. This is why REMI's approach matches our own strategy, which has been a decisive factor for entering into a cooperation.

Why do you consider this cooperation important? After all, many companies are in fact reducing their commitment to society during this crisis.

Schumacher: The active exchange with science ensures that we are always in step with the latest economic research – and one major step ahead of our competitors. This is a key advantage for our clients as well as for our staff. As forward-looking property finance specialists, we must retain our ability to be innovative and flexible. More than ever, the transfer of knowledge from scientific research can support us in our quest – seeking the best solutions for the future.

What does this mean for your employees?

Schumacher: Expertise is the strongest advantage in international competition. The strongest businesses are those with the best staff. To match our own professional standards, we simply have to maintain the continuing professional development of our experts. This will also raise our profile as an attractive employer.

Rottke: And your staff are happy to make use of the opportunities for further qualification. And they do well: for example, Johann Patrick Hofmann and Sotirios Kontinakis have just completed their Real Estate Investment Management and Real Estate Investment Banking courses as the best in their year.

„The Aareal Award of Excellence in Real Estate Research recognises outstanding contributions to property management research.“

Dr Schumacher, does your commitment extend beyond Aareal Bank's immediate needs?

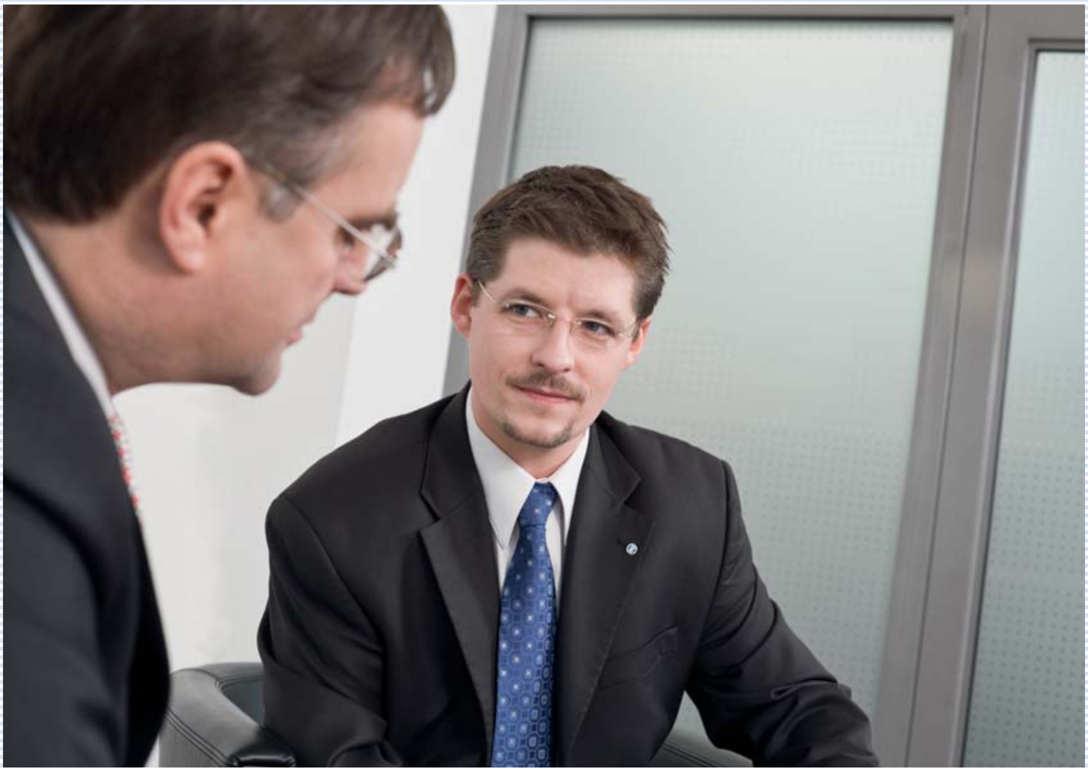
Schumacher: Yes, definitely. Our experts have evolved into top performers in the sector, thanks to a top-quality professional and personal education – which society made possible in the first place. Based on their education, these experts contribute to the success of our business. We want to fulfil our responsibility to society by returning a part of the income we generate to society, by way of sponsoring education. In addition, we thus strengthen Wiesbaden as a business location, and the region.

Professor Rottke, how do you integrate scientific research and business practice in your everyday activities?

Rottke: First of all, we integrate top performers from business in our professional development courses, as lecturers and presenters. Moreover, we cover 'real' case studies defined by our corporate partners. In other words, our students endeavour to solve the problems arising in real business. For instance, this includes feasibility studies or profitability analyses for various current business projects. Students also deal with issues brought up by our sponsors, in their studies and master thesis.

How do you promote top scientific performance, as a university?

Rottke: In cooperation with Aareal Bank, we initiated the research prize "Aareal Award of Excellence in Real Estate Research" in 2008. Recognising outstanding contributions to property management research, the award is targeted at junior researchers in particular. In this way, we hope to stimulate their enthusiasm for science. This year, they will be able to submit papers on the topics of property finance, property risk management, or environmental efficiency in property management. We tender the prize – which includes € 12,000 in prize money – but it is actually awarded by an independent jury.



Dr Wolf Schumacher and Prof Dr Nico B. Rottke discussing the cross-relationship of science and business in property management.

The property crisis in the US has led to a recession affecting many regions around the globe. What support can practitioners in the property management sector expect from scientists?

Rottke: Our current study on the financial markets crisis, which we prepared for "iddiw", the Institute of the German Property Management Sector, is a good example. From the perspective of the property management sector, the study identifies options to restructure the financial services industry which could help to restart the system. To name but a few proposals, we need equity cover requirements keeping multiple securitisations in check, modern risk management systems, and an enhanced control of rating agencies, whereby rating services must be separated from advisory services.

Schumacher: I also see opportunities in continuing professional development. There are numerous professionals with excellent know-how of the property management sector. There are also many outstanding financial professionals. But the number of professionals who are competent in both sectors is very low. To integrate both areas of expertise is one of the key tasks for scientific research in the property management sector, particularly against the background of the prevailing financial markets crisis.

How will your cooperation be shaped, going forward?

Rottke: REMI wants to make a consistent contribution to the future growth and success of the property sector, leveraging our international profile and our interdisciplinary, practical and transaction-based approach. Innovation drives education – and it is research that breeds innovation.

Schumacher: The cooperation between Aareal Bank and REMI brings together two powerful partners that are the perfect match: both in their claim of being innovative in what they do, and in their international profile. We see REMI as a valuable interface to the scientific findings in property management. We want to continue benefiting from this, not only as a bank, but as participants in the entire sector.

Transparency

Corporate Governance Report

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.

Aareal Bank AG implemented its own Corporate Governance Code in 1999. At the time, this code was established to ensure internal corporate governance standards exceeding the suggestions stipulated by the German Government Commission on Corporate Governance. Over recent years, Aareal Bank AG's code has been regularly reviewed and harmonised with the German Corporate Governance Code.

As a result of the ongoing developments and enhancements which have improved the German Corporate Governance Code, a separate, company-specific code has become largely redundant. To emphasise the importance of the German Corporate Governance Code, the Management Board and Supervisory Board of Aareal Bank AG have therefore decided to no longer maintain a company-specific Corporate Governance Code for Aareal Bank AG, to the extent that this Code is identical with the German Corporate Governance Code. The Corporate Governance principles Aareal Bank has implemented over and above the German Corporate Governance Code have been published on the bank's website.

Aareal Bank AG regularly monitors and analyses the annual amendments to the German Corporate Governance Code. The bank's Memorandum and Articles of Association, as well as the internal rules of procedure for the Management Board and the Supervisory Board, are reviewed regarding their compliance with the Government Commission's suggestions and recommendations, and amendments made as appropriate. Our annual Declaration of Compliance gives information on the extent to which the bank complies with recommendations. Once it has been adopted by the Management Board and the Supervisory Board, the Declaration of Compliance is published on the bank's website, which also includes archived Declarations of Compliance issued for previous years.

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. Our internal Code of Conduct is an integral part of responsible corporate governance. We revised the Code of Conduct for our staff during the 2008 financial year. The Code contains binding rules governing the legal and ethical conduct of employees vis-à-vis clients, business partners, and colleagues. In this way, Aareal Bank also aims to affirm and further strengthen stakeholders' confidence in the company.

Recommendations of the German Corporate Governance Code

The German Corporate Governance Code (the "Code"), as last amended on 6 June 2008, comprises new recommendations and 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 18 December 2008. The Declaration was published on the bank's website, and is shown after this Corporate Governance Report.

Aareal Bank 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 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 a company's executive bodies. For this reason, the members of the company's executive bodies believe that it does not require a deductible.

Section 4.2.3 nos. 4 and 5 recommend that severance payments for members of the Management Board be capped. The Supervisory Board of Aareal Bank AG already discussed severance payment caps in detail in the past: for instance, the contracts entered into with members of the Management already provide for capped severance payments in the event of a change of control. The newly-added recommendation regarding caps on severance payments in the event of premature termination of the term of office on the Management Board refers to new contracts to be entered into with Management Board members. The recommendation is thus currently irrelevant for Aareal Bank AG. In the event of a new contract being considered, Aareal Bank AG's Supervisory Board will review implementing the recommendation.

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. In the previous year, there was no immediate need to implement this, as at the time, the Supervisory Board of Aareal Bank AG in its current composition had been in office for only a short term. As indicated last year, Aareal Bank AG assessed and reviewed this provision and its implementation in the marketplace during the 2008 financial year. Based on the results of its review, the Supervisory Board resolved to implement the recommendation even though there is no immediate need to do so, given the ongoing term of office of the current Supervisory Board. The Chairman of the Supervisory Board coordinated the identification of candidates for the Nomination Committee, from amongst shareholder representatives, reporting to the plenary meeting of the Supervisory Board on 18 December 2008. Shareholder representatives elected the members of the Nomination Committee at this plenary meeting.

Please refer to the remuneration report on page 184 for details on incentive systems in accordance with section 7.1.3 of the Code.

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 2008 financial year.

Main components of the compensation system for members of the Management Board

The Supervisory Board determines the structure and amount of remuneration for members of the Management Board. It determines the overall structure of the compensation package; specifically, setting fixed and variable (and any other) remuneration components for members of the Management Board. Details regarding remuneration for members of the Management Board are provided in the remuneration report on page 184 of this 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 2008 financial year in its report on page 42 of this Annual Report. The Executive Committee prepares the plenary meetings of the Supervisory Board.

The option of preparing meetings separately with shareholder representatives and employee representatives is used by the Supervisory Board in exceptional cases only. No such separate preparations took place during 2008, nor were there any Supervisory Board meetings without the members of the Management Board in attendance.

In line with the recommendation of item 5.2 of the Code, the Chairman of the Supervisory Board does not chair the Accounts and Audit Committee: this position is held by Mr Neupel, who is an experienced certified auditor and tax advisor.

The members of the Supervisory Board have declared in writing that no conflicts of interest pursuant to section 5.5.2 of the Corporate Governance Code arose during the financial year under review.

The Supervisory Board reviews the efficiency of its own activities on a regular basis, where considerations are examined regarding the content, frequency and results of Supervisory Board meetings, as well as specific topics pertaining to the Supervisory Board and its 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 2008 review has not indicated any material need for improvement to the work of the Supervisory Board. The Chairman of the Supervisory Board presented the results of the examination of efficiency in the meeting on 18 December 2008, and discussed these with the members in detail. No organisational changes to enhance efficiency were required.

The Report of the Supervisory Board on page 42 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 2008 are provided in the separate Remuneration Report on page 184 of this Annual Report.

Purchase or sale of the company's shares

One transaction involving the company's shares was carried out in 2008 by members of the company's executive bodies. This was published on our website (amongst other places) in accordance with the legal provisions. 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 on page 183 of this Annual Report.

Accounting policies

Aareal Bank AG prepares the Group's accounts in accordance with 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 21 May 2008 appointed PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt / Main, as the auditors for the 2008 financial year. The Supervisory Board appointed PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, 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 136.

The Supervisory Board approves the financial statements and the consolidated financial statements, and thus confirms the financial statements. 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 internal growth programme, where we have set ourselves among other things 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 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 its financial position and results of operations four times annually. On these occasions, the Management Board gives a personal account of results, within the scope of press conferences and analysts' events.

We are not currently using 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 degree of acceptance 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.

Declaration of Compliance within the meaning of section 161 of the German Public Limited Companies 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 14 June 2007 and, with effect from 6 June 2008, as amended on that date) since the last Declaration of Compliance was issued in December 2007; in each case, except for the recommendations stated below.

Section 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 4.2.3 sections 4 and 5 of the Code recommend that severance payments be capped within the scope of the remuneration of members of the Management Board. The Supervisory Board of Aareal Bank AG already discussed severance payment caps in detail in the past: The present contracts for members of the Management Board already include for example, capped severance payments in the event of a change of control.

The newly-added recommendation regarding caps on severance payments in the event of premature termination of the term of office on the Management Board refers to new contracts to be entered into with Management Board members. The recommendation is thus currently irrelevant for Aareal Bank AG. In the event of a new contract being considered, Aareal Bank AG's Supervisory Board will review implementing the recommendation.

Aareal Bank AG will also comply with the recommendations of the German Corporate Governance Code (as amended on 6 June 2008) throughout the financial year 2009, with the aforementioned exceptions of section 3.8 and section 4.2.3 nos. 4 and 5.

For further details on the Corporate Governance Principles of Aareal Bank AG, please refer to our website: http://www.aareal-bank.com/investor-relations/corporate-governance/entsprechens-erklaerung-gemaess-161-aktg/.

Wiesbaden, December 2008

The Management Board

Dr Wolf Schumacher | Norbert Kickum | Hermann J. Merkens | Thomas Ortmanns

For the Supervisory Board

Hans W. Reich (Chairman)

Report of the Supervisory Board of Aareal Bank AG, Wiesbaden

Ladies and gentlemen, dear shareholders,

During the financial year under review, the crisis affecting international financial markets subjected the financial sector to turbulences on an unprecedented scale. To date, Aareal Bank AG successfully weathered the resulting challenges. The Supervisory Board takes this as a confirmation of the viability of Aareal Bank Group's business model.

During the difficult 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, key financial indicators, and market developments. In addition, detailed reports and explanations were given to the Supervisory Board regarding the prevailing risk situation, and on the Group's 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 a Supervisory Board resolution was required, the proposals and documentation were submitted to the Supervisory Board, and a decision taken.

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 five scheduled occasions during the financial year under review. 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. Dealing with the challenges brought about by the financial markets crisis was a focal aspect of deliberations and reporting during all meetings. Specifically, this included monitoring the prevailing developments in Aareal Bank's business and regulatory environment, and the bank's necessary response. A further key aspect of the Supervisory Board's work was the reporting on the internal growth programme, together with related discussions and the implementation of measures. Reports and extensive discussions covered the programme as well as various individual aspects and consequences. The Supervisory Board supports the Management Board in implementing the programme, which is essential for the Company's future.

The main aspects discussed during individual meetings are outlined below.

The Management Board kept the Supervisory Board informed on the developments and consequences of the crisis affecting financial markets throughout the financial year, during all meetings as well as outside meetings, in a timely, detailed and transparent manner. The Management Board gave a comprehensive and complete account of the measures taken to respond adequately to the prevailing challenges for Aareal Bank AG posed by the financial markets crisis, and its consequences for the bank.

Aareal Bank Group was not invested in US sub-prime or US RMBS securities, nor in Collateralised Debt Obligations (CDOs), Asset Backed Commercial Paper (ABCP), Structured Investment Vehicles (SIVs); it also did not hold any exposures secured by monoline insurers. Aareal Bank has not held any Icelandic exposures (including any investments with banks in Iceland). The bank's exposure to products issued by Lehman Brothers was less than € 10 million. More than 90 per cent of the bank's approx. € 590 million ABS portfolio consist of AAA-rated issues; this includes approx. € 50 million invested in US Commercial Mortgage Backed Securities (CMBS). The loans underlying these instruments have been serviced without any defaults so far, which is why the amount invested is continuously falling. The bank's conservative investment policy, supported by its comprehensive internal reporting and control mechanisms continued to pay off.

Presentations regarding the progress made in implementing the internal growth programme were given at all Supervisory Board meetings, with detailed discussions held on the achievements in 2008.

In its March meeting, the Supervisory Board concerned itself in detail with the financial statements presented for the 2007 financial year, and with the auditors' report. The relevant facts were presented in the Supervisory Board report for the previous year. The meeting discussed the proposal for election of the external auditors to be submitted to the Annual General Meeting, as well as the subsequent instruction of the auditors. This included the scope and focal points of the Supervisory Board of the audit for the 2008 financial year.

Other topics of the March meeting were preparations for the Annual General Meeting in May 2008, the annual reviews prepared by Internal Audit and by the Compliance Officer. Adequate time was also dedicated to discussing the early extension of the terms of office of the members of the Management Board, Dr Schumacher and Messrs Kickum and Ortmanns, as well as the extension of Mr Merkens' term which was up for renewal.

The Supervisory Board held two meetings during the month of May. The first of these meetings involved the detailed discussion of the bank's strategic options given the current situation on the financial markets. The second meeting, held immediately after the Annual General Meeting, focused largely on the follow-up of the Meeting, and on the current state of planning regarding the organisational realignment of sales and risk management units in the Structured Property Financing segment.

The September meeting was dedicated to discussing the basics of corporate planning for the years ahead, as well as Corporate Governance issues.

The meeting in December focused on Group planning for the years 2009 to 2011. The Management Board submitted the planning and explained it in detail. Corporate governance issues were discussed as well. The Supervisory Board approved giving up the bank's own Corporate Governance Code, in favour of the German Corporate Governance Code, and adopted the Declaration of

Compliance, pursuant to section 161 of the AktG, 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 2008 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. As in the previous year, no organisational changes to enhance efficiency were required.

In its plenary meeting in September, the Supervisory Board resolved to establish a Nomination Committee, in line with the recommendation of the German Corporate Governance Code, and on the basis of preceding discussions. Shareholder representatives discussed the composition of the Committee during the plenary meeting in December, under my direction. The members of the Committee were elected, and the Committee constituted, during the same plenary meeting. Please refer to the list of Supervisory Board Committees on page 199 of this Annual Report for details on the composition of the Committees.

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 strategic guideline 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.

Several Supervisory Board decisions were taken in writing, by way of circulation; a report on the implementation of said decisions was given in the subsequent meeting.

No conflicts of interest of members of the Supervisory Board, as defined in No. 5.5.3 of the German Corporate Governance Code, have been reported during the financial year 2008.

Activities of Supervisory Board committees

The Supervisory Board has established five committees in order to perform its supervisory duties in an efficient manner: the Executive Committee, the Credit and Market Risk Committee, the Committee for Urgent Decisions, and the Accounts and Audit Committee, as well as the Nomination Committee, which was established during the year under review.

The Executive Committee, which advises the Management Board and prepares the resolutions of the Supervisory Board, met on three occasions. The Executive Committee's area of responsibility also includes assessing the internal condition of the Group. Further tasks include personnel planning and negotiating service contracts with regard to each member of 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.

The Executive Committee prepared the plenary meetings of the Supervisory Board, together with proposed resolutions. In its meeting in March 2008, the Executive Committee also discussed the degree to which the Management Board had achieved set targets in the 2007 financial year, and determined the variable remuneration of the members of the Management Board on that basis. In the same meeting, the Executive Committee renewed the appointment of incumbent members of the Management Board, Dr Wolf Schumacher (Chairman of the Management Board), Norbert Kickum, and Thomas Ortmanns, prior to the regular expiration of their service contracts. Their appointment to the Management Board was thus extended for another five years, from 1 April 2008 to 31 March 2013. The appointment of Hermann J. Merkens was also extended; his contract was up for renewal. By extending the terms of office of said Management Board members ahead of their renewal, the Supervisory Board wanted to demonstrate that Aareal Bank's executive team is strong and well-recognised in the market. With their successful execution of a fundamental realignment of the company, they have guided the bank towards sustainable growth, on the basis of a viable strategy. In doing so, it was the Supervisory Board's objective to retain this successful management team for the long term. During the same meeting, the Executive Committee discussed the membership of the Chairman of the Management Board in an executive body outside the Group, and approved it.

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, as well as supplementary reports on property markets that have been affected by the current financial markets crisis in particular. The committee members discussed these reports and market views in detail. The committee also dealt with the granting of loans requiring approval. The committee also noted any transactions subject to reporting requirements. The Management Board presented individual exposures of material importance for the bank to the committee members, who discussed these exposures with the Management Board. Furthermore, the committee discussed 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. The committee discussed reports submitted on the bank's risk situation, which were 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. Besides credit and country risks, the committee concerned itself with market and operational risks.

The Committee for Urgent Decisions is a subcommittee 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. Any decisions taken outside scheduled meetings of the Credit and Market Risk Committee were dealt with in the subsequent meeting of the parent committee.

The Accounts and Audit Committee, which is responsible for all Group accounting and audit issues, held five meetings during the year under review. The committee is responsible for preparing and supervising the conduct of the audit of the bank's financial statements and consolidated financial statements; it prepares the Supervisory Board decisions on the basis of its analysis of the audit reports submitted by the external auditors. For this purpose, it reports on the results of its analysis, and the resulting assessments, to the Supervisory Board. Preparing the audit of the financial statements also includes the preparations for instructing the external auditors, in accordance with the resolution adopted by the Annual General Meeting, verifying the independence of the external auditors, negotiating the audit fee, and determining focal points for the audit. Additional responsibilities of the Accounts and Audit Committee include verifying the budget planning submitted by the Management Board, and receiving the report of the Group Compliance Officer.

In its meetings, in line with its duties under the bank's 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 March 2008, the Accounts and Audit Committee received the external auditors' report on the 2007 financial year and discussed the results with the auditors. Having examined the audit reports presented and discussed these with the external auditors (who gave a personal account of the audit), the members of the committee formed their own judgement of the audit results. During the autumn meeting, preliminary information was given on the progress of the audit for the 2008 financial year, and issues discussed, which arose in the course of preparing the financial statements. This also included current developments in accounting practices and their implications for Aareal Bank Group. 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 December meeting, together with an update on the audit progress.

Following the publication of amendments to the German Corporate Governance Code, the committee convened additional meetings during which the quarterly results to be published were presented to the committee members, and discussed with the Management Board.

In its meeting on 19 March 2009, the Accounts and Audit Committee received the external auditors' detailed report on the audit and audit results for the 2008 financial year, and extensively discussed these results with the auditors and the Management Board.

In its September meeting, the Supervisory Board resolved to establish a Nomination Committee, in accordance with the recommendations of the German Corporate Governance Code. As outlined above, the committee was elected during the December plenary meeting, but held no meetings in 2008. The task of the committee is to coordinate and conduct the search for new Supervisory Board members in the event of shareholder representatives retiring. Given that the incumbent Supervisory Board's current term of office is still ongoing, no activities of the committee were required.

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 above 90 %.

Transactions of particular importance during 2008

On 20 May 2008, Aareal Bank AG announced an agreement on the successful disposal of a portfolio of residential property loans totalling € 1.47 billion to Deutsche Postbank AG. The retail business no longer forms part of Aareal Bank's core business, and thus no longer is actively pursued. Shareholders gave their required approval of this transactions with a resolution passed by the Annual General Meeting on 21 May 2008. With this transaction, which was also approved by the antitrust authorities, Aareal Bank reduced its retail home loan portfolio by approx. 84%. For Aareal Bank AG, securing a sustained and comprehensive service for customers was a priority: this has been safeguarded with the sale to one of Germany's largest retail banks. Both parties to the transaction took great care to ensure that the legal details preserve customers' rights without restriction.

In September 2008, Aareon AG took over Sylogis.com AG, a French software house, acquiring 100 % of its capital effective 1 October 2008. This has allowed the bank's subsidiary to significantly strengthen its business in France, where it has been present with its Aareon France unit since 2000. Besides Aareon France, Sylogis.com is one of the leading providers of property management software: the new subsidiary is well established in the social housing, commercial housing, and corporate property market segments. The Supervisory Boards of Aareal Bank and Aareon approved this acquisition, which has turned Aareon into a leading French provider.

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 2008, 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 and the Group Management Report, and certified them 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, PriceWaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, 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 26 March 2009, 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, together with the consolidated financial statements prepared in accordance with IFRS and the Group Management Report, and thus confirmed the financial statements. 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.

In conclusion, the Supervisory Board would like to thank all of the company's employees for their successful work during the 2008 financial year. Throughout the recent months, which were characterised by fundamental upheaval on the international financial markets and indeed the entire banking sector, their commitment and motivation contributed to the successful manner in which Aareal Bank Group mastered the challenges of these exceptional times.

Kronberg, March 2009

For the Supervisory Board

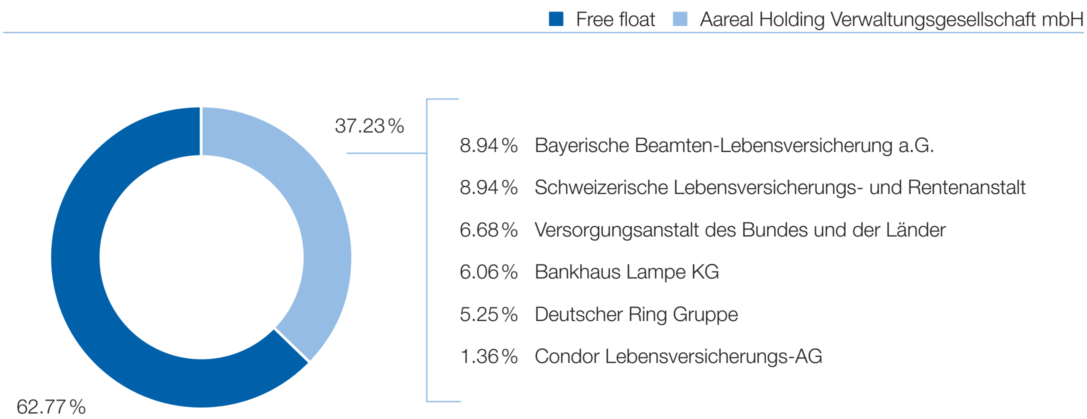
Hans W. Reich, Chairman

Aareal Bank Share

Aareal Bank's well-balanced business model, incorporating the two columns of Structured Property Financing and Consulting/Services, has proved to be sustainable – particularly in a challenging market environment. However, Aareal Bank Group's sound financial position – and its very good results for the 2008 financial year as a whole – were not accurately reflected in the performance of the Aareal Bank share. As investors no longer differentiated between different banks, the Aareal Bank share price became entangled in the web of negative sector developments.

Our share has been listed at the Frankfurt Stock Exchange since 17 June 2002. Since 1 January 2003, it has also been included in the Prime Standard segment, which requires that we comply with strict international standards of transparency. With a stake of 37.23 %, Aareal Holding Verwaltungsgesellschaft mbH is Aareal Bank's major shareholder.

Shareholder structure



Global equity market performance

The past year was both the most turbulent one since 2002, and also the one with the worst performance in equity markets. Equity prices experienced a true rollercoaster development, as developments on financial markets escalated several times and signs of economic weakness became increasingly obvious. The Dow Jones Industrial Average recorded the biggest daily losses (in index points) in its history – but also posted similarly historical daily gains. Over the course of the year, the index, lost 35.1 %, closing the year at a level of 8,668.39 points. The German equity market experienced a genuine rout. The DAX was down 40.4 % year-on-year, closing the year at 4,810.20 points. Not least as a reflection of market turbulence, the DAX index composition was changed on several occasions, and the calculation rules were amended. The MDAX mid-cap index (of which Aareal Bank was a constituent in 2008), was also down significantly, falling by 43.2 % year-on-year, to a year-end closing of 5,601.91 points.

During the first half of the year, market sentiment was dominated by soaring commodity prices, and by investor concerns about the further development of the crisis affecting financial markets. Several European banks increased their capital, with sovereign wealth funds from the Middle East and South East Asia acquiring stakes in particular. Even though crude oil prices fell again significantly during the second half of the year, reality exceeded earlier negative scenarios for the outcome of the financial markets crisis: in the banking sector, some troubled institutions needed rescue packages and had to resort to forced sales to fend off insolvency.

The financial markets crisis reached a peak on 15 September 2008 with the insolvency of Lehman Brothers, a US investment bank, which triggered dramatic losses at exchanges around the world. Due to the resulting chain reaction – which had started with the US sub-prime crisis – German financial markets also became deeply embroiled in the crisis. As refinancing terms on the money and capital markets worsened dramatically, Hypo Real Estate – formerly one of Aareal Bank's main competitors – got into trouble. It took a concerted rescue mission by the German government and several German banks to salvage the ailing property finance and public-sector finance house.

In response to the dramatic intensification of the financial markets crisis, affected governments launched rescue packages to stabilise the international financial system. In Germany, the German Financial Markets Stabilisation Act ("FMStG") was adopted by both houses of German Parliament on 17 October 2008.

Endowed with € 480 billion, the German Financial Markets Stabilisation Fund ("SoFFin") was established in this context to stabilise the German financial system, and to restore confidence amongst and between market participants.

The money markets also reflect a massive loss of trust amongst banks. Even concerted interest rate cuts and liquidity injections by central banks around the world could not prevent money markets from drying up. Towards the end of the year, the dire economic outlook added further downward pressure on global equity prices.

Performance of the Aareal Bank share

In spite of solid fundamental data, the general loss of confidence in the banking sector exerted growing selling pressure – Aareal Bank's sound financial situation and its sustainable business model were almost completely ignored. As investors no longer differentiated between different banks, the Aareal Bank share price became entangled in the web of negative sector developments. At € 5.75, the year-end share price was down 81.6 % year-on-year. This massive loss reflected the negative overall market performance. There was a significant swing of approx. € 25 from the year's high of € 30.46 on 2 January 2008 to the low of € 5.06 posted on 18 December 2008; in addition, share price volatility was extremely high. At just under € 246 million, the market capitalisation as at the balance sheet date was significantly lower than the book value of Aareal Bank Group – an example of some of the irrational market developments in the current environment.

Aareal Bank's share performance was closer to the overall sector development: the CXPB (Prime Banks Performance Index) was down 70.9 % year-on-year, closing the year at 159.94 points.

Dividends

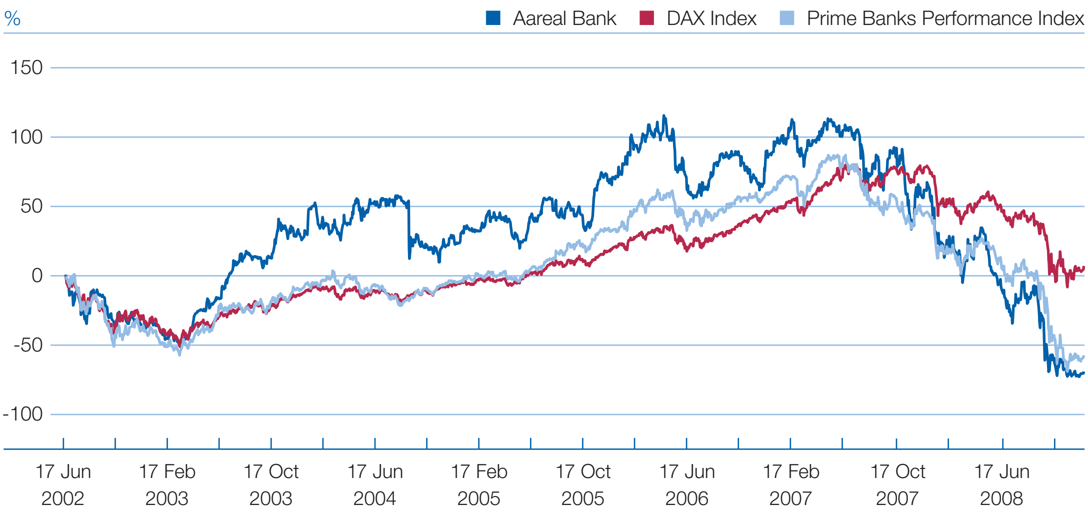
In the interests of achieving a swift redemption of the silent partnership contribution by SoFFin, Aareal Bank will not distribute any dividends for the 2008 and 2009 financial years. Any subsequent dividend distribution during the term of the silent contribution will increase the interest payable on the silent contribution by 0.5 per cent for each € 0.25 in dividends paid per share.

Analysts' opinions

More than 20 bank equity analysts regularly publish independent studies and comments on the current development of Aareal Bank Group. We have got the impression that these analysts have not identified any reason specific to the company's development for the share price losses: the primary reason cited is the current difficult market environment.

As at the balance sheet date, four analysts issued a "sell" vote for our share, and one recommended to "hold" it. The other 17 analysts rated it as a "buy". Even though price targets have been brought in line with the current market environment,

Relative performance of the Aareal Bank share price since listing



	2008	2007	2006
Key data and indicators of the Aareal Bank share			
Share price (Euro)[1]			
Year-end price	5.75	31.30	35.27
High	30.46	39.90	40.33
Low	5.06	24.93	29.15
Back value per share (Euro)	27.55	33.40	26.38
Dividend per share (Euro)[3]	–	0.50	0.50
Earnings per share (Euro)	1.41	6.77	2.49
Price/earnings[2]	4.05	4.62	14.16
Dividend yield (%)[2]	–	1.6	1.4
Market capitalisation (Euro mn)[2]	246	1,338	1,508

ISIN	DE 000 540 811 6
WKN (German Securities ID)	540 811
Quote symbols	
Deutsche Börse	ARL
Bloomberg (Xetra)	ARL GY
Reuters (Xetra)	ARL.DE
Issued share capital (number of notional no-par value bearer shares)	42,755,159

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

analysts have expressed trust in the sustainability of our business model, recognising Aareal Bank's sound position during times of uncertainty for the financial and property markets.

We regularly update recommendations by analysts in the Investor Relations portal on our website www.aareal-bank.com.

Investor Relations activities

We attach great importance to an open dialogue with investors and analysts. It is particularly the challenging market environment that has especially strengthened our ambition to keep capital markets participants informed about current company developments, in a transparent and timely manner. That is why we intensified our capital markets communications even further during 2008: during the period under review, the Investor Relations team attended nine international capital markets conferences and held more than 20 roadshows worldwide, with the Chairman of the Management Board in attendance at some events. More than 250 individual discussions were held with investors and analysts. Investors very much appreciated the availability of top management for personal discussions during difficult times. The annual press conference to present the financial statements and the analysts' conference, were held in Frankfurt/Main, on 28 March 2008. At this event, the Management Board presented the previous year's results and the strategic objectives for 2008.
In addition, the bank's quarterly reports were discussed in regular conference calls.

Intensive communications with private shareholders also played a key role in Investor Relations during the financial year under review. Private shareholders who telephoned the bank were given detailed answers to their questions.

The importance of the internet in providing timely information to the capital markets has grown tremendously. Shareholders and analysts can use our website www.aareal-bank.com to obtain comprehensive information on our Structured Property Financing and Consulting / Services segments. The ad hoc and press releases, financial reports and current Investor Relations presentation can be downloaded from our Investor Relations portal. Key corporate events can be tracked using the financial calendar. Our internet presence was recently relaunched, with enhanced navigation functionality.

We will continue to pursue our capital market communications activities throughout the current year, to underscore the long-term success of Aareal Bank Group's business model, and to enhance the trust our shareholders place in us.

Group Management Report

Group Management Report

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

Business and environment

Corporate structure and business activities

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

1. Structured Property Financing

The Structured Property Financing segment brings together all the property finance and refinancing activities of Aareal Bank.

In this segment, Aareal Bank services domestic and international clients on their property projects in more than 25 countries. Its particular strength lies in its success in combining local market expertise and sector-specific know-how. In addition to local experts, the bank also has industry specialists at its disposal, to create financing packages for logistics properties, shopping centres and hotels. We can offer financing solutions tailored to meet clients' requirements in our target markets.

Aareal Bank has many years of experience in domestic and international commercial property finance. The bank is active in Europe, North America and Asia within the scope of its "three-continents strategy".

Aareal Bank is a regular and reliable 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. Despite the turbulence on financial markets, Aareal Bank continued to issue the targeted volume of asset-covered securities, albeit incurring higher costs than in the past.

Aareal Bank is a member of the Association of German Mortgage Banks (vdp).

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 subsidiary Aareon AG cooperates closely with the Institutional Housing Business.

We operate our IT systems 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 software products, support and IT services, as well as advisory and training facilities.

Aareal Bank operates automated mass payments systems for its institutional housing clients, which are integrated into their administrative processes. The settlement of payment transactions via Aareal Bank generates client deposits that also contribute to the funding mix of the entire Group.

Company management

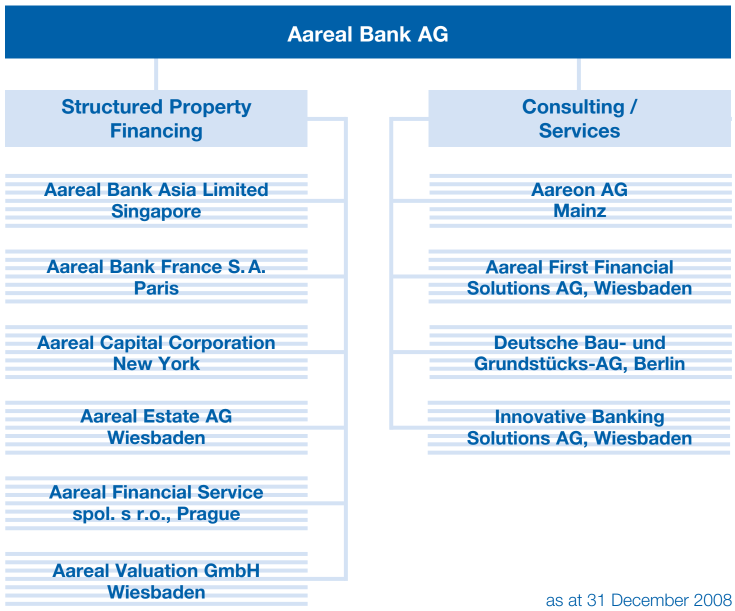
Sustained company development is at the core of Aareal Bank Group's management concept, where the standard is to create continued added value for our shareholders, for our clients, and for our staff.

Aareal Bank Group is managed on the basis of various economic indicators. Besides the economic indicators and the management of operational risks, conservative risk policy and liquidity management are the key tools of our company management.

Specific key indicators are also used for each segment. These comprise for example, risk-adjusted return on equity, the risk indicators (see Risk Report), the cost/income ratio and the lending policies for the Structured Property Financing segment. The credit standards for each country are defined by product in the lending policies.

The indicators used in the management of the Consulting/Services segment depend on the characteristics of the individual subsidiaries; these characteristics comprise mainly EBIT and EBIT margin, plus key indicators for the advisory and other IT services, such as customer satisfaction with the project work and utilisation ratios in Consulting.

Group Structure of Aareal Bank



as at 31 December 2008

Macroeconomic and industry-specific environment

Global business environment

The environment of the 2008 financial year was defined by a significant economic downturn, heightened by the crisis affecting financial markets, and which saw the recession deepening in many economic regions.

Crisis affecting financial markets

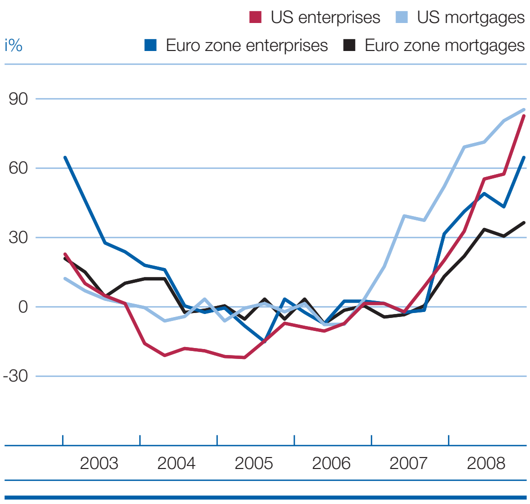
What started as a crisis associated with the so-called sub-prime loans on the American housing market gave rise to a global financial crisis in 2007, which gathered pace even further in 2008.

The crisis was triggered by distortions on the housing market in the USA. The fall in house prices that started in the second half of 2006 in the USA led to an increase in sub-prime loan defaults in the months that followed. These defaults had already spread to Europe by mid-2007, via the securitised products that had been sold worldwide.

As a consequence of this, activities on all other markets for securitised transactions – used by many banks for refinancing purposes and to provide relief for balance sheet ratios - came to a virtual standstill. A loss of confidence prevailed among the banks and investors, leading to a credit crunch on the interbank market. Risk premiums increased.

This situation intensified during 2008. The economic downturn, the credit crunch and uncertainty in relation to the risk situation led to much stricter lending criteria for corporate loans being imposed by banks in the US and the eurozone. Companies found it increasingly difficult to gain access to loans.

Change in lending standards



Source: Bank for International Settlements

The crisis heightened in September 2008 when the investment bank Lehman Brothers was forced to apply for protection against creditors owing to threatening bankruptcy. This had the effect of drying up the interbank lending market. Various central banks once again provided their affiliated banks with considerable amounts of liquidity, in order to bridge the credit crunch.

There was a general rise in the risk premiums on financial markets: lending conditions plus access to credit were hampered anew.

Having taken action to benefit individual financial institutions, the governments of the US and many European countries agreed to launch financial stability packages across the industry. The stabilisation programmes – presented as the Law on the Implementation of a Package of Measures to Stabilise the Financial Market (FMStG) in Germany – include recapitalisation of the financial institutions in question via the government, the provision of indemnities or guarantees for the liabilities of the affected banks to facilitate refinancing, plus the purchase of their assets that are in danger of default. Many European countries also reinforced their credit protection facilities.

Individual states, such as Iceland, Ukraine, Hungary or Latvia also experienced financial problems and received financial assistance from the IMF.

The crisis affecting financial markets and economic concerns impacted upon equity markets, leading to a significant fall in equity prices worldwide. The DAX had fallen by 40.2 % at year-end compared with the start of the year, while the Eurostoxx 50 was down by 44.2 % and the Dow Jones Industrial Average by 33.8 %. This situation, together with the declining prices on housing markets of the US and many other countries, such as Great Britain and Spain, contributed to the slide in asset values. Banking indices in particular were hit hard. As at year-end 2008, the Dow Jones Euro Stoxx Banks index for example, was down 63.7 % and the CXPB Prime Banks Performance index had fallen 70.9 % from the end of the previous year.

Economy

The global economic boom, which was beginning to show signs of weakness already in 2007, finally came to an end in 2008. Having enjoyed growth rates of 4.0 % in 2006 and 3.7 % in 2007, global economic growth contracted to around 2.5 % in 2008.

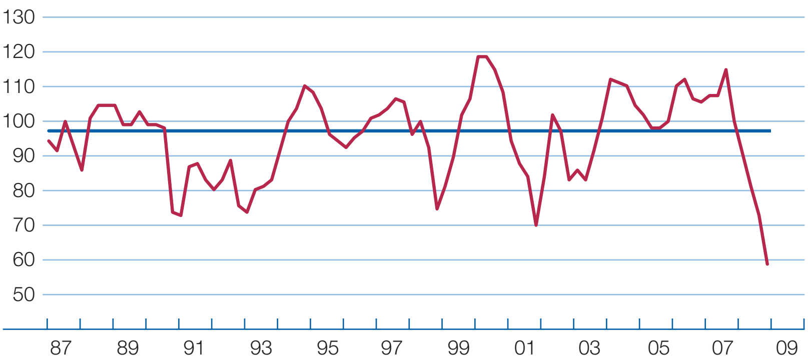
The economic downturn in Europe and North America was considerable, especially in the second half of the year. Many countries are now technically in recession, which is defined by negative

Consumer confidence in the EU

Source: European Commissions
Taken from the ECB Monthly Report, January 2009

ifo Global Economic Climate*

1995 = 100



Source: ifo World Economic Survey (WES) IV/2008.
* Arithmetic mean of assessment of current situation and expected developments

growth for at least two consecutive quarters. The downturn has recently spread to Asia as well.

In addition to the end of the cyclical economic growth phase, the crisis affecting financial markets also contributed to the global economic downturn. Real economic development is also burdened by hesitant consumption among private households and the poor sentiment in many sectors of the economy.

In the fourth quarter of 2008, many countries announced – or had already launched – economic stimulus programmes designed to support the economy, and slow down (or at best, halt) the momentum of the downturn during 2009.

Inflation, monetary policy and exchange rates

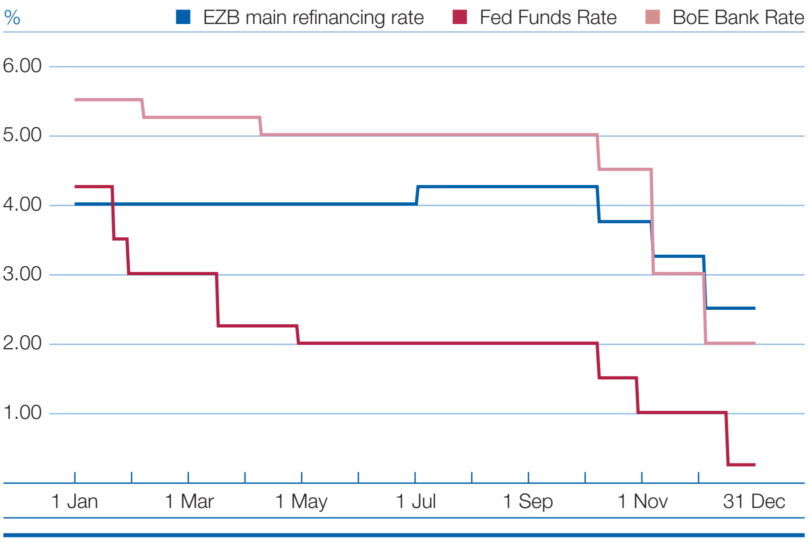
Inflation rose considerably worldwide in the first half of 2008, driven by sharp price increases on commodity markets, especially in crude oil and foodstuffs. Inflation eased initially from August/September onwards and declined more sharply towards year-end. The highly volatile price of oil was also a key factor behind this scenario.

As inflation accelerated in the first half of the year, many central banks faced the dilemma of combating inflation on the one hand and countering the economic downturn on the other. The ECB initially gave precedence to its goal of combating inflation, and on 3 July 2008 it hiked the key interest rate for the first time in over a year, by 0.25 %. However, easing inflation and the deterioration of the economic situation, together with the financial markets crisis, forced the ECB to change tack from October onwards, when it cut the base rate in three steps, down to 2.50 %.

In contrast, the American Federal Reserve Bank (Fed) and the Bank of England reacted to the threat of recession by cutting key rates several times throughout the year. The Fed cut its key interest rate from 4.25 % to a corridor of 0.00 % to 0.25 % at year-end, and the Bank of England from 5.50 % to 2.00 %.

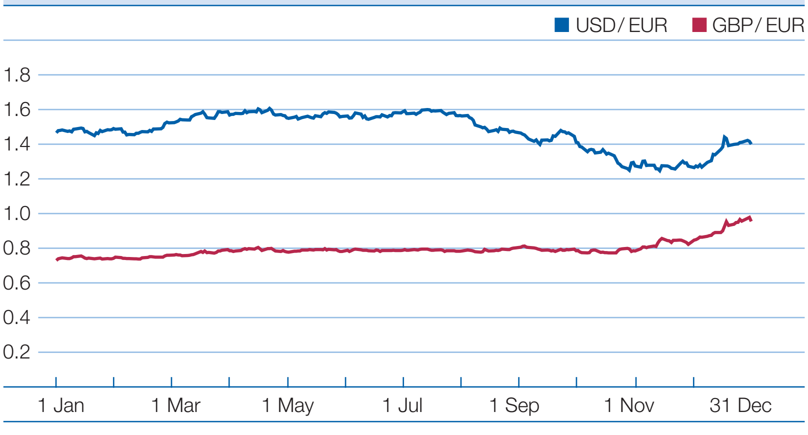
As the crisis affecting financial markets heightened, other central banks followed suit – sometimes in concerted actions – with key rate cuts. In the last two months of the year, the Russian central bank was the only one among the economically significant central banks to still hike key interest rates.

Key interest rates 2008



Sources: ECB, Federal Reserve, Bank of England

Exchange rates 2008



Source: Bloomberg

Apart from interest rate policy, the key role of the central banks in 2008 was to furnish the commercial banks with liquidity. When the interbank market came to a standstill, the ECB announced it would conduct its main refinancing operations as a fixed-price auction procedure as of October 2008. The ECB also agreed to increase the frequency of the refinancing operations and extend the range of collateral accepted for these transactions. Other important central banks also opened up the provision of liquidity to the commercial banks.

The euro / USD exchange rate was highly volatile during 2008. The euro appreciated continuously against the USD up until mid-April and remained at a relatively high level until well into the month of July. The euro then entered a phase of significant depreciation until November, before reverting again into a swift appreciation of the currency. The euro made slight gains against pound sterling initially, remaining stable for a long period of time after which it appreciated considerably in the last month of the year. Towards year-end the euro reached its highest level against Pound Sterling since it was launched.

Global commercial property markets

The financial markets crisis and the economic slowdown worldwide continued to weigh on property market development in 2008. Restricted lending as a consequence of the withdrawal of liquidity from the interbank market impacted heavily on the commercial property markets.

Negative performance aside, restrictive lending also contributed considerably to the lower volume of commercial property transactions in 2008, after the record levels of the previous two years.

Insecurity among investors, uncertainty regarding economic development and divergence in the price perceptions of property buyers and sellers constituted further key reasons behind the fall in the volume of transactions. Large-volume transactions were becoming increasingly less important once the securitisation and syndication market had ground to a halt.

Price declines in 2008 drove up yields on commercial property investments almost universally in all regions, and for the different types of commercial property (office, hotel, retail and logistics property), which had been at a very low level in 2007.

Rents for commercial property came under pressure in 2008. However, top rents for top-quality property in the best locations remained stable in many markets during the year, owing to the very positive development in the first six months. Nonetheless, top rents fell in important markets, such as the market for office and logistics property in London.

Performance of key regional markets

Europe

Europe was affected by the sharp economic downturn and the recession, albeit to varying degrees in the individual countries. Inflation gathered pace initially before declining again. The rate of inflation in the eurozone – calculated on an annual basis – climbed from 3.2 % in January to a high of 4.0 % in July, after which it retreated to 1.6 % at year-end.

The volume of commercial property transactions was considerably lower in 2008 compared with the year before. Top rents remained stable on many commercial property markets. Investment returns on most European markets increased, on the back of price declines during the course of the year.

Western Europe

The economic downturn impacted heavily on Western European countries in 2008. In Germany, economic output declined from the second quarter onwards compared with the relevant previous quarters. Annual economic growth, which still measured roughly 1.3 %, was supported by the sharp increase at the start of the year. The labour market, which generally lags behind economic development, developed favourably and the number of persons on the German unemployment register fell below the 3 million mark for the first time since 1992. However, the figure rose again to 3.1 million at year-end.

The economy came under pressure in France and Switzerland too: growth in France came in at only around 0.9 % and in Switzerland at approx. 1.9 %. The Benelux countries faced a similar scenario, with lower economic growth in Belgium (approx. 1.5 %), Holland (around 2.2 %), and Luxembourg (around 2.4 %).

In addition to the crisis affecting financial markets, the United Kingdom was particularly affected by the fall in property prices. Year-on-year growth was very low, at roughly 0.8 %.

Despite the economic downturn, top rents in Germany for office premises in the five main locations of Berlin, Dusseldorf, Frankfurt, Hamburg and Munich remained stable or climbed marginally on an annual basis. The vacancy ratio for office space even fell slightly in the course of the year. The positive labour market undoubtedly had a stabilising effect here.

Office rentals in France and the Netherlands also remained relatively constant. Top rents for office properties climbed slightly in Paris and Lyon. The vacancy ratio for office space in Lyon fell slightly compared with Paris, which posted a moderate rise. Top rents for office properties in Switzerland declined in the key locations of Zurich, Basel and Geneva. The vacancy ratio for office space declined in Zurich, but rose in Basel and Geneva.

Vacancy ratios also fell during 2008 in the Netherlands' key locations for office properties: Amsterdam, Den Haag, Rotterdam and Utrecht. Top rents in the four cities remained unchanged, or rose marginally during the year. At around 2 % in 2008, the vacancy ratio for office space was very low in Luxembourg. Top rents for office properties remained constant for the year.

On the other hand, development on the markets for office properties was more negative in the United Kingdom and Belgium. Top office rents in Brussels fell in 2008, while the vacancy ratio fell slightly. London also experienced a sharp decline in the top rents paid for office properties. Vacancy ratios were also up from 4.2 % to 5.1 % in line with rental development. Top office rents posted a moderate fall in Manchester compared with slight year-on-year increases recorded in other UK cities such as Birmingham, Edinburgh, Leeds or Glasgow.

Unlike office properties, retail properties in London saw a rise in top rents for first-class properties on an annual basis. Logistics properties in London on the other hand posted a slight decline. Top rents for retail properties in most of the UK's other cities such as Manchester, Birmingham, Glasgow and Leeds, were down. The only exception was Edinburgh, where performance was constant. Top rents for logistics properties were still constant in most British cities outside the capital, apart from Manchester where top rents in fact increased on an annual basis. Top retail property rents in the key locations of France and Germany rose for the year as a whole. Top rents for logistic properties in key areas were largely unchanged. Hamburg alone posted a rise in top rents, compared with a decline in Lyon.

The logistics sector is very important in the Netherlands and Belgium. Top rents here remained stable, or rose on an annual basis. Top rents in the retail sector were also seen to be stable or rising in the region's key locations. In Switzerland, top rents for retail properties were down in Zurich, Basel and Geneva, whilst rising in Berne. Logistics properties on the other hand carry less weight on the Swiss market. They are frequently owner-occupied and are therefore not available to investors.

The deteriorating macro-economic environment also impacted on the market for hotel property. Average occupancy on the German hotel market fell in both Berlin and Munich, compared with Hamburg, where rates were virtually constant or rose slightly. Average recovery ratios per hotel room was well down year-on-year in Berlin and Munich. The ratios were up in Hamburg. Falling returns were also recorded in Paris and Amsterdam. Average occupancy ratios were also down in these cities, especially in Amsterdam. Average occupancy ratios also fell in London. However, at more than 80 %, they remained the highest in Europe. Owing to higher room rates, average return per hotel room remained quite constant in London.

Investment returns on the Western European markets increased in 2008 due to price declines across all types of commercial property. The rise in yield was particularly pronounced in UK population centres outside the capital, such as Manchester, Birmingham or Edinburgh. Relatively minor increases in returns were seen in Germany.

Southern Europe

Economic development in Southern Europe was also defined by serious economic problems in 2008. The Italian economy, which had grown only marginally in previous years, came under significant pressure in 2008 and contracted by around 0.4 %. Strong construction activity in Spain had led to high growth in recent years. However, owing to the decline in residential property prices and collapse of the construction industry, growth was considerably lower here than in 2008.

The development in rents for office properties in Southern Europe varied greatly. Office rents in Spain came under substantial pressure, with falling rents recorded in Barcelona. At the same time, the vacancy ratios for office space rose in Barcelona and Madrid. In contrast, top office rents in Milan (Italy) posted a year-on-year increase on falling vacancy ratios (from 7.2 % to 6.0 %).

The trend for top rents for retail and logistics properties in Milan was still rising on an annual basis at the end of 2008. Top rents for retail properties in Barcelona and Madrid fell slightly, but remained robust or increased slightly for logistics properties.

Investment returns on commercial property increased in Italy and Spain. As a result of price declines, the returns on office property, in particular in Barcelona and Madrid, increased from previously low levels.

Northern Europe

The decline in residential property prices also weighed upon the Danish economy, which virtually stagnated in 2008. On the other hand, positive economic growth rates (albeit easing) were recorded by Finland (approx. +2.1 %), Norway (approx. +2.7 %) and Sweden (approx. +0.8 %).

Development of top rents for office properties varied. Top rents rose in Helsinki, compared with Stockholm and Oslo, where they were already in decline. The vacancy ratios for office properties fell in Oslo and Stockholm, but rose in Helsinki. The top rents for retail properties in the Northern European capital cities were still stable or rising slightly at the end of the year. Rental levels for logistics properties on the other hand were constant in Stockholm and Oslo, but declined in Helsinki. Investment returns rose in all Northern European countries.

Central and Eastern European Countries (CEE)

The markets in the Central and Eastern European countries developed very differently. Although the growth rates in Poland (economic growth of approx. + 5.4 %) and the Czech Republic (approx. + 4.4 %) and Slovakia (approx. + 7.3 %) were considerably lower than in 2007, other countries such as Hungary are facing serious problems and have encountered significant financial difficulties. The IMF and the EU have committed financial assistance to Hungary to tackle its financial problems.

Russia benefited at the start of the year from the rise in commodity prices, which was measured by economic growth of around 6 % in the region. However, the sharp drop in commodity prices and the financial markets crisis, which also led to a credit crunch and distortions in the banking system, weighed heavily on the Russian economy in the second half of the year. Industrial production collapsed at the end of the year. At 13.5 %, the annual rate of inflation was very high.

The Baltic States are particularly affected by the economic and financial markets crisis. Economic output in Estonia and Latvia in fact shrank, following the very high growth rates of previous years. Latvia received financial assistance from the EU, the International Monetary Fund (IMF), the World Bank and various European countries, to tackle the crisis affecting financial markets.

In Turkey, economic growth contracted to around 3.3 %, after the good results of recent years.

Moscow and London command the highest office rents in Europe. However, top rents for office property in Moscow fell on an annual basis, and particularly towards year-end. The fall in rental prices was accompanied by a significant rise in the vacancy ratio (from 5.2 % to 14.3 %). Top office rents increased in Prague but fell in Warsaw. The vacancy ratio for office space in Prague rose (5.8 % to 9 %) while the already low ratio in Warsaw fell again slightly on an annual basis (3.1 % to 2.9 %).

Top rents for logistics properties in Prague and Moscow were stable. Warsaw posted a rise. While retail rents for first-class properties in Prague and Warsaw rose, Moscow suffered a sharp decline at year-end. As in many other European cities, the average vacancy ratios in the hotel sector in Prague and Warsaw – plus the average recovery ratio per hotel room – were down.

Poland, the Czech Republic and Russia each posted rising returns on the various property types. Returns in Moscow remained considerably higher than Western European levels.

Retail property in Turkey is particularly interesting for international investors. The rise in rents for Turkish retail properties in recent years has been followed by a saturation trend, especially in Istanbul. Nonetheless, rents in top-class locations rose. The lack of first-class modern office properties in the main business centre of Istanbul has driven up rents there. Rents for logistics properties in Istanbul were also up due to the continued short supply of modern logistics properties in Turkey. Rent levels for commercial property in Turkey remained considerably higher than the levels commanded in established European locations.

North America (NAFTA states)

While the US still enjoyed notable growth rates in the second quarter, due to the government's economic programme, economic output contracted as of the third quarter, mainly because of falling consumption and exports. Economic growth for the full year was only around 1.4 %. Unemployment in the USA rose sharply in the second half of the year. Inflation also climbed in the course of the year, only to decline again later.

Canada and Mexico also saw lower growth rates of around 0.5 % and 1.9 % respectively, due to shrinking exports.

The volume of commercial property transactions concluded was down significantly on the previous year in North America, especially in the United States.

The economic downturn and sharp rise in unemployment burdened demand for office space in the US, especially in the second half of the year. This resulted in a rise in the average vacancy ratio nationwide. Higher vacancy ratios led to a drop in the average top rents for office properties nationwide on an annual basis.

Financial market hubs such as Manhattan, and suburban regions, were particularly affected by the rise in vacancies. The effects of concerns about economic development and falling consumer confidence on retail properties in the US became apparent, and were reflected in pressure on rents, feeding through as falling rents. The market for logistics properties in the US is also affected by diminishing consumer confidence and falling transport volumes. Demand for rental properties was muted, resulting in higher average vacancy ratios and downside pressure on rents. The US hotel market was also adversely affected by economic development. The average occupancy ratio fell, as did the recovery ratio per hotel room.

The volume of new construction projects for commercial property fell recently and even halted in some instances, due to lack of rental interest.

Commercial property prices contracted in the course of 2008, thus leading to a rise in the investment returns.

The commercial property market in Canada was relatively robust compared with the US, with top rents for office property rising slightly in the course of the year. There was a moderate increase in the average vacancy ratio nationwide. Despite the recent rise in the vacancy ratio on the logistics market, rents remained constant. Average occupancy ratios on the Canadian hotel market declined, while the average recovery ratio per hotel room rose slightly.

The Mexican market for commercial property was also relatively robust in 2008, defined by stable rents and moderate, albeit rising, vacancy ratios for office properties.

The volume of property investments fell in Canada as well as in Mexico. Investment returns rose in both countries.

Asia / Pacific region

The Japanese economy is being severely affected by the downturn. Economic output has fallen since the second quarter of 2008, and has posted a slight decline for the year as a whole.

Singapore's economy shrunk significantly in the last two quarters of the year, and economic growth for 2008 as a whole was only achieved due to the very strong growth in the first quarter: full-year economic growth was roughly 1.5 % after 7.7 % in 2007.

Asia's emerging markets were robust in the first half of the year. However, falling import demand from North America and Europe also burdened these countries, leading to lower growth rates over the previous year, even though they are higher by worldwide standards (China roughly +9.4 %; India roughly +6.3%). Inflation in Asia also eased at year-end.

While the volume of transactions concluded at the start of the year on the Asian market for commercial property was very robust compared with North America and Europe, the year-on-year decline in the second half of the year was significant.

The effects of the crisis affecting financial markets and the global economic downturn also affected the Asian office property market in the second half of the year. Demand for renting office premises in the Chinese centres of Beijing and Shanghai dropped. Downward pressure on rents in China's office property markets was evident in the second half of the year, leading to a fall in the top rents for office space in most of Beijing's and Shanghai's individual markets at year-end. On an annual basis however, office rents rose there apart from a few exceptions in individual markets.

Rental growth for office premises in Singapore declined substantially at the start of the year, although it still remained robust. Meanwhile, rents came under pressure in the second half of the year and were down overall on an annual basis. The vacancy ratios for office premises rose in Beijing, Shanghai and Singapore. However, the level in Singapore remains considerably lower than in Beijing or Shanghai.

Top rents for office premises in Tokyo were already declining during the year as a whole, accompanied by a rise in the vacancy ratio. The trend in relation to top rents for first-class retail properties in Beijing and Shanghai was inconsistent; rents rose in Shanghai on an annual basis, Beijing also saw increases in some individual markets while others posted a decline. Retail rents in Singapore came under pressure at year-end.

Rents for logistics properties in Beijing and Shanghai rose slightly in the course of the year. The substantially increased supply in Japan resulted in a higher vacancy ratio. In Singapore, rents for logistics properties rose only at the start of the year, but declined at year-end. On an annual basis however, rent increases outweighed declines in 2008.

Tourism in Asia experienced a downward trend, so that the average occupancy ratio on the Asian hotel market declined.

In the second half of the year, investors were showing signs of demanding higher returns on all Asian markets.

Summary

Aareal Bank AG integrated its property financing and refinancing activities in the Structured Property Financing segment (see page 54). The developments in the sectors outlined in the section "Performance of key regional markets" were anticipated early on in the 2008 financial year, and proactive steps were taken to deal with them. Our loan portfolios were subject to even more intensive monitoring, especially in countries with volatile property markets, such as the UK, Spain and the US. The success of these measures is reflected in our allowance for credit losses, which remains within the framework of our budget (please refer to the Report on expected developments, concerning developments in our allowance for credit losses) despite the recognition of increased portfolio impairment.

The German institutional housing business

With consistently high equity ratios and stable rental income, the German institutional housing business proved itself as a solid market segment in 2008, against the background of ongoing crisis in financial markets.

Property management companies continued to invest heavily.

They continued to modernise many properties, with a view to enhancing the marketability and attractiveness of the apartments with up-to-date furnishings. Investments in 2008 focused increasingly on improving the substance in terms of saving energy on the back of the legal requirements of the 2007 Energy Savings Ordnance (Energieeinsparverordnung – EnEV), while the use of other energy supply solutions also gained in importance. Besides the EnEV and the introduction of the mandatory statement of energy usage, various other legal regulations impacted on the German housing sector in 2008; these include the business tax reform for 2008 (especially the interest cost deduction barrier and withholding tax) and the EU anti-terror regulations (especially the prohibition of business transactions).

The market for residential property transactions has been made considerably more difficult by the financing environment, which is characterised by the financial markets crisis and economic outlook. The considerable trading activity volume of the last few years was followed by a significant drop in the number of portfolio sales during 2008. The size of the transactions also declined. Apart from the sale of LEG NordrheinWestfalen with 93,000 apartments, most trades consisted of packages with fewer than 3,000 residential units. Despite falling transaction volumes, international financial investors remained committed to the German property market. However, they are meanwhile more focused on inventory management, rather than selling on the properties.

Some short-term oriented investors, who had entered the market with very optimistic return targets, overestimated the potential for privatising rental property or increasing rents.

The housing market continues to recover at a moderate pace. According to surveys carried out by the consulting firm F+B Forschung, average rents in all cities and rent levels in Germany were up by 1.7 % over 2007. Apartment vacancies continued to fall. However, the potential for increasing rents – and the vacancy ratios – differ widely by region. While apartment block vacancies continued to rise, especially in rural regions, the ratio fell in the cities. The gap between rents commanded in growth centres and those in rural or weak economic regions widened further.

Summary

Aareal Bank Group is active in the institutional housing sector via its Consulting / Services segment. The segment offers the institutional housing sector services and products for managing residential property portfolios, through its wholly-owned subsidiary Aareon AG and the bank's Institutional Housing Business (see page 54). We seized on the topics relevant to the industry that were listed in the section on ”Institutional Housing Sector“ early on, and took proactive steps to deal with them. They are a continuous part of further developing the products and services of this segment (see business development, page 70 ff).

Group profitability

In an extremely difficult year for the financial sector as a whole, Aareal Bank Group achieved operating profit of € 117 million in 2008 (adjusted € 153 million; 2007: € 380 million, adjusted € 159 million). Taking taxes and minority interest income into consideration, consolidated net income after minority interests was € 60 million (2007: € 290 million).

Net interest income rose by 14.8 % over the previous year, to € 472 million (2007: € 411 million). The increase is largely attributable to higher margins achieved, the replacement of senior unsecured issues with Pfandbriefe, and the more favourable interest rate environment.

Considering the allowance for credit losses of € 80 million (2007: € 77 million), net interest income after allowance for credit losses amounted to € 392 million (2007: € 334 million). This equates to an increase of more than 17 %.

Net commission income increased also, by € 8 million compared with the same period of the previous year, from € 142 million in 2007 to € 150 million. Both segments contributed to the increase.

Net trading income / expenses of -€ 23 million (2007: -€ 26 million) reflects the continued market turbulence experienced within the scope of the financial markets crisis. Positive effects from hedges concluded for our securities portfolio are offset by, amongst other things, charges from the valuation of derivatives and fixed-income securities in the trading portfolio, as well as current expenses from securitised transactions.

Based on the change in international accounting regulations (IFRS) with retrospective effect from 1 July 2008, in the third quarter of 2008 we undertook a reclassification of the securities in the held-for-trading category (with a nominal value of € 570 million) into the loans and receivables portfolio. The reclassification was carried out because an active market no longer existed for these assets in the third quarter, and it is our intention to hold them over a longer-term horizon. By the reclassification the group avoided incurring expenses in the amount of € 56 million up to 31 December 2008.

Furthermore, € 487 million and € 2.4 billion of available-for-sale securities were reclassified to the loans and receivables category on 1 July 2008 and 31 October 2008 respectively. Similarly, no active market existed for these assets, and it is also our intention to hold them over a longer-term horizon. This represented a discharge of € 129 million on the revaluation surplus as at 31 December 2008. Please refer to the explanations in Note (68) to the Consolidated Financial Statements for more detailed information on the accounting procedures as well as on the type and volume of the securities in question. Aareal Bank monitors the development of the held-for-trading or available-for-sale securities reported on the balance sheet on an ongoing basis in relation to the existence of active markets. If we find that there are no active markets, we will also allow for these market circumstances and conduct reclassifications if necessary, if it is our intention to hold them over a longer-term horizon.

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Net interest income	472	411
Allowance for credit losses	80	77
Net interest income after allowance for credit losses	**392**	**334**
Net commission income	150	142
Net result on hedge accounting	0	1
Net trading income / expenses	-23	-26
Results from non-trading assets	-95	206
Results from investments accounted for using the equity method	7	68
Results from investment properties	-1	1
Administrative expenses	347	361
Net other operating income / expenses	34	18
Impairment of goodwill	0	3
Operating profit	**117**	**380**
Income taxes	39	72
Consolidated net income / loss	**78**	**308**
Consolidated net income / loss attributable to minority interests	18	18
Consolidated net income / loss attributable to shareholders of Aareal Bank AG	**60**	**290**

The net result from non-trading assets was negative, at € -95 million, and also reflects the impact of the current financial markets crisis. The figure reflects the restructuring in the securities portfolio we undertook within the scope of our conservative risk policy, in order to reduce the volatility in the results. Net expenses of around € 61 million were incurred on the sales conducted. In addition, the measurement of the non-trading portfolio at fair value resulted in expenses of € 34 million. Last year's figure of € 206 million, which was defined by extraordinary items, was due in particular to the sale of the stake in Immobilien Scout GmbH (€ 153 million).

The net result from investments accounted for using the equity method amounted to € 7 million (2007: € 68 million), attributable to distributions by Deutsche Interhotel Group. Last year's figure includes the positive non-recurring effect

(€ 63 million) from the measurement of our stake held in Deutsche Interhotel Group.

At € 347 million, administrative expenses were down considerably on the previous year's figure of € 361 million. The 4.4 % reduction reflects our strict cost discipline. Administrative expenses comprise staff expenses of € 212 million (2007: € 230 million) and non-staff expenses of € 135 million (2007: € 131 million).

At € 34 million, net other operating income and expenses also exceeded the previous year's figure of € 18 million. The reported result includes income from a waiver of claims in the amount of € 15 million, which was granted by the financing bank within the scope of the restructuring of a property investment.

On aggregate, the items resulted in consolidated operating profit of € 117 million (adjusted: € 153 million) compared with € 380 million for 2007 (adjusted: € 159 million).

After deduction of € 39 million in taxes (2007: € 72 million) and minority interest income of € 18 million (2007: € 18 million), consolidated net income attributable to shareholders of Aareal Bank Group for 2008 amounts to € 60 million (2007: € 290 million)

Segments

Structured Property Financing

Business development

During 2008 we continued to apply our orientation strictly towards quality and return, and concentrated on transactions with attractive risk / return profiles.

The segment generated € 5.5 billion in new business in the 2008 financial year, after € 11.7 billion in 2007. We consider this volume corresponds to the market situation in 2008. It is a sign of the difficult market environment, defined by the financial markets crisis, and is also reflected by the considerably lower transaction volume on the markets for commercial property compared with previous years. Both issues led to lower borrowing demand in structural terms and to fewer prepayments compared with previous years. Our new business activities concentrated above all on supporting our existing customers, whose property expertise we were very familiar with.

We successfully increased the interest margin achieved on new business over the previous year.

Three-continents strategy

Aareal Bank pursues a "three-continents strategy" that extends across Europe, North America and Asia. Europe accounted for 63.8 % of new business in 2008, North America for 25.2 % and Asia for 10.9 %.

Key regional markets

Europe

Western Europe
The volume of new business we achieved in Western Europe amounted to € 1.4 billion in the 2008 financial year. This corresponds to 25.0 % of our new commitments overall.

We support our clients in Germany through our branches in Berlin, Hamburg, Munich as well as our Wiesbaden-based head office. New commitments in Germany amounted to € 0.6 billion in 2008.

We established a presence in Paris with our subsidiary Aareal Bank France S.A., from which we manage our distribution activities for other countries, including Switzerland, Belgium and Luxembourg. We also maintain a presence in these countries with our Brussels and Zurich branch offices. We generated new business of € 0.4 billion in these three countries.

Our London branch is responsible for distribution management in the UK and the Netherlands. We are also represented in the Netherlands via our branch office in Amsterdam. Our aggregate volume of new business in these two locations amounted to € 0.4 billion.

Southern Europe
In Southern Europe, we operate our business in Italy through our branches in Rome and Milan. We also have a presence in Spain, via our representative office in Madrid.

All in all, we generated € 0.6 billion in new business in Southern Europe. New business in Italy amounted to € 0.5 billion, with € 0.1 billion coming from Spain.

Northern Europe
We generated new business of € 0.7 billion in the Nordic countries, with Denmark accounting for € 0.4 billion, Sweden for € 0.2 billion, followed by Norway and Finland making up the balance. Our branch in Stockholm is also charged with managing distribution operations for Northern Europe. We also maintain a presence in this region via our Helsinki and Copenhagen representative offices.

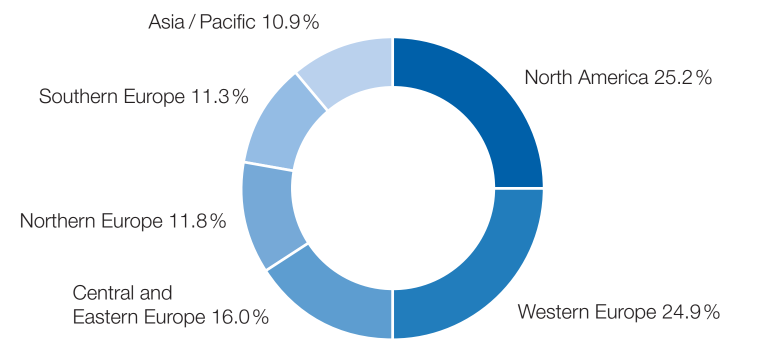
Central and Eastern European Countries (CEE)
We generated new business in the amount of € 0.9 billion in CEE countries during 2008.

We transferred the business activities of Aareal Bank's Polish subsidiary – Aareal Financial Service Polska Sp. z o.o. – to our newly-established Warsaw branch, with effect from 1 August 2008. The Warsaw branch now acts as a hub for our Central and Eastern European business.

Following receipt of official approval from the Central Bank of Russian Federation, we opened a representative office in Moscow in 1 July 2008. Our distribution network in the region also includes our Prague-based subsidiary Aareal Financial Service spol. s r.o.

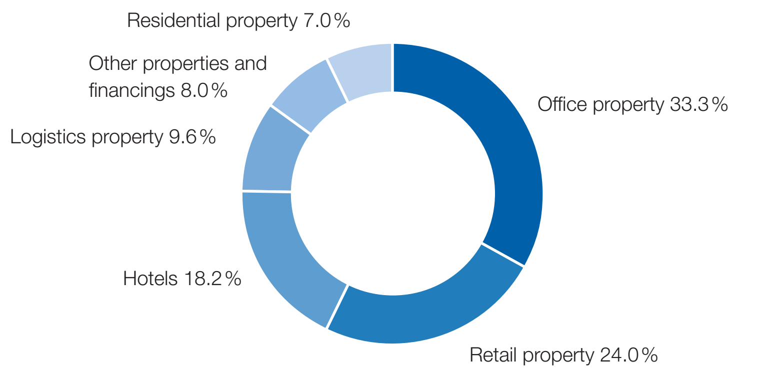
New business 2008

by region



New business 2008

by type of property



Owing to the lack of what we consider to be suitable opportunities, we did not conduct any new business transactions in Turkey. Similarly, we deliberately conducted no new business in the Baltic States in 2008.

North America (NAFTA states)
We have an active presence in North America, through our new subsidiary established in New York in 2008; Aareal Capital Corporation replaced our subsidiary Aareal Financial Services USA, Inc. The key parts of our loan portfolio for the US were transferred to Aareal Capital Corporation. New business generated in North America in 2008 was equivalent to € 1.4 billion.

Asia / Pacific region

On account of the attractiveness of the Chinese market, Aareal Bank AG opened a representative office in Shanghai in September in order to expand its presence in the region, following the receipt of a licence from the Chinese authorities.

We manage our distribution activities in the Asia / Pacific region through our subsidiary Aareal Bank Asia Limited, Singapore.

€ 0.6 billion of new business was achieved in Asia during 2008. In addition to China and Singapore, we also generated new business in the region's selected hotel destinations.

Pooling the resources of industry specialists nationwide

Besides our regional expertise, we also benefit from the proven property expertise and sector know-how of our industry specialists in Wiesbaden, providing financing for shopping centres, hotels and logistics.

The new business figures for the individual types of property listed below are already included in the new business figures for the regions recorded below.

Shopping centres

We acquired € 1.3 billion in new retail property business during 2008. The regional emphasis was on North America, followed by Southern Europe as well as Central and Eastern Europe.

Hotels

New business for hotel financings amounted to € 1.0 billion, with a regional focus on North America, Asia / Pacific and Northern Europe.

Logistics properties

New business in logistics properties amounted to € 0.5 billion. The regional focus was on Western Europe, followed by Central and Eastern Europe. This development is due to the structural shortage of suitable logistics property in Central and Eastern Europe.

Segment result

Net interest income attributable to the Structured Property Financing segment was € 403 million for the full-year 2008, after € 347 million in 2007. The 16.1 % increase over the previous year is largely attributable to higher margins achieved, the replacement of senior unsecured issues with Pfandbriefe, and the more favourable interest rate environment.

Allowance for credit losses of € 80 million remained within the scope of our annual planning (2007: € 77 million). The figure comprises net allocation to allowances for specific credit losses of € 35 million, portfolio allowances of € 11 million, and a further € 34 million in valuation allowances as additional provisioning in the current difficult market environment.

Net commission income was up € 5 million compared with the same period of the previous year, to € 29 million (2007: € 24 million).

Net trading income / expenses of -€ 23 million (2007: -€ 26 million) reflects the experience of continued market turbulence within the scope of the financial markets crisis. Positive effects from hedges concluded for our securities portfolio are offset by, amongst other things, charges from the valuation of derivatives and fixed-income securities in the trading portfolio, as well as current expenses from securitised transactions.

We undertook a reclassification of the securities in the held-for-trading category (with a nominal value of € 570 million) into the loans and receivables portfolio during the third quarter of 2008, based on the change in international accounting regulations (IFRS) with retrospective effect from 1 July 2008. The reclassification was carried out because an active market no longer existed for these assets in the third quarter, and it is our intention to hold them over a longer-term horizon. By the reclassification the group avoided incurring expenses in the amount of € 56 million up to 31 December 2008. Furthermore, € 487 million and € 2.4 billion of available-for-sale securities were transferred to the loans and receivables category on 1 July 2008 and 31 October 2008 respectively. Similarly, no active market existed for these assets, and it is also our intention to hold them over a longer-term horizon. This represented a discharge of € 129 million on the revaluation surplus as at 31 December 2008. Please refer to the explanations in Note (68) to the Consolidated Financial Statements for more detailed information on the accounting procedures, as well as on the type and volume of the securities in question.

Aareal Bank monitors the development of the held-for-trading or available-for-sale securities reported on the balance sheet on an ongoing basis in relation to the existence of active markets. If we find that there are no active markets, we will also allow for these market circumstances and conduct reclassifications if necessary, if it is our intention to hold them over a longer-term horizon.

The net result of -€ 95 million (2007: € 52 million) from non-trading assets also reflects the effects of the financial markets crisis. The figure reflects the restructuring we undertook within the scope of our conservative risk policy to reduce the volatility in the results of the securities portfolio. Net expenses of around € 61 million were incurred on the sales conducted. In addition, the measurement of the non-trading portfolio at fair value resulted in expenses of approx. € 34 million.

The net result from investments accounted for using the equity method amounted to € 7 million (2007: € 68 million), attributable to distributions by Deutsche Interhotel Group. Last year's figure includes the positive non-recurring effect (€ 63 million) from the measurement of our stake held in Deutsche Interhotel Group.

Administrative expenses of € 200 million were down € 12 million on the previous year. Our strict cost discipline is reflected in stable other administrative expenses and lower staff costs.

Net other operating income / expenses of € 33 million was up € 8 million on the previous year. The reported result includes earnings from a waiver of claims in the amount of € 15 million, which was granted by the financing bank within the scope of the restructuring of a property investment.

Overall, operating profit for the Structured Property Financing segment amounted to € 73 million (2007: € 197 million; adjusted: € 129 million). Taking into consideration tax expenses of € 25 million and € 16 million due to minority interests, the segment result after minority interest income was € 32 million (2007: € 120 million).

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Structured Property Financing		
Net interest income	403	347
Allowance for credit losses	80	77
Net interest income after allowance for credit losses	**323**	**270**
Net commission income	29	24
Net result on hedge accounting	0	1
Net trading income / expenses	-23	-26
Results from non-trading assets	-95	52
Results from investments accounted for using the equity method	7	63
Results from investment properties	-1	1
Administrative expenses	200	212
Net other operating income / expenses	33	25
Impairment of goodwill		1
Operating profit	**73**	**197**
Income taxes	25	61
Segment result	**48**	**136**
Segment result attributable to minority interests	16	16
Segment result after minority interests	**32**	**120**

Consulting / Services

Business development Institutional Housing Sector

Aareon AG

Aareon AG extended its market position as a leading consultancy and IT systems house for the property management sector during the 2008 financial year. The company not only achieved distribution success in all product lines, but also reported a high level of demand for advisory services for additional modules and so-called integrated services. However, the company also focused on optimising and developing the product range.

Aareon's four property management ERPs (Enterprise Resource Planning) products in particular – Blue Eagle on the basis of SAP®, Wodis, GES and WohnData – continued to develop their market successes. The systems provide property management solutions designed to meet the needs of Aareon's customers, and offer efficient data management services.

The Blue Eagle roll-out has commenced for customers – including Altonaer Spar- und Bauverein eG, Hamburg; HANSAINVEST Hanseatische Investmentgesellschaft mbH, Hamburg; and NEULAND Wohnungsgesellschaft mbH, Wolfsburg. GAG Immobilien AG, Köln and the Bremen-based GEWOBA Aktiengesellschaft Wohnen und Bauen have also opted for Blue Eagle. Aareon's IT infrastructure operates more than 100 SAP systems – the highest number of installations in the European property market. These installations comprise customer systems, internal systems and test systems.

More than 20 systems were rolled out for Wodis, an ERP solution for SMEs established within the scope of Aareon's multi-product strategy. Additionally, ten new customers decided to switch to Wodis.

Aareon reported strong demand for consulting services and individual customer projects with the established GES system, which includes the ASP (Application Service Providing) solution. A new release from WohnData, the established system for in-house customers, met with great interest when it was introduced in September 2008.

Together with Aareal's Institutional Housing Business, Aareon offers the BK XL system, including digital signature, for the GES, Wodis and WohnData systems, and for the BK 01 payments systems, as well as exclusively for Blue Eagle. These systems can be used by property management companies to structure account entries, payments and accounting in a highly efficient manner.

All ERP solutions can be complemented by the addition of integrated services and additional product use, such as the online service portal Mareon, which offers modules for connectivity to craftsmen, and inventory data management. Customer interest for the portal remained high in 2008. The volume of orders processed through the platform increased to around € 470 million in the 2008 financial year. Mareon is presently used by roughly 150 property management companies and more than 6,000 craftsman businesses.

Aareon AG strengthened its international position with the acquisition of Sylogis.com in France, which enabled it to expand its market position to become one of the leading providers of ERP systems in this country. It also disposed of its subsidiary Aareon Schweiz AG to the Swiss company W&W IMMO INFORMATIK AG with retrospective effect from 1 January 2008, within the scope of its policy of focusing on international activities in large strategic markets.

Payments and deposit-taking

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. Developed by our subsidiary Aareal First Financial Solutions AG together with the bank, BK 01 is a payments system with high integration capability that facilitates a significant degree of process automation in clients' systems.

We successfully transferred all of our clients' ERP systems to new SEPA account management systems during the 2008 financial year.

The year also saw us acquire 81 new housing companies managing a good 110,000 units for the payments and deposit-taking business. The deposit volume from the institutional housing sector averaged € 4.3 billion during 2008. This was just under last year's level of € 4.5 billion on average, despite the ongoing crisis in financial markets, and reflects client confidence in our economic basis and viability.

We also placed a new, second product line on the market, under the name of Aareal Account. This product allows us to offer high-quality, computerised payment services to those property management companies that do not use a licensed BK 01 system. The first clients have already switched to Aareal Account.

Our product range provides us with an excellent basis to secure stable, regular cash flows – thereby boosting our deposit base and securing refinancing funds.

Aareon AG's IT systems generate significant income synergies: roughly 80 % of Aareon's customers maintain a business relationship with Aareal Bank.

We enhanced this cooperation between the bank and Aareon through the targeted acquisition of clients that use our Wodis IT system.

Segment result

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Consulting / Services		
Sales revenue	229	223
Own work capitalised	1	2
Changes in inventory	0	0
Other operating income	12	162
Cost of materials purchased	36	36
Staff expenses	99	102
Depreciation, amortisation and impairment losses	14	16
Results from investments accounted for using the equity method		5
Other operating expenses	49	55
Interest and similar income/expenses	0	0
Results from ordinary activities	**44**	**183**
Income taxes	14	11
Segment result	**30**	**172**
Segment result attributable to minority interests	2	2
Segment result after minority interests	**28**	**170**

The result attributable to the Consulting/Services segment is reported on the basis of an income statement classification aligned to industrial companies. A reconciliation to the segment result shown in the segment reporting can be found in section (E) of the Notes to the Consolidated Financial Statements.

At € 44 million, operating profit in the Consulting / Services segment was some 50 % higher than the adjusted result of € 30 million reported in 2007.

Sales in the 2008 financial year amounted to € 229 million, which represents a € 6 million (2.7 %) increase over the previous year. The figure includes income of € 3 million from the subsidiary Sylogis.com S.A.S., which was consolidated for the first time in Q4 2008.

Net other income and expenses of € 12 million exceeded the adjusted figure of € 9 million for 2007 (previous year's figure of € 153 million was accounted for by the sale of the investment in ImmobilienScout).

At € 36 million, the cost of materials was unchanged from the previous year, despite the rise in sales revenue.

Staff expenses were down € 3 million to € 99 million (-3 %), in spite of the additional expense incurred through consolidation of the subsidiary Sylogis.com S.A.S. (€ 2 million) for the first time in Q4 2008. This segment also adheres to the strict cost discipline pursued by Aareal Bank Group.

In addition to a decline in write-downs to € 14 million (2007: € 16 million), other operating expenses were also reduced by € 6 million to € 49 million.

On balance, the result from ordinary activities in the Consulting / Services segment was € 44 million (2007: € 183 million; adjusted: € 30 million).

After deduction of € 14 million in taxes and minority interest, the segment result stood at € 28 million after minority interests (2007: € 170 million).

Assets and financial position

Total assets

Consolidated total assets as at 31 December 2008 amounted to € 41.2 billion (31 December 2007: € 40.2 billion).

The Group's assets comprise predominantly the property finance portfolio, the securities portfolio, and loans and advances to banks and non-banks. Shareholders' equity and liabilities comprise long-term funding as well as customer deposits, liabilities to banks, non-interest bearing assets, and other assets.

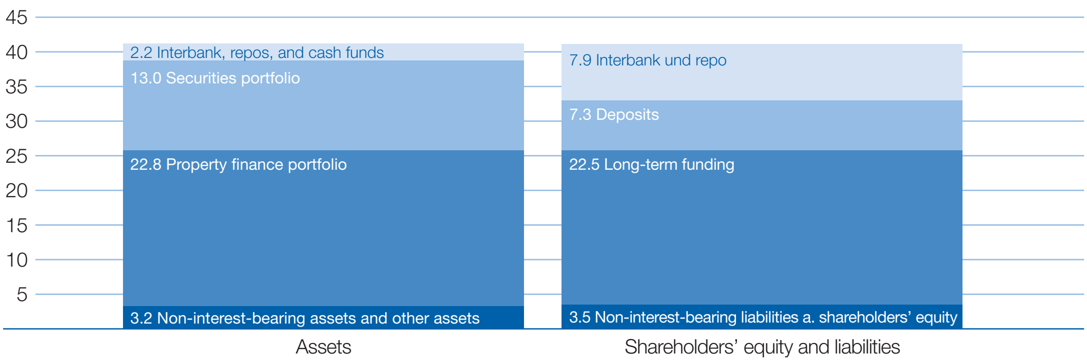
Assets

Property financing portfolio

As at 31 December 2008, international property financing under management accounted for € 23.5 billion. This equates to a slight decline over the previous year's figure of € 24.0 billion. The rise in the international property financing business was offset by the significant reduction of our German portfolio.

Structure of assets, and of shareholders' equity and liabilities, as at 31 December 2008

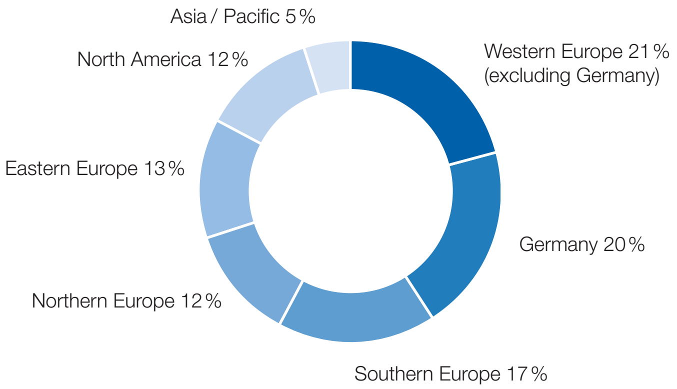
Euro bn



Property finance portfolio as at 31 December 2008

by regions

Total volume: Euro 23.5 bn [1]



[1] Property financing volume under management

Within the scope of originating new business, we have applied a policy of conservative lending that is aimed at mortgage lending value ratio and a sustained ability to cover interest and principal payments.

We were able to raise the share of international financings in the overall portfolio to a total of € 18.7 billion (up 10%), whilst the share of the German portfolio was reduced by 32%, to € 4.8 billion.

Securities portfolio

As at 31 December 2008, the securities portfolio amounted to € 13.0 billion, comprising high-quality investments of securities and promissory note loans of public-sector issuers (approx. 70%), covered bonds (approx. 8%), and bank bonds (approx. 17%). A minor part of the portfolio, with a nominal value of less than € 600 million (approx. 5% of the portfolio), is invested in an ABS portfolio predominantly based on European assets.

Portfolio management and exit strategies

In order to develop risk and return-oriented strategies for our financing portfolio, we evaluate suitable market and business data, simulating appropriate strategies for our lending business. This makes it easier for us to react in good time to changes in the market that could potentially impact on our portfolio. 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 restrictions set through maximum portfolio limits for individual countries, products and property types to guarantee a high degree of diversity within the portfolio.

Our exit strategies are consistent with our portfolio management. We use techniques such as syndication to optimise and manage 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.

Syndications and synthetic securitisations

The developments that emerged in the second half of 2007 continued into 2008. The markets for exit instruments became less receptive as the crisis affecting financial markets and the related reticence among market participants continued.

Nonetheless, we were able to syndicate lending volume of € 0.5 billion (2007: € 0.7 billion) to our international partner bank network in the 2008 reporting period. The continued unfavourable environment meant that securitisations could still not be used as exit instruments. Due to terminations, the total volume of synthetic securitisations – all of which were entered into during previous years – fell from € 2.4 billion as at 31 December 2007 to a residual volume of € 23.9 million.

Disposal of a portfolio of residential property loans

In the second quarter of 2008, Aareal Bank AG disposed of a portfolio of domestic residential property loans totalling € 1.47 billion to Deutsche Postbank AG. The portfolio comprised exclusively performing loans. The portfolio consisted of Aareal Bank exposures in the amount of around € 1.04 million, plus roughly € 0.43 billion from DEPFA Deutsche Pfandbriefbank AG's residual property finance portfolio, which Aareal Bank has managed since 1999. The disposal of the portfolio of residential property loans complies fully with Aareal Bank's policy of focusing consistently on its core business of commercial property financing. We have no longer been active in the private client business since 2002. The transaction reduced roughly 84 % of Aareal Bank's residential property loan portfolio. The transaction was closed on 11 July 2008.

Refinancing

Refinancing structure

Aareal Bank Group successfully conducted the refinancing activities planned for 2008, even in the extremely challenging macro-economic environment that was defined by immense turbulence on financial markets. However, Aareal Bank was unable to escape fully the changed circumstances on the capital markets. The numerous negative reports from the financial world heightened investors' preference for secure investments. Government bonds and Pfandbriefe were the main beneficiaries here, in contrast to unsecured issues. This is also clearly reflected in Aareal Bank's capital market activities: the share of mortgage bonds in the funding mix has risen significantly compared with previous years.

Aareal Bank refinances its lending activities on the capital market mainly in medium-term and long-term maturities. The long-term refinancing portfolio, comprising unsecured issues and asset-covered bonds, amounted to € 22.4 billion as at 31 December 2008. The long-term refinancing funds comprised 26 % mortgage bonds, 13 % public-sector covered bonds, 55 % unsecured issues and 6 % subordinated issues.

Our capital market activities are enhanced by our exposures on the money market, where we generate deposits from our institutional housing clients and other institutional investors.

The deposit volume from the institutional housing sector averaged € 4.3 billion during 2008. Reflecting the structure of the commercial housing sector business, these deposits fluctuate each month, with a residual balance that is generally equivalent to the month-end size of deposits. Deposits were largely stable.

As the crisis affecting financial markets deepened in September 2008, many institutional investors withdrew their short-term deposits from the banks. Our bank was also affected by this, and we reported a decline in short-term client deposits in this segment. In the meantime, these deposits increased again. The unsecured interbank market dried up increasingly in 2008 as a consequence of the crisis. Aareal Bank therefore only invested excess liquidity in secured transactions in the repo market.

Mortgage bonds, unsecured and subordinated issues in the amount of € 19.5 billion, as well as deposits of € 3.6 billion from the institutional housing sector (as at 31 December 2008) plus institutional investor deposits of € 3.7 billion are used to refinance the € 22.8 billion property loan portfolio. The excess liquidity is invested in a portfolio of liquid, high-quality securities eligible for ECB or repo refinancing, which is additionally refinanced through public-sector covered bonds in the amount of € 2.9 billion. The part of the securities portfolio that is used as a liquidity reserve can be used for the purposes of open-market transactions with the ECB , at short notice and where required. Further short-term investments are carried out in the money market and via repo transactions.

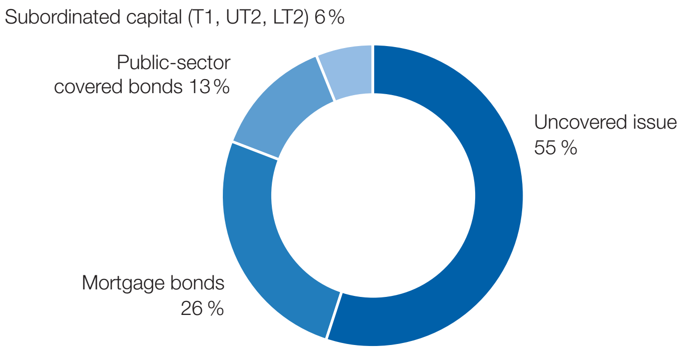
The long-term refinancing funds have an average term of five years and the average contractual lifetime of the loan portfolio is 3.7 years. The analysis of Aareal Bank's maturity profile confirms our comfortable liquidity position. The contractual repayments from the property loan portfolio will exceed the maturities of the long-term funds in the years ahead.

Refinancing activities in 2008

During the period under review, Aareal Bank had raised a total of € 3.5 billion of long-term refinancing funds. Mortgage bonds account for just under € 2.7 billion of new issuance and public-sector covered securities for € 83 million. Pfandbriefe therefore account for around 80 % of new issuance, thus highlighting how quickly Pfandbriefe are becoming increasingly important to Aareal Bank's refinancing activities. At € 710 million, issuance of long-term unsecured funds fell significantly as a result of the market environment and accompanying high costs. The figure includes the successful public placement of a € 400 million bearer bond. Aareal Bank successfully used a window of opportunity in June of 2008 to place this issue, which was well-received in the market.

The Pfandbrief has established itself as a guarantee for security, especially in these turbulent financial markets. The Pfandbrief business will continue to play a central role in Aareal Bank's refinancing mix. In view of the level of quality, strict legal requirements and successful capital market history, Pfandbriefe offer a reliable refinancing source and allow Pfandbrief banks to acquire long-term funding, especially in times when investors are demanding high security requirements. This gives us a clear refinancing advantage. In 2008, the share

Refinancing mix as at 31 December 2008



of asset-covered bonds (mortgage bonds and public-sector covered securities) was increased further to around 39 % of Aareal Bank's long-term funding mix.

Impact of the financial markets crisis

Aareal Bank has emerged from the current crisis affecting financing markets as an fundamentally sound company, with profitable operations and a coherent business model, together with committed and experienced employees and a strong management team. In the midst of severe distortions on the financial markets over the past year, alongside the more recent drastic economic downturn, we achieved results that – given the circumstances – are very satisfying. We see this as confirmation of our focus on two business segments. Similarly, our large international network of small, flexible teams of experts within the framework of our three-continent strategy contributed to this success.

Nonetheless, Aareal Bank was unable to escape fully the changed circumstances brought about by the financial market crisis that deteriorated further in 2008. We therefore deliberately scaled back new business originated by Aareal Bank Group in the 2008 financial year, from € 11.7 billion in 2007 to € 5.5 billion. We view this volume to be appropriate in light of the market situation in

2008. It is a sign of the difficult market environment that was defined by the financial market crisis and is also reflected by the considerably lower transaction volume on the markets for commercial property compared with previous years.

The effects of the crisis affecting financial markets on our credit exposures were at the core of our business strategy. We thus adopted a very restrictive lending policy in the 2008 financial year and stepped up the monitoring and active management of the credit risk exposure considerably. In this context, we carried out a comprehensive additional risk analysis for all material individual exposures in our property finance portfolio.

One result of the measures taken was an increase in the volume of exposures included in cover for Pfandbrief issues. Our new business activities concentrated above all on supporting our existing customers, whose property expertise we were very familiar with.

The changed circumstances on the capital markets also impacted on Aareal Bank. The deposit volume from institutional money market clients, which amounted to roughly € 6.3 billion at mid-year, declined after the bankruptcy of Lehman Brothers. Aareal Bank lost roughly € 3 billion at most in institutional client deposits compared with June 2008. However, we have seen a slight trend turnaround since mid-November, with institutional deposit volumes stabilising at around € 4 billion. We were able to offset this loss in client deposits without any problems and at any time, for example through repo transactions on the basis of our liquid securities portfolio. We met the heightened need for information amongst our institutional investors in this environment by actively targeting investors.

Deposits of our institutional housing investors were largely stable over the year.

Suitable measures secured our foreign currency liquidity on a longer-term basis. In some cases, this also involved incurring additional costs.

Owing to the higher inclusion in the cover assets pool, especially of property financings, Aareal Bank successfully issued just under € 2.7 billion in Pfandbriefe, albeit at higher costs than in the past.

Despite the high quality of our securities portfolio, the crisis affecting financial markets also resulted in price declines, especially owing to spread widening among sovereigns and financial institutions.

We had already embarked on a programme of risk reduction and portfolio restructuring at the start of 2008, within the scope of our investment strategy. We scaled bank our equity investments almost entirely during the course of the year. Fund investments were also reduced.

The impact of risk-reducing markets is visible in net trading income / expenses, and in net income from non-trading assets.

Following an amendment to International Financial Reporting Standards, Aareal Bank Group opted for reclassification during the third quarter of 2008, and now carries certain securities (which were previously measured at market value) at amortised cost.

Based on this amendment, the Group undertook a reclassification of the securities in the held-for-trading category (with a nominal value of € 570 million) into the loans and receivables portfolio during the third quarter of 2008, with retrospective effect from 1 July 2008. The reclassification was carried out because an active market no longer existed for these assets in the third quarter, and it is our intention to hold them over a longer-term horizon. Furthermore, € 487 million and € 2.4 billion of available-for-sale securities were transferred to the loans and receivables category on 1 July 2008 and 31 October 2008 respectively. Similarly, no active market existed for these assets, and it is also our intention to hold them over a longer-term horizon.

Aareal Bank has a high-quality securities portfolio, which the bank carefully monitors (including the existence of active markets, which is continuously verified on the basis of the prevailing market situation). If we find that there are no active markets, we will also allow for these market circumstances and conduct reclassifications if necessary, if it is our intention to hold them over a longer-term horizon.

On the basis of more intensive risk monitoring, we proactively adjusted our counterparty and issuer limits during the year.

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 € 2,778 million, of which Tier I capital accounted for € 1,863 million. Aareal Bank Group has applied the Credit Risk Standard Approach (CRSA) pursuant to the German Solvability Ordinance since 1 January 2008. The CRSA replaced the capital ratio according to the German Banking Act (Grundsatz I), and the standard applied by the Bank for International Settlements (BIS). Calculated in accordance with the CRSA, the Tier I ratio as at 31 December 2008 was 8.0 %, with the total capital ratio at 12.0 %. Aareal Bank Group's risk-weighted assets according to the CRSA amounted to € 23,238 million, which includes € 50 million in assets exposed to market risk.

Following confirmation of Aareal Bank AG's financial statements, the Tier I ratio (in accordance with the German Banking Act) as at 31 December 2007 was 8.0 %, and the total capital ratio 12.3 %.

Our employees

Employee data (as at 31 December 2008)

	31 Dec 2008	31 Dec 2007	Change
Total (Aareal Bank Group)	2,502	2,536	-1.4 %
Total (Aareal Bank AG)	1,056	1,102	-4.4 %
of which: outside Germany	112	109	2.7 %
Share of female employees	47.3 %	47.3 %	
Period of employment	11.1	10.8	2.7 %
Average age	41.9	41.7	0.5 %
Fluctuation rate	4.4 %	5.1 %	
Percentage of part-time staff	14.9 %	12.6 %	
Retired employees and surviving dependants	567	549	3.2 %

Qualification and continuing professional development

Aareal Bank attaches great importance to promoting qualification and continuing professional development (CPD). This is underscored by the broad range of qualification offers provided by Aareal Academy, our inhouse corporate university, which are increasingly popular with staff. Management seminars, designed to intensify the exchange of information across the Group, were also attended frequently.

Introduced in 2007, the employee review ("Structured Appraisal and Target Setting Dialogue") is the starting point for all qualification and succession planning measures: more than 350 individual personal development plans were agreed upon between managers and staff during 2008. In parallel, the personnel development dialogue conducted by Human Resources with the various departments provides the foundation for the development programmes on offer, particularly for Aareal Bank's managerial staff. For this purpose, HR develops customised packages for the various areas.

Thanks to this systematic approach to staff development, Aareal Bank's employees attend one week of seminars and workshops each year on average.

Aareal Bank, in cooperation with European Business School (EBS) have the opportunity to attend four continuing education courses at EBS's Real Estate Management Institute (REMI). Accordingly, the number of staff who supplement their international grades with an executive graduate course targeted on the property sector at our partner university continued to rise. The close cooperation is supported in particular by experts from Aareal Bank enhancing the training through hands-on case studies and presentations.

Aareon AG organised development centres for managers for the first time in 2008, where participants have the opportunity to develop their key skills and potential in a targeted manner. Additional CPD programmes focused on the conversion to MS Office 2007, and included SAP® training sessions.

Sponsoring new talent

Sponsoring qualification programmes to support and develop new talent is a key aspect in our personnel work. In this context, Aareal Bank has been offering trainee programmes targeting university graduates since 2000, in cooperation with various universities with whom we join forces for seminars and exchange programmes.

Responding to the competition for highly-qualified staff, Aareal Bank thinks outside the square when recruiting. We launched a comprehensive internship programme in 2008. The participants of this programme, and those who will join in 2009, will be recruited for vacant trainee posts over the next years. Thanks to the strong response, the programme already helped to establish an efficient network.

Report on material events after the reporting date

On 15 February 2009, the Aareal Bank Group entered into an agreement with the German Special Fund for Financial Market Stabilisation ("SoFFin") on a comprehensive set of measures to ensure the long-term future of the bank's sustainably profitable business, and in order to be well positioned to manage the very difficult market environment. In accordance with this agreement, SoFFin will make € 525 million in capital available to Aareal Bank by way of an unlimited silent participation. In addition, SoFFin will grant Aareal Bank a guarantee facility for new, unsecured issues with a maximum maturity of 36 months for a total volume of up to € 4 billion. The agreement is subject to the conclusion of the final contracts, and approval by the European Commission.

Taking into account the silent participation by SoFFin, which is fully recognised as Tier 1 capital, Aareal Bank's Tier 1 ratio is increased significantly.

This recapitalisation in form of a silent participation protects the interests of shareholders, since it avoids a dilution of existing shares. Aareal Holding Verwaltungsgesellschaft mbH announced that it will not reduce its 37.23 % stake during the entire term of the silent participation. Aareal Holding and SoFFin will enter into a voting agreement, obliging Aareal Holding to maintain a blocking minority stake. This will ensure the stability of the shareholder structure and the independence of Aareal Bank Group, with Aareal Holding as an anchor shareholder.

Beyond the applicable legal provisions, SoFFin has not imposed additional conditions on the Aareal Bank Group. In particular, there will be no state influence on the company's corporate governance, nor will any changes be required to its proven business model. In the interest of a swift redemption of the silent participation, Aareal Bank will not distribute any dividends for the 2008 and 2009 financial years.

On 25 February 2009, Fitch Ratings affirmed our Long Term Issuer Default Rating of "A-" (stable outlook). The Bank Individual Rating was changed from "C" to "C/D". The Short Term Issuer Default Rating was upgraded from "F2" to "F1". At the same time, the "AAA" ratings of our mortgage bonds and our public-sector covered bonds were affirmed.

Risk report

1. Aareal Bank Group Risk Management

The assumption of risk is an integral part of banking business. In order to control risk in a responsible manner, and to ensure the sustained development of the company, our operational decision-making process centres around professional risk management. Against this background, we have established a comprehensive system for the measurement, limitation and control of risk, which we continuously update and expand, using considerable human and technical resources.

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.

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 of the respective entity, and investment controlling.

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 Contolling, Credit Management
Credit risks	Property Finance Portfolio risks	Credit Management, Credit Portfolio Management	Risk Controlling
Credit risks	Treasury business	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-independent monitoring: Internal Audit			

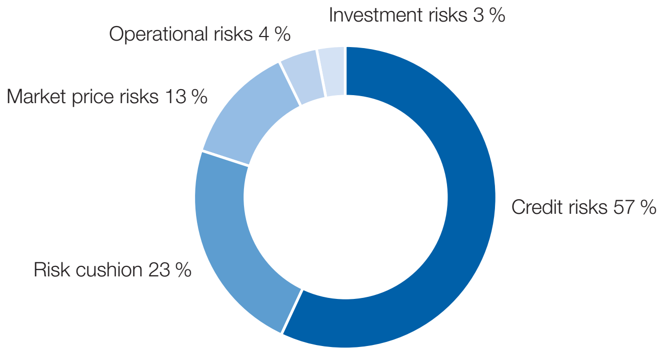
Overall responsibility for risk management and risk monitoring remains with the Management Board and the Supervisory Board of Aareal Bank. The diagram above provides an overview of the responsibilities assigned to the respective organisational units.

1.2 Strategies

The business policy 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 safeguard the bank's risk-bearing capacity. During the finan-

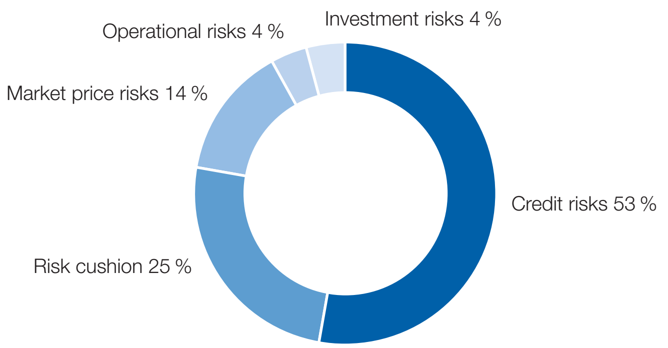
Allocation of aggregate risk cover

31 December 2008



Allocation of aggregate risk cover

31 December 2007



cial year under review, risk strategies as well as the bank‘s business strategy were adapted to the changed environment, and the new strategies adopted by the Management Board and the Supervisory Board.

1.3 Risk-bearing capacity and risk limits

The bank‘s ability to carry and sustain risk – which is defined by the amount of aggregate risk cover – is a core determining factor governing the structure of its risk management system. Aggregate risk cover is defined as Tier 1 capital plus the budgeted net income before taxes. The calculation does not include additional funds such as supplementary and subordinated capital. 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 23 % as at 31 December 2008 – 31 December 2007: approx. 25 %) as a risk cushion, which is not applied to risk limits, and is thus available for risk types that cannot be quantified (for example, reputational or strategic risks). Overall, limits are set in a way so as to ensure Aareal Bank‘s ability to bear risk at any time. even against the background of market distortions as a result of the financial markets crisis during the financial year under review. The diagrams shown left illustrate the allocation or aggregate risk cover across individual types of risk as at 31 December 2007 and 31 December 2008, respectively.

Concerning liquidity risk, aggregate risk cover is not an appropriate measure to assess risk-bearing capacity. Therefore, 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 Group‘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 system at a portfolio level.

Lending decisions regarding credit business classified as relevant for the bank's risk exposure require two approving votes submitted by a market unit and a credit management unit. The bank's Assignment of Approval Powers defines the relevant lending authorities within market and credit 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 credit management vote regarding the approval of counterparty, issuer, or country limits.

We have implemented and documented the clear separation of market and credit management process 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 supplementary processes for intensified handling, the handling of problem loans, and – if necessary – for provisioning/impairment. The corresponding processing principles are laid down in the bank's standardised rules and regulations, which are applicable throughout the Group.

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; depending on the risk situations, the review cycle may be significantly shortened. 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

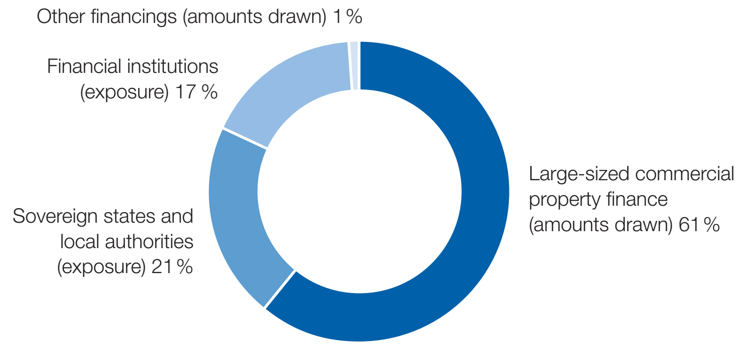
The early identification of credit risk exposure, using individual or combined (early warning) criteria is a core element of our risk management approach.

In particular, the procedures applied for the early detection of risks serve the purpose of identifying borrowers or exposures where higher risks start emerging, at an early stage. For this purpose, we generally monitor individual exposures and the parties involved (such as borrowers or guarantors) 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 Group's 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.

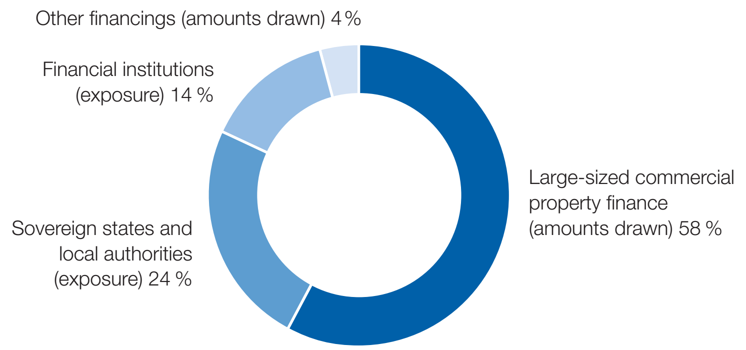
Breakdown of exposure / drawdowns by rating procedure

31 December 2008 100 % = Euro 36.7 bn



Breakdown of exposure / drawdowns by rating procedure

31 December 2007 100 % = Euro 36.5 bn



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

2.1.4 Risk classification procedures

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, and on its pricing.

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

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

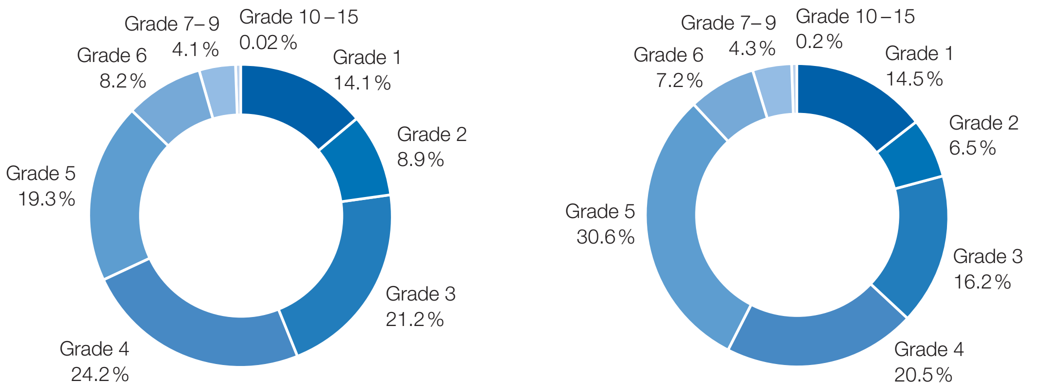
The second step involves calculating the loss given default (LGD), through an assessment of collateral provided for the relevant financing. The bank's maximum risk exposure (plus a cushion for potential fees and charges incurred) is determined for this purpose: expected proceeds from the realisation of collateral, and from uncollateralised residual receivables, are deducted from this exposure at default (EaD). When evaluating collateral, haircuts are applied or recovery rates used, depending on the type of collateral involved and specific realisation factors. For financings of domestic properties, recovery rates are taken from a pool of data used across the bank, whilst recovery rates for international properties are derived using statistical methods, given the low number of realisations.

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

The diagrams shown below depict the distribution of lending volume by EL grades as at 31 December 2008 and 31 December 2007, based on the maximum current or future drawdown. The distribution excludes exposures for which no rating has been concluded, or which are in default (as defined under Basel II).

Large-sized commercial property finance

by internal expected loss grades | as at 31 December 2008 | as at 31 December 2007

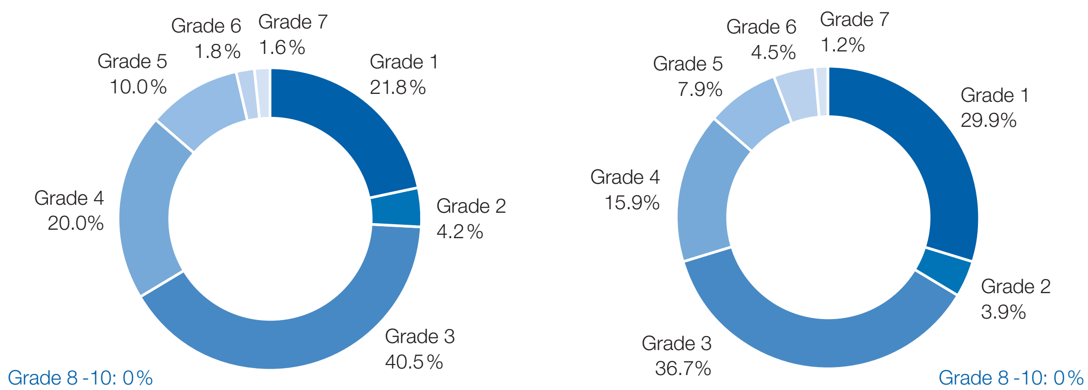


Aareal Bank employs an internal rating procedure for financial institutions, which incorporates qualitative and quantitative factors as well as our client's group affiliation, to classify the risk exposure to banks, financial services providers, securities firms, public-sector development banks, and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

In addition, Aareal Bank employs internal rating methods for sovereign borrowers and regional governments, local and other public-sector entities.

Financial institutions

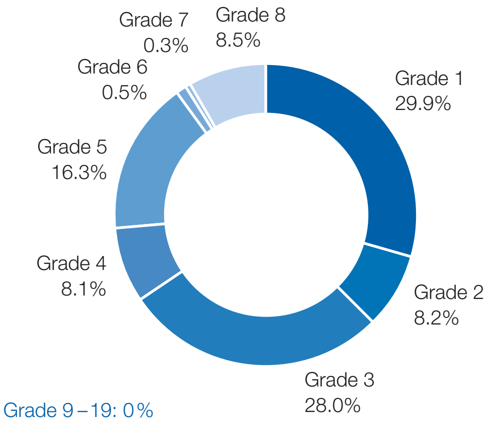
by rating grades | as at 31 December 2008 | as at 31 December 2007

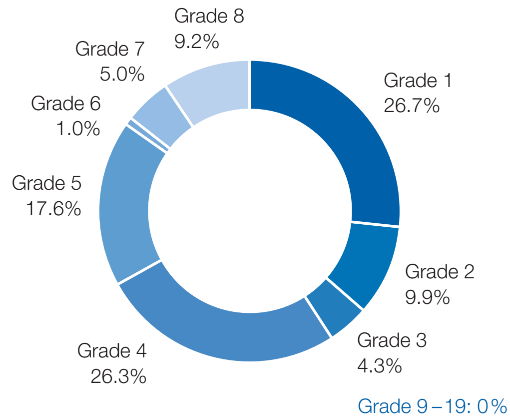


Sovereign states and local authorities

by rating grades

as at 31 December 2008 | as at 31 December 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.

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"). 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 (verification of market conformity), as well as for the legal assessment of non-standard agreements, and of new standard documentation / master agreements.

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

The bank has also established a Counterparty and Country Limit Committee that votes on all limit applications, and is responsible for conducting the annual review of limits. Where required by current developments, the Committee may reduce or revoke counterparty or issuer limits.

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.

2.2.2 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.

During the financial year under review, a new process was established for intensified handling, and handling of problematic exposures of counterparties and issuers. This standardised process comprises identifying early warning indicators, applying them for the purposes of risk analysis, and determining further action to be taken. In the event of counterparty or issuer default, the Counterparty and Country Limit Committee will coordinate an action plan in cooperation with the bank's departments involved.

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

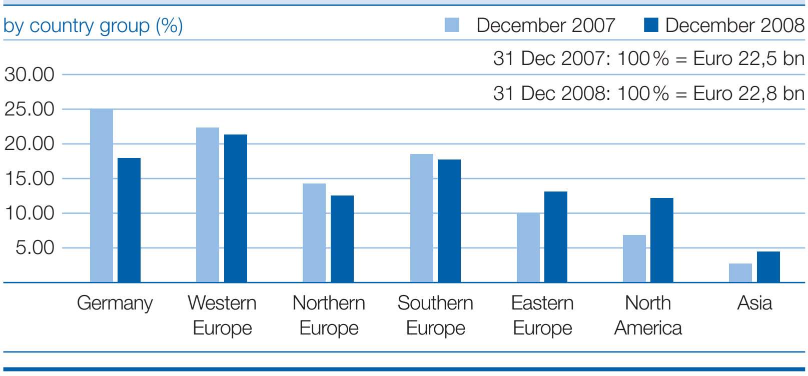
Based on the bank's overall business strategy, Aareal Bank's credit risk strategy sets out all material aspects of the Group's credit risk management and policies. Proposals for the credit risk strategy are prepared jointly by market and risk management units, and adopted by the entire Management Board.

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 sections, who submit a proposal (on which they are both agreed) to management.

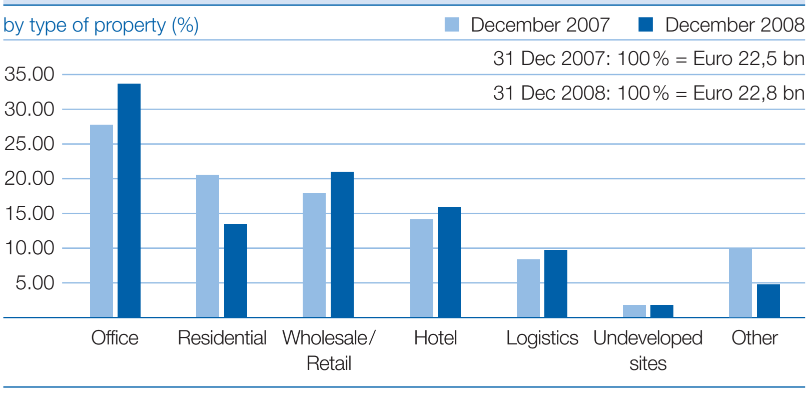
Designed in principle for a medium-term horizon, the credit risk strategy is adapted when necessary to reflect material changes in the Group's credit risk and business policies, or in the Group's business environment (as in the case of the financial markets crisis).

Aareal Bank'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 stands above individual sub-strategies.

Property finance volume (amounts drawn)



Property finance volume (amounts drawn)



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, from which both the expected and unexpected loss (credit-value-at-risk) are derived. Credit value-at-risk corresponds to the maximum amount by which the actual loss can exceed the expected loss, at portfolio level, 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 property finance exposures, and of business with financial institutions. The models permit to identify, measure, monitor and manage risks at a portfolio level. We deployed a new technical environment for the special model used to analyse the property finance business during the financial year under review. As a result, portfolio information required to take risk management decisions are now available within an even shorter time frame than before. 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 rating reviews, monitoring of construction phase loans or residential property developers, the monitoring of payment arrears, and the regular, individual analysis of the largest exposures.

A risk report that complies with the Minimum Requirements for Risk Management (MaRisk) 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, using a standardised escalation process.

3.1.4 Credit risk mitigation

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

As an international property finance house, Aareal Bank focuses on property when collateralising loans and advances. 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 internal or external 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 governing the valuation of such collateral.

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

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

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

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

The derivatives master agreements used by the bank contain netting agreements to reduce prepayment risk at a single transaction level (payment netting), and arrangements for the termination of individual or all transactions under a master agreement (close-out netting). For repo transactions, depending on the counterparty, payment or delivery netting is agreed upon; contract documentation also generally provides for close-out netting. To further reduce default risks, the provision of collateral is agreed upon.

Derivatives entered into with financial institutions provide equity relief in accordance with the Solvability Ordinance ("SolvV"); repo transactions are generally not eligible.

Prior to entering into agreements, the responsible legal services unit within the Operations department assesses the legal risks, and the legal effectiveness and enforceability. The bank uses an internal rating system to assess the credit quality of counterparties. For derivatives transactions entered into with financial institutions, where the bank is looking for capital adequacy relief in accordance with the SolvV, a clause providing for a review of eligibility is added to the netting agreements. This review is carried out in accordance with sections 206 et seq. of the SolvV, particularly through obtaining regular legal opinions, using a database developed for this purpose.

Operations is responsible for the daily valuation of the bank's trades, including collateral accepted or pledged, and using validated valuation procedures. Collateral for derivatives transactions is transferred on a regular basis, as provided for in the respective agreements. Margin calls for repo transactions are determined on a daily basis. Haircuts are applied to account for potential fluctuations in collateral value.

Only cash collateral is accepted for derivatives, whereas collateral for repos can be provided in cash or in securities. Some of the collateral agreements the bank has entered into provide for a reduction in the allowance and the minimum transfer amount under the collateral agreement in the event of a downgrade of the bank's external rating; as a result, the bank might have to provide additional collateral.

Aareal Bank enters into credit derivatives exclusively with financial institutions having an investment-grade rating.

In principle, Aareal Bank pursues a "buy, manage and hold" strategy in managing its credit portfolio: this means that loans are generally held until maturity; sales of loans to third parties during their term are only used on a selective basis, and by selling parts of exposures. Loan syndication is used as an active element of portfolio management.

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 AG 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.

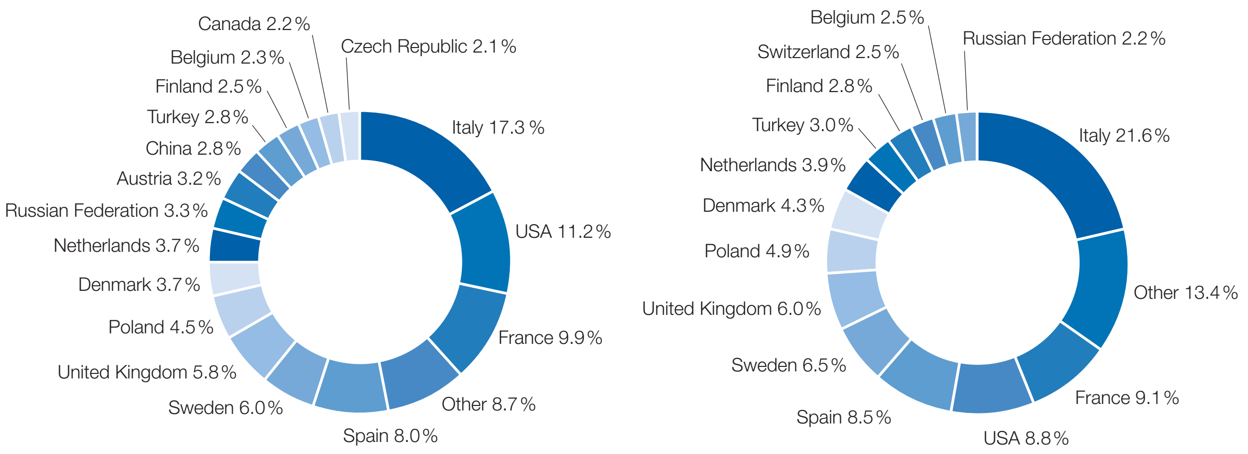
Country risk measurement and monitoring

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. Country limits defined for the purposes of risk management were always observed during the financial year under review.

Breakdown of country exposure – international business

in % 2008 | 2007



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 methods and procedures used to manage the bank's country risk exposure were refined further during the period under review, implementing a new technical infrastructure.

The diagram above illustrates 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.

3.2 Market price 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. The risk exposure from bonds that is not related to market price or interest rate risks – in particular, credit and liquidity risk exposure of the bond portfolio – is managed as part of "specific" risk.

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.

By its very nature, VaR calculations are based on numerous assumptions regarding the future development of the business, and the related cash flows. Key assumptions used include current account balances which are factored into calculations for a period of two years, using the average residual amount of deposits observed in the past.

Loans are taken into account using their fixed-interest period (for fixed-rate exposures), or using their expected maturity (variable-rate exposures). Aareal Bank's shareholders' equity is not taken into account as a risk-mitigating item. This tends to overstate VaR, demonstrating the conservative approach adopted in our risk measurement processes.

Since 2008, the Group has extended the calculation of "specific" risks (those which are not correlated with general market movements) to include all bonds held (as opposed to only those in the trading book). Accordingly, overall Group VaR increased as of 1 January 2008.

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.

When interpreting the VaR figures stated below, it should be noted that these refer to the overall portfolio (thus including all non-trading positions as defined in IFRS). Hence, the analysis provided represents a very extensive disclosure of market price risks compared to industry standards.

	MAX	MIN	Mean	Limit
2008 (values for 2007) 99 %, 10-day period				
Aareal Bank Group – general market price risks	50.1 (32.2)	26.7 (23.7)	36.8 (26.8)	– (–)
Group VaR (interest rates)	35.6 (27.2)	7.3 (10.0)	22.3 (15.2)	– (–)
Group Var (FX)	16.1 (7.0)	3.8 (1.7)	8.7 (3.7)	– (–)
VaR (funds)	29.9 (26.4)	10.3 (17.9)	24.1 (21.7)	60.0 (60.0)
Aggregate VaR in the trading book (incl. specific VaR)	12.4 (4.0)	1.3 (0.1)	4.1 (0.9)	20.0 (20.0)
Trading book VaR (interest rates)	11.8 (2.8)	0.1 (0.1)	2.0 (0.7)	– (–)
Trading book VaR (FX)	0.2 (0.2)	– (–)	– (–)	– (–)
VaR (equities)	1.9 (3.6)	0.0 (0.0)	0.2 (0.5)	– (–)
Aareal Bank Group – specific risk	112.0 (5.3)	40.1 (0.6)	65.4 (3.7)	– (–)
Aggregate VaR – Aareal Bank Group	118.3 (32.6)	51.3 (23.7)	75.3 (27.1)	181.0 (181.0)

Aggregate VaR – Aareal Bank Group
Limits were unchanged during the 2008 financial year. No limit breaches were detected.

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). Due to increased volatility in interest rate markets, a detailed review of the parameters used to calculate interest rate risk was carried out, and the relative parameters recalibrated in view of continued market turbulence. The number of negative outliers – after recalibration – did not exceed five during 2008 (always lower than three in 2007; both figures at Group level), affirming the high forecasting quality of the VaR model we use.

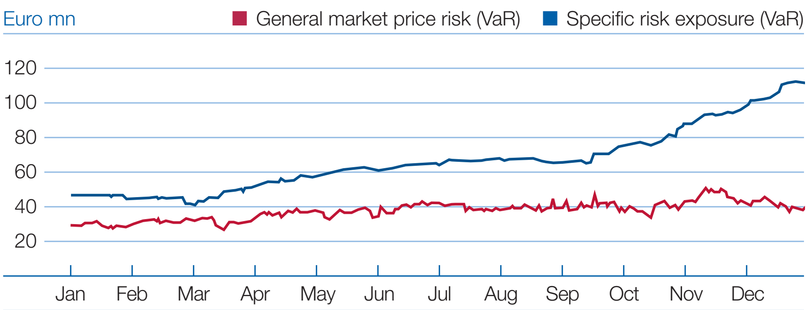
Stress testing
Although VaR has become a standard tool, the concept may fail to adequately project the actual risk in extreme situations – for example, the 1997 crisis in Asia. For this reason, the VaR projection is supplemented by simulating stress scenarios on a weekly basis.

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.

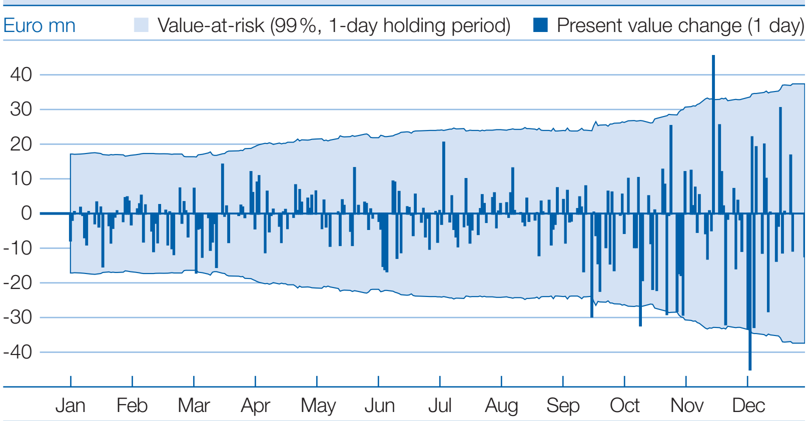
The "worst-case" scenario used in the financial year under review was a 100 basis point upwards parallel yield curve shift. This scenario implied a present value loss of 31 % of the limit as at 31 December 2008.

No breach of set limits occurred during 2007.

General market price risk and specific risk during the course of 2008



Present values and 1-day VaR during the course of 2008



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.

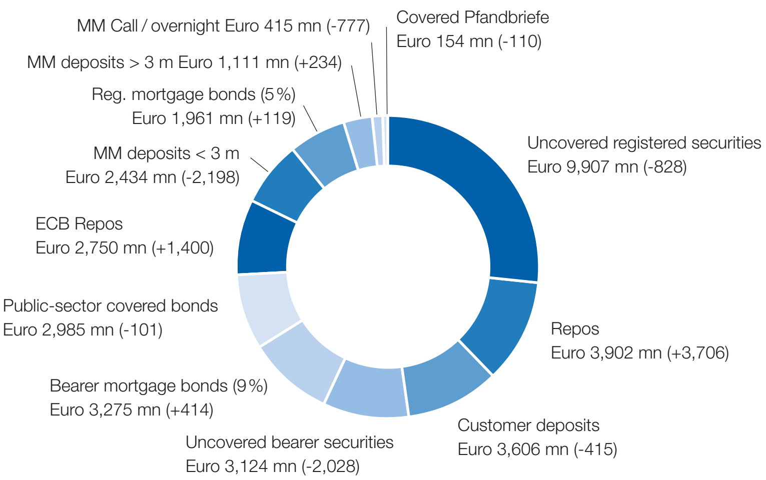
Trading book

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 by the German Banking Act. Given the small number of transactions and low volumes concluded during 2008, trading book risks played a low role in the overall risk scenario.

During the 2008 financial year, the processes employed proved to be able to quantify the risks arising from market price fluctuations in a timely and accurate manner.

Refinancing portfolio diversification by product

as at 31 December 2008, compared to 28 December 2007 — Total volume: Euro 35,6 bn



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.

Despite the decline in the liquidity reserve, on account of the financial markets crisis, no liquidity shortages occurred during 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.

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.

We generally consider the withdrawal of customers' current account balances as the most significant scenario. Even in this stress scenario, liquidity is sufficient to cover the expected liquidity needs under stress conditions.

Liquidity Ordinance (Liquiditätsverordnung)

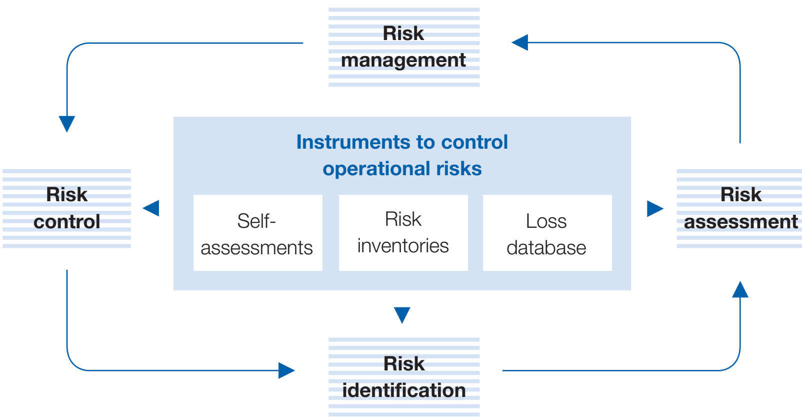
The requirements of the liquidity ratio in accordance with the Liquidity Ordinance, which is relevant to liquidity management, were always complied with, as were the limits set by reference to the liquidity run-off profile.

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.

Management of operational risks



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 all material operational risks across the Group are ensured.

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

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, evaluation, and management – through to risk control.

We continued to develop the system deployed for monitoring and managing risks from outsourced activities and processes during the financial year under review. Under this system, the relevant organisational units assess the performance of the service provider in regular intervals, using defined criteria. The results of this process, and actions taken, are communicated to the bank's senior management within the scope of operational risk reporting, thus allowing for risk-mitigating steps to be taken where needed.

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. Key entities within this segment are the 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, project risks, and financial risks, with market, organisational, and technical risks also being relevant; these risks are very often interrelated.

The process of change in the property management sector prevailed during 2008. 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. To sustainably enhance the profitability of its Blue Eagle and SAP® business, Aareon optimised support and other services. Application management services were added to the existing product portfolio, adapting the range of services to the changing market environment for SAP®-based software applications.

Against the background of the financial markets crisis, the creditworthiness of individual outsourcing clients was verified. No further measures were necessary to date.

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. Where customised software is developed for a specific client, functional specifications are prepared – jointly with the client – prior to commencing development. Developments of standard software modules on the basis of client requests are initially tested with pilot client installations. In addition, the Management Board regularly examines the list of all software development projects (which includes a risk assessment).

Software development is also generally exposed to the risk of being unable to fully comply with client requirements set out in the relevant agreements, which may result claims for damages or warranty claims. To counter such risks, Aareon AG deploys a tool-based requirements management system which tracks all requirements and the relevant compliance. Testing at various levels forms an integral part of the development process. In addition, ERP software is certified on the basis of Audit Standard 880 of the Institute of Public Auditors in Germany: within the scope of certification, the software manufacturer's external auditors affirm compliance with generally-accepted accounting principles. The software user's external auditors are expected to accept certification under the relevant Audit Standard. Finally, information regarding release documentation is forwarded internally, to the sales and consulting teams.

The risk of potential claims for damages from software implementation projects is being mitigated via a 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.

To minimise qualitative risks, Aareon regularly conducts surveys regarding its customers' requirements. A standardised, anonymous customer survey which is conducted on an annual basis is the key indicator of customer acceptance of the company's products and the Aareon brand. This allows Aareon to recognise the market requirements, and to take them into consideration at an early stage in product development.

Executing 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 mitigates these risks through its proprietary project management standards, whereby project launch, project management and closing are divided into phases (initialisation, concept design, realisation, implementation, and closing). The records from client projects as well as internal projects (including the status report, project progress and key results / scheduled progress plus target / actual comparison) are discussed by the Management Board once a month. A multiple project management approach was chosen in order to simultaneously coordinate several projects, also facilitating larger and more complex client projects.

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.

Aareon AG uses integration projects to implement organisational changes such as the merger of French software company Sylogis.com with Aareon France. The focus is on involving everyone concerned, assuring professional and transparent project planning, and on actively identifying and dealing with the risks involved.

All those involved in a project are connected under the motto of "One Company": this is realised, for example, by establishing cross-entity meetings, jointly working on jobs, and through the extensive exchange of information. The targeted project management approach is completed by integrating staff across different Group entities in Germany, supporting integration projects by staff with change management skills, and by leveraging experience gained and procedures developed with past organisational projects.

The Management Committee for the international business continues to conduct regular reviews of the entities in the United Kingdom, Italy, and France. Business development with the international subsidiaries also involves earnings risks. To counter these risks, the restructuring and consolidation measures embarked upon were continued during 2008, with the chose strategy reviewed on an ongoing basis.

The "Value 2010" growth programme was devised for the strategic development of Aareon AG.
The programme's key elements include expanding Blue Eagle, further developing the ERP product strategy, optimising the product portfolio, exploring new business lines related to the property management sector, pursuing the strategy for the international business, and fine-tuning human resources programmes. Aareon AG believes that this strategic project has minimised potential risks regarding revenues and income. Risks of cost increases are countered through cost-conscious business conduct, implemented by way of budgeting.

Risk exposure from potential major disasters affecting the operation of clients' software are minimised, through well-documented and regularly-rehearsed practical counter-measures, 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 AG 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, who 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 6.01 that is already in production, it does not involve any material risks. Following the migration to the new BK@1 accounting system, the risk exposure due to the parallel operation of the legacy ZKF accounting system has been largely eliminated. Migration was successfully completed for all branches, with the exception of very few clients who were unable to execute migration on the planned date, for individual reasons. Assuming successful migration progress going forward, it will be possible to terminate ZKF operations during the first half of 2009, at which point parallel operation of BK@1 and ZKF will cease.

Risk exposure resulting from the operation of the BK@1 software solution is sufficiently covered through the operational processes installed. No serious faults which would have led to serious damages have occurred during the first four years of production.

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's 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.

Aareal First Financial Solutions regularly reviews the emergency scenarios it considers relevant; contingency plans are verified using BCP testing. The market risk regarding utilisation of BK 01® solutions was mitigated by developing (and continuously refining) 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.

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 2008 – 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.

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 this 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 coordinates 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.

Future opportunities and outlook

Development of the environment

The deterioration in the economic environment, which became apparent as early as in 2006, was further significantly exacerbated by the crisis affecting financial markets.

The global economy collapsed on a massive scale towards the end of 2008, with many countries already in recession or approaching it.

The weak economy is burdened further by the financial markets crisis, where banks are facing large-scale write-downs in conjunction with higher capital adequacy requirements. On top of this, banks secure liquidity by investing with central banks, restricting their ability to lend as one of the consequences. In addition, private households saw their wealth diminish, burdening consumption. Sentiment indicators, which already had been in negative territory, fell dramatically during the final months of 2008. The dire mood and negative outlook prevailing in numerous sectors of the economy represent an additional major burden for economic developments over the next 12 to 24 months.

Against this background, it is fair to expect the various sources of demand – corporate investment, consumption, and exports – to remain under significant pressure in 2009. Through feedback effects and cross-relationships, factors burdening individual sources of demand (for example, the impact of lost wealth on consumption) negatively influence other demand components. The economic decline is expected to continue throughout 2009, with any recovery in 2010 likely to be slow and gradual.

Essentially, global economic output is expected to stagnate in 2009. Developed economies are likely to face shrinking output and recession, with very few exceptions. Although the Asian emerging economies will also see a marked slowdown, they can still expect positive growth rates. As a consequence of the economic decline, a global increase in unemployment is anticipated, which may last until 2010.

The numerous action plans adopted by governments to support the financial markets help stabilise markets, which is positive – even though differences in their objectives might lead to critical distortions of the competitive environment.

Economic stimulation packages currently being implemented in many countries may also have a positive effect. To what extent they will in fact be effective will not only depend on the specific actions taken, but also to the extent to which these measures will have a lasting effect improving the dire mood. Despite such positive effects, therefore, it cannot be excluded that downside risks exceed opportunities.

Thanks to lower commodity prices, particularly for crude oil, global inflation declined significantly towards the end of 2008. Given the weak state of the economy, inflation is likely to remain low in 2009 as well. Against the background of lower inflation and economic weakness, ECB cut its interest rate for the Eurosystem's main refinancing facility on 15 January 2009 by 50 basis points to 2.00 %, effective 21 January 2009.

Deflationary risks cannot be excluded for some countries in 2009. Since commodity prices depend upon industrial and consumer demand – with speculative factors also playing a role – a precise forecast is difficult. The slight recovery expected for 2010 is likely to push up inflation again.

We are unable to asses how extensive and lasting the negative effects on the economy will be, given the numerous imponderabilities involved. Specifically, these include the length and intensity of the financial markets crisis, which still impedes the supply of credit to the economy.

Europe

All West European countries are expected to suffer from a shrinking economy. The situation in Central and Eastern Europe is more diverse: even though we expect the economies of Poland, the Czech Republic and Slovakia to slow down in the current macro-economic environment, in contrast to Western Europe, their output is likely to remain largely unchanged, and might even show a minor increase. The situation is markedly different in countries that faced significant financial difficulties at the end of 2008, such as Hungary or the Baltic states. These economies are expected to decline in 2009. The Russian economy came under pressure not only as a result of the crisis affecting financial markets and the economy, but also on account of falling commodity prices. Given the weak global economy, commodity prices are expected to remain rather low, adding further pressure for Russia.

North America (NAFTA states)

The outlook for the US is similar to Western Europe, with the economy in recession during 2009 and some hope for a slight recovery in the following year. The US administration has also launched extensive economic stimulation programmes; whether this will be effective remains to be seen.

Due to the importance of the trading relationships with the US, the economic decline also strongly impacts on Canada and Mexico; our assessment for the US thus applies to the entire NAFTA area.

Asia / Pacific

Japan and Singapore already saw declining economic output during the second half of 2008. In view of the deteriorating world economy and the troubles in the financial sector, these economies will remain under significant pressure during 2009, with lower BIP expected.

Following strong performance over recent years, the Asian emerging economies have also been affected by the global economic slowdown. Lower opportunities for exports to North America and Europe pose the risk of excess industrial production capacity, which could in turn feed back into domestic demand. Even though countries like China are still expected to grow, the rates of growth will be significantly lower compared to previous years, due to the factors discussed.

International property markets

The financial markets crisis has caused uncertainty amongst commercial property investors as well as tenants, leading to great reluctance. As a result, any forecast remains difficult. The following trends are currently foreseeable.

Transaction volumes are expected to remain at very low levels during 2009, and probably also into 2010, particularly compared to the record levels seen in 2006 and 2007. We anticipate higher expected investment yields – and hence, lower prices – for commercial property. We expect rental levels for commercial property to be under pressure around the globe. Even top locations may well see rents fall, albeit at a lower scale of the problem compared to peripheral locations. Rent reductions will become visible in the form of rent-free periods, fixtures and improvements paid for by the landlord, lower rent indexing, and shorter contractual terms, rather than an outright lowering of nominal rent. We believe that office, retail, logistics and hotel properties will suffer from lower returns, given the impact of economic decline across all sectors. Since commercial property markets tend to follow the economic cycle with a certain time lag, we expect this impact to be felt well into 2010.

Europe

Against the background of economic decline and an expected increase in unemployment, we expect vacancies at European locations to increase, with the risk of falling rents (albeit to a varying extent). In our view, this will not be limited to Western Europe, but will also affect the Central and Eastern European economies. We expect yields to rise further as prices fall: this will also affect countries – such as Russia – where yields are already high by European standards.

North America (NAFTA states)

We forecast very low transaction volumes and rising returns (due to falling prices) for commercial property in North America, and particularly in the US. Rents will come under pressure, with declines expected in 2009 on the back of recession and unemployment which rose strongly during the second half of 2008. Whether this trend will continue into 2010 will depend on whether there are any signs of economic recovery by then. The Canadian and Mexican markets, which were still relatively resilient in 2008, will not be immune against the development outlined over the longer term.

Asia / Pacific

Transaction volumes in Asia will also decline in the context of global economic trends. There is a high probability for yields to rise due to falling prices in the region. In view of strong construction activity in China over recent years, and the slowing economies in Japan and Singapore, the commercial property markets will come under pressure.

Going forward, economic activity and developments of commercial property markets will be strongly influenced by market sentiment. Although market participants currently anticipate a negative trend, there is a chance for currently unanticipated positive factors – such as the programmes launched by governments to stimulate the economy – to emerge, improving the mood in the market.

Positive signs in the property markets could materialise if well-capitalised investors start buying again, or if pressure on rents turns out to be less than expected, due to the decline in construction activity.

The German commercial housing sector

Rising energy and operating costs, together with climate protection measures, continue to hold long-term challenges for the sector. Given that prices of fossil fuels are expected to rise over the medium term, the importance of alternative energy technology for residential property portfolios is going to increase. Housing enterprises need to comply with a new legal framework, due to the more demanding minimum requirements for energy-efficient construction and modernisation brought about by the new energy saving regulations which came into force in 2009.

Businesses in the sector will continue to focus on the continuous maintenance and modernisation of housing portfolios, to increase their value. Corporate investments will increase, thanks to significant support by the German government: around € 400 million alone will be made available for the energetic modernisation of large housing estates, under a Federal support programme.

Reflecting the impact of the financial markets crisis, transaction volumes on the residential property market have remained very low, with no recovery expected for 2009. Nonetheless, international investors have retained their exposure as investors in German housing companies. The potential for selling flats to tenants, or to raise rents, was often overstated – as a consequence, investors in residential property are unlikely to see their target returns, which were frequently very optimistic. This will lead investors who saw their business plans falter to try and sell their property – increasing the supply of residential property portfolios, whilst demand is slowing due to difficult financing terms.

Individual segments of the residential property market will show further signs of differentiation, irrespective of the financial markets crisis. Whilst prices and rents will increase in major cities and urban areas, prices in weak economic regions will continue to slump. Moreover, tenants are becoming more demanding: housing enterprises will respond by accommodating modified household structures (such as ‚patchwork' families, singles, and senior citizens) as well as the combination of working and private life.

To succeed in competition, housing enterprises will have to maintain a sustainable portfolio management, optimising their portfolio structure and competitiveness whilst offering their customers housing products in line with their specific needs. Against the background of increasing cost-sensitivity throughout the sector, the need for efficiency-enhancing IT and payments solutions will continue to rise.

Corporate development

With the agreement entered into with SoFFin at the beginning of 2009, Aareal Bank has addressed the key risks resulting from the crisis. The bank is well positioned to weather the challenges it faces in the years to come. In particular, the bank has retained full flexibility in its operative business, improving its starting position for the post-crisis period. At the same time, this maintains a level playing field for Aareal Bank for competing with various domestic and international banks who have already received government support. The bank will continue to be a reliable partner for its clients and investors. Moreover, by seeking support the bank complied with its social responsibility, and secured jobs.

Taking into account the silent participation from SoFFin, which is fully eligible for inclusion in Tier I capital, Aareal Bank's Tier I ratio (based on the Credit Risk Standard Approach) would have increased to 10.3 % as at the end of 2008.

Structured Property Financing

In our property finance business, we continue to feel the negative influence of the financial markets crisis and economic decline. Given the high volatility prevailing on capital markets, it is currently impossible to responsibly communicate a concrete projection for the next 24 months. The fees payable for the provision of the silent participation, and for any utilisation of the guarantee facility, will burden Aareal Bank's net interest income and net commission income.

We anticipate the returns on properties serving as collateral for our exposures to decline on account of the economic decline. In conjunction with the difficult situation many property investors find themselves in anyway, this may lead to higher loan loss provisions in the years 2009 and 2010, compared to 2007 and 2008. The silent participation has increased our risk-bearing capacity. Moreover, we focus on first-ranking property loans, concentrating on financing existing properties which ensure a stable cash flow thanks to their good rental situation. At around 70 %, the average loan to value ratio of our exposures is significantly lower than during other crises in the past. Accordingly, given the high quality and broad regional and sector diversification of our property financing portfolio (and our clients), there is the chance of being able to compensate for potential spikes in individual markets.

We also expect that property investors in particular will face increasing problems to procure follow-up financing to refinance their existing loans. Accordingly, we envisage that many property investors – irrespective of the outstanding quality of their properties – will be forced to rely on their existing banking relationships for extending the terms of existing loans. Repayments are thus expected to be low during the current year. Having gained access to government-backed funding, we are in a position to continue financing our clients' projects. In doing so over the next twelve months, our main focus will be on our existing client base, and on existing financings. Over and above such extensions of existing facilities, we will continue to adopt a selective stance in originating new business in 2009, consistently exploiting opportunities as they arise.

We have a sound refinancing structure: we have access to sufficient liquidity, and the average term of loans extended is shorter than the maturities of refinancing in place. However, in a scenario where our credit clients are unable to repay their loans when due, over a longer period of time and in a significant amount, forcing us to extend the maturity of such exposures, combined with our possible inability to roll over our own liabilities, we will take necessary steps such as utilising SoFFin guarantees.

We observe a re-entry of well-capitalised property investors with a long-term investment horizon: this is a good sign for the medium to long-term development. Those investors focus on generating long-term returns from property investments, rather than on short-term profits from market fluctuations. In the long run, this will lead to a rise in market 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.

So far, the various rescue and development programmes launched in 2008 to support banks have not yet sustainably boosted confidence amongst market participants, which is a precondition for reducing market volatility. The resulting scope for volatility to remain high during the current financial year holds major challenges for banks.

On a medium to long-term view, we expect competitive pressures to abate, as some competitors will abandon or cut back their activities, thus reducing the overall number of banks competing for property finance business.

Consulting / Services

Due to its structure, the Consulting / Services segment is much less sensitive to the impact of the financial markets crisis and the resulting volatility, allowing for more concrete forecasts.

Aareon

The investment phase for Blue Eagle / SAP® has already been concluded. We anticipate the number of residential units managed through Blue Eagle to rise in the 2009 and 2010 financial years, which will boost consulting revenues. However, we expect our clients to be more reluctant towards new investments over the next 24 months as originally anticipated. Accordingly, we slightly reduced our expectations regarding growth rates in the profit contribution generated by Blue Eagle.

Aareal Bank will largely retain its market share in relation to the existing GES and WohnData products. We expect a slight decline in the product result of our GES solution for SMEs over the next two years, as further clients will migrate to other Aareon ERP products.

The integration of the Wodis product into Aareon AG's service range, together with other available integrated services, has been very well received by the market. The integrated services offer our clients added value as well as being key features that distinguish us from our competitors. We expect the product's profit contribution to increase in 2009, with the Mareon services portal and BauSecura's insurance service expected to provide support through attracting new clients.

Payments services

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 is 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 offers the bank the potential to acquire new clients.

In spite of the expected economic framework, we continue to believe that we will be able to reach our target segment result before taxes of € 50-60 million in 2009.

Aareal Bank Group

Aareal Bank Group envisages consolidated net interest income for the current year to be burdened as a result of the lower new business volumes generated in the Structured Property Financing segment. From today's perspective, new business will range between € 2 billion and € 3 billion, with a predominant focus on business with the existing client base.

The Management Board envisages the allowance for credit losses to remain at a manageable, but significantly higher level than in 2008. Administrative expenses are expected at the previous year's level, including consolidation effects.

In the Consulting / Services segment, the Aareal Bank Group envisages a continuation of the positive performance seen over recent years, with further earnings increases.

It is not possible to give a reliable, comprehensive forecast for Group results at this time in light of the ongoing crisis affecting financial markets and the economy.

We maintain our medium-term target return on equity of 13 % after taxes. In the current environment, however, it is no longer possible to define this target with respect to a specific year: instead, we pursue achieving the target over the next two to five years.

Main features of the remuneration system

The Supervisory Board determines the structure and amount of remuneration for members of the Management Board. It determines 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 I) 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 II). 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.

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.

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.

Please refer to the Notes to the Consolidated Financial Statements (Remuneration Report) on pages 184 et seq. 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.

Disclosure pursuant to section 315 (4) of the HGB and explanatory report pursuant to section 120 of the AktG

Composition of subscribed capital

The issued share capital of Aareal Bank AG amounts to € 128,265,477.00, divided into 42,755,159 notional no-par value bearer shares (‘unit shares’), with a proportionate share in the share capital of € 3.00 per share. Each share casts one vote at a General Meeting. There are no shares with special rights granting supervisory powers to any shareholder or shareholder group. The company currently does not hold any treasury shares, which would not be entitled to vote.

Restrictions affecting voting rights or the transfer of shares

The exercise of voting rights and the transferability of shares by shareholders are governed exclusively by applicable law. The exercise of voting rights from the shares concerned is precluded by law in the cases where section 136 of the AktG applies. Where the company holds treasury shares, section 71b of the AktG prohibits the exercise of rights vested in such shares. We are not aware of any other restrictions affecting voting rights or the transfer of shares.

Shareholdings exceeding 10 % of voting rights

Pursuant to the German Securities Trading Act (WpHG), any investor whose shareholding in a listed company reaches, exceeds or falls short of certain threshold values in terms of voting rights (whether by purchase, sale or by any other means) must notify the company and the German Federal Financial Supervisory Authority. The lowest threshold for this notification duty is 3 %. 62.77 % of Aareal Bank AG shares are held in free float. Aareal Holding Verwaltungsgesellschaft mbH is the company's largest shareholderl, with a stake of 37.23 %. During the course of the financial year under review, BT Pension Scheme Trustees Limited, London, reduced its shareholding to less than 10 % of voting rights. Aside from these shareholdings, we are not aware of any direct or indirect shareholding which would exceed 10 % of voting rights.

Shares with special rights granting the holder supervisory powers

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

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

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

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

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

Pursuant to section 179 of the AktG, the Memorandum and Articles of Association may be amended by way of resolution passed by the General Meeting. In the event of a capital change, the Supervisory Board is authorised to modify the wording of the Articles of Association in line with the amount of the capital change (Article 5 (8) of the Memorandum and Articles of Association). Resolutions of the General Meeting regarding amendments to the Memorandum and Articles of Association are passed by a simple majority of the votes cast, or – to the extent permitted by law – by the majority of the issued share capital present at the Meeting. In accordance with section 181 (3) of the AktG, amendments to the Memorandum and Articles of Association become effective upon their entry in the company's Commercial Register.

Authorisation of the Management Board to issue or repurchase shares

Authorised capital

The Annual General Meeting held on 15 June 2005 resolved to authorise the Management Board 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 shares for contribution in cash or in kind. This authorisation will expire on 14 June 2010. The shareholders must be granted subscription rights in the event of a capital increase against cash contributions. The Management Board is authorised to exclude shareholders' pre-emptive subscription rights in the event of a capital increase not exceeding 10 % of the issued share capital at the time of exercising the authorisation, subject to approval by the Supervisory Board and provided that the issue price is not significantly lower than the prevailing market price. Article 5 (4) lit. b) to d) of the Memorandum and Articles of Association sets out further conditions for excluding shareholders' pre-emptive subscription rights. The Management Board may exclude shareholders' pre-emptive subscription rights in the event of a capital increase against contributions in kind. Following the capital increase resolved on 6 November 2005 and implemented on 21 November 2005, the residual amount of this authorised capital currently amounts to € 46,639,504.00.

In addition, the Annual General Meeting held on 21 May 2008 resolved to authorise the Management Board to increase, on one or more occasions, the company's share capital by up to a maximum nominal amount of € 12,826,545.00 by issuance of new shares for contribution in cash or in kind. This authorisation will expire on 20 May 2013. In the event of a capital increase against cash contributions, shareholders must be granted a subscription right unless this is exceeded by virtue of one of the reasons set out in Article 5 (6) lit. a)-d) of the Memorandum and Articles of Association. The Management Board may exclude shareholders' pre-emptive subscription rights in the event of a capital increase against contributions in kind.

Conditional capital

Pursuant to Article 5 (5) of the Memorandum and Articles of Association, the share capital is subject to a conditional capital increase of up to € 30 million by means of issuing up to 10 million new notional no-par value bearer shares. The purpose of the conditional capital increase is the granting of shares to holders or creditors of convertible bonds and / or bonds cum warrants issued in accordance with the authorisation by the General Meeting held on 21 May 2008, which authorises the issue of convertible bonds and / or bonds cum warrants in an aggregate nominal amount of € 600 million until 20 May 2013. Under the authorisation, subsidiaries of Aareal Bank AG may also issue convertible bonds and / or bonds cum warrants, and subject to approval by the Supervisory Board allows the company to guarantee such issues as well as to issue shares to fulfil the resulting conversion or option rights.

Subject to the approval of the Supervisory Board, the Management Board may exclude shareholders' pre-emptive rights in the certain cases. Notwithstanding the provisions of section 9 (1) of the AktG, in certain circumstances holders of conversion or option rights are entitled to be protected against dilution. The new shares will be issued at the conversion or option price to be set as defined in the resolution passed by the General Meeting on 21 May 2008. 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 is performed, and to the extent that treasury shares are not utilised to service such convertible bonds and / or bonds cum 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, by way of exercise or conversion. The Management Board is authorised to determine any further details of the conditional capital increase, subject to approval by the Supervisory Board. The purpose of this authorisation to issue convertible bonds and / or bonds cum warrants (where the issue of shares to honour the obligations under such convertible bonds and / or bonds cum warrants is covered by the conditional capital) is to provide the Management Board with the flexibility to act swiftly when raising finance, in the interests of the company. The Management Board has not yet exercised this authorisation.

Authorisation to purchase treasury shares

The General Meeting held on 21 May 2008 authorised the Management Board, pursuant to Section 71 (1) No. 8 of the AktG, up to 20 November 2009, to acquire and sell treasury shares for purposes other than securities trading, up to a maximum volume of ten per cent (10 %) of the issued share capital at the time of passing the resolution or – if this value is lower – of the share capital existing at the time of exercising this authorisation for purposes other than securities trading. Shares may be acquired via the stock exchange or by means of a public offer to buy, which is addressed to all shareholders. The Management is authorised to effect the sale of any treasury shares acquired in accordance with this authorisation, subject to approval by the Supervisory Board, via channels other than the stock exchange or an offer to all shareholders, provided that the sale is carried out at a price that is not significantly lower than the stock exchange price of the company's shares at the time of sale. This authorisation is subject to the proviso that the aggregate value of shares sold under this authorisation and 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. Subject to approval by the Supervisory Board, pre-emptive subscription rights on the sold shares may also be excluded in the event of a sale against contributions in kind, or if the sold shares are given to the holders of conversion or option rights in lieu of new shares from a contingent capital increase. The Management Board is also authorised to exclude the pre-emptive subscription rights to the extent required to grant subscription rights to new shares to owners of convertible bonds or bonds cum warrants which were issued in the meantime in such an amount as would be due to them once they exercised their option rights. The Management Board is authorised to call in any of the shares acquired under this authorisation, without any further resolutions by the General Meeting being necessary. The company did not exercise this authorisation to purchase or dispose of treasury shares during the year under review.

Renewing the authorisation to purchase treasury shares on an annual basis is in line with widely accepted practice of German listed companies. In line with authorised capital and conditional capital, this serves the company's interest of having access to flexible financing options.

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

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

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

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 approx. 45 % 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 approx. 30 % of the annual fixed remuneration.

Contents II

Consolidated Financial Statements

Consolidated Financial Statements

Consolidated Income Statement of Aareal Bank Group

Euro mn	Note	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Interest income		2,002	1,903
Interest expenses		1,530	1,492
Net interest income	25	**472**	**411**
Allowance for credit losses	26	80	77
Net interest income after allowance for credit losses		**392**	**334**
Commission income		212	205
Commission expenses		62	63
Net commission income	27	**150**	**142**
Net result on hedge accounting	28	0	1
Net trading income/expenses	29	-23	-26
Results from non-trading assets	30	-95	206
Results from investments accounted for using the equity method	31	7	68
Results from investment properties	32	-1	1
Administrative expenses	33	347	361
Net other operating income/expenses	34	34	18
Impairment of goodwill	35	0	3
Operating profit		**117**	**380**
Income taxes	36	39	72
Consolidated net income / loss		**78**	**308**
Allocation of results			
Consolidated net income/loss attributable to minority interests		18	18
Consolidated net income/loss attributable to shareholders of Aareal Bank AG		60	290
Appropriation of profits			
Consolidated net income/loss		78	308
Consolidated net income/loss attributable to minority interests		18	18
Transfer to retained earnings		–	143
Consolidated profits		**60**	**147**
Euro			
Earnings per share	37	**1.41**	**6.77**
Diluted earnings per share	37	**1.41**	**6.77**

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

Consolidated Income Statement (Quarterly Development)

Euro mn	Quarter 4 2008	Quarter 3 2008	Quarter 2 2008	Quarter 1 2008	Quarter 4 2007
Interest income	511	512	494	485	505
Interest expenses	377	395	380	378	396
Net interest income	**134**	**117**	**114**	**107**	**109**
Allowance for credit losses	20	20	20	20	14
Net interest income after allowance for credit losses	**114**	**97**	**94**	**87**	**95**
Commission income	69	47	49	47	53
Commission expenses	21	13	14	14	16
Net commission income	**48**	**34**	**35**	**33**	**37**
Net result on hedge accounting	-3	1	0	2	-3
Net trading income/expenses	-23	25	-3	-22	-20
Results from non-trading assets	-59	-37	-8	9	18
Results from investments accounted for using the equity method	4	–	3	0	–
Results from investment properties	-1	0	0	0	0
Administrative expenses	86	84	89	88	88
Net other operating income/expenses	17	-5	16	6	-9
Impairment of goodwill	0	–	–	–	3
Operating profit from continuing operations	**11**	**31**	**48**	**27**	**27**
Income taxes	3	11	16	9	5
Consolidated net income/loss	**8**	**20**	**32**	**18**	**22**
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	4	15	28	13	18

Consolidated Balance Sheet of Aareal Bank Group

Euro mn	Note	31 Dec 2008	31 Dec 2007
Assets			
Cash funds	38	693	1,051
Loans and advances to banks	39	1,165	2,245
Loans and advances to customers	40	24,771	24,985
Allowance for credit losses	41	-232	-190
Positive market value of derivative hedging instruments	42	1,256	899
Trading assets	43	2,168	1,819
Non-current assets held for sale and discontinued operations	44	8	20
Non-trading assets	45	10,654	8,811
Investments accounted for using the equity method	46	3	92
Investment properties	47	94	10
Intangible assets	48	86	80
Property and equipment	49	96	101
Income tax assets	50	60	32
Deferred tax assets	51	135	61
Other assets	52	202	186
Total		**41,159**	**40,202**
Shareholders' equity and liabilities			
Liabilities to banks	53	8,977	4,953
Liabilities to customers	54	20,605	21,790
Certificated liabilities	55	6,424	7,862
Negative market value of derivative hedging instruments	56	1,313	1,128
Trading liabilities	57	649	995
Obligations from disposal groups held for sale and discontinued operations	58	–	0
Provisions	59	258	273
Income tax liabilities	60	21	18
Deferred tax liabilities	61	55	55
Other liabilities	62	162	183
Subordinated equity	63	1,266	1,318
Shareholders' equity	64		
Subscribed capital		128	128
Capital reserves		511	511
Retained earnings		678	554
Other reserves		-192	44
Minority interest		244	243
Consolidated profits		60	147
Total shareholders' equity		1,429	1,627
Total		**41,159**	**40,202**

Consolidated Statement of Changes in Shareholders' Equity [1)]

				Other reserves							
Euro mn	Sub-scribed capital	Capital reserves	Retained earnings	Trans-actions under common control	from business combination	Revaluation surplus	Hedging reserves	Currency translation reserves	Con-solidated profits	Minority interest	Con-solidated share-holders' equity
Consolidated shareholders' equity as at 1 January 2008	**128**	**511**	**554**	**-26**	**0**	**69**	**1**	**0**	**147**	**243**	**1,627**
Changes in gains/losses recognised directly in equity						-402	-2	1			-403
Reclassifications of gains/losses previously recognised in equity to the income statement						78					78
Remeasurement upon business combinations											0
Changes in tax effects (deferred taxes)						71					71
Income and expenses recognised directly in equity, net					**0**	**-253**	**-2**	**1**			**-254**
Consolidated net income/loss									60	18	78
Total income and expense for the period					**0**	**-253**	**-2**	**1**	**60**	**18**	**-176**
Transfer to retained earnings			126						-126		0
Dividend payment									-21		-21
Effects from transactions under common control				18							18
Reclassifications											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 December 2008	**128**	**511**	**678**	**-8**	**0**	**-184**	**-1**	**1**	**60**	**244**	**1,429**

[1)] Please see Note (64) for general information on consolidated shareholders' equity

				Other reserves							
Euro mn	Sub-scribed capital	Capital reserves	Retained earnings	Trans-actions under common control	from business combination	Revaluation surplus	Hedging reserves	Currency translation reserves	Con-solidated profits	Minority interest	Con-solidated share-holders' equity
Consolidated shareholders' equity as at 1 January 2007	**128**	**511**	**314**	**-18**	**0**	**89**	**-2**	**-1**	**107**	**244**	**1,372**
Changes in gains/losses recognised directly in equity						5	1	1			7
Reclassifications of gains/losses previously recognised in equity to the income statement						-33	2				-31
Remeasurement upon business combinations					13						13
Changes in tax effects (deferred taxes)						8					8
Income and expenses recognised directly in equity, net					**13**	**-20**	**3**	**1**			**-3**
Consolidated net income/loss									290	18	308
Total income and expense for the period					**13**	**-20**	**3**	**1**	**290**	**18**	**305**
Transfer to retained earnings			229						-229		0
Dividend payment									-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 December 2007	**128**	**511**	**554**	**-26**	**0**	**69**	**1**	**0**	**147**	**243**	**1,627**

Consolidated Statement of Cash Flows [1)]

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Consolidated net income/loss	**78**	**308**
Write-downs, valuation allowances and write-ups on loans and advances	80	63
Additions to and reversals of loan loss provisions, net	10	16
Amortisation, depreciation, impairment and write-ups on non-current assets	89	24
Other non-cash changes	-2,723	643
Gains/losses on the disposal of non-current assets	65	-197
Other adjustments	400	57
Subtotal	**-2,001**	**914**
Changes in loans and advances to banks	1,089	444
Changes in loans and advances to customers	519	-1,923
Changes in trading assets	–	0
Changes in other assets from operating activities	188	465
Changes in liabilities to banks	4,250	-417
Changes in liabilities to customers	-599	164
Changes in certificated liabilities	-1,323	722
Changes in trading liabilities	0	0
Changes in provisions	-82	-102
Changes in other liabilities from operating activities	-132	-260
Income taxes paid/income tax refunds	-44	27
Interest received	1,632	2,668
Interest paid	-1,837	-2,565
Dividends received	0	0
Cash flow from operating activities	**1,660**	**137**
Proceeds from the disposal of non-trading assets and investments accounted for using the equity method	591	2,748
Payments for the acquisition of non-trading assets and investments accounted for using the equity method	-2,404	-3,028
Proceeds from the disposal of property and equipment, intangible assets and investment properties	22	194
Payments for the acquisition of property and equipment, intangible assets and investment properties	-140	-218
Effect of changes in reporting entity structure	–	–
Changes due to other investing activities	–	0
Cash flow from investing activities	**-1,931**	**-304**
Dividends paid	-21	-21
Changes in subordinated equity	-49	-72
Changes due to other financing activities	-17	-20
Cash flow from financing activities	**-87**	**-113**
Cash and cash equivalents as at 1 January	**1,051**	**1,331**
Cash flow from operating activities	1,660	137
Cash flow from investing activities	-1,931	-304
Cash flow from financing activities	-87	-113
Cash and cash equivalents as at 31 December	**693**	**1,051**

[1)] Please see Note (81) for general information on the consolidated statement of cash flows

Notes to the Consolidated Financial Statements (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 2008 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 10 March 2009 and were published on 27 March 2009.

All subsidiaries and joint ventures of Aareal Bank AG have been included in the consolidated financial statements as at 31 December 2008 by way of consolidation. Companies over which Aareal Bank AG may exercise a significant influence ("associates") are measured using the equity method.

In the financial year 2008, the following changes occurred in the reporting entity structure:

Effective 31 March 2008, Aareal Financial Services USA Inc., Wilmington / Delaware, hitherto a company of the Aareal Bank Group, was merged into Aareal Capital Corporation, Wilmington / Delaware, which was established in January 2008 (also as a member of the Aareal Bank Group).

In the fourth quarter of 2008, Aareal Bank AG acquired 25% of the shares in Main Triangel GmbH, Wiesbaden, for a consideration of € 1. The bank's total shareholding in the company thus increased from 50 % to 75 %. The German Federal Cartel Office (Bundeskartellamt) approved the transaction on 15 October 2008.

The company, which previously was included in the consolidated financial statements by proportionate consolidation, has been included by way of full consolidation since November 2008. The assets and liabilities attributable to Main Triangel GmbH within the framework of the consolidated financial statements are listed in the following table:

Euro mn	Carrying amounts prior to remeasurement in acc. with IFRS 3.36	Carrying amounts after remeasurement in acc. with IFRS 3.36
Property	76	76
Other assets	4	4
Liabilities to banks	61	61
Other liabilities	19	19

Full consolidation resulted in recognition of goodwill in the amount of € 0.5 million. The consolidated income statement of the Aareal Bank Group for the year ended 31 December 2008 includes the Group's share in Main Triangel GmbH's earnings for 2008, until the date of initial consolidation (€ 4 million). Gains and losses incurred since the date of full consolidation are fully included in the consolidated income statement (net loss of € 1 million). This amount is allocated to the shareholders of Aareal Bank AG (€ 0.8 million) and minority interests (€ 0.2 million).

There was also a number of mergers within the Aareal Bank Group as well as individual purchases and disposals which are insignificant from a Group perspective.

An overview of material subsidiaries as at 31 December 2008 (quoting their country of domicile and the percentage of voting rights held) is given in section (G) "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.

General accounting policies

(1) Accounting standards

Recognition and measurement is based on principles consistently applied throughout the Group.

We generally 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. If the criteria of IAS 12.74 are met, deferred tax assets and deferred tax liabilities are offset.

Income and expense are recognised on an accrual basis.

The presentation of the financial position and the financial performance in the consolidated financial statements depends on the recognition and measurement methods underlying the preparation of the financial statements, as well as on estimates and assumptions as a result of the uncertainty associated with future events. Any assumptions and estimates required for recognition and measurement are in line with the relevant accounting standards. Estimates and assumptions are based on historical experience and other factors, such as planning and current expectations and forecasts with respect to the occurrence of future events.

The most significant forward-looking assumptions and key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year primarily refer to the calculation of pension obligations, allowances for credit losses and loan loss provisions, the measurement of goodwill, property and deferred tax assets as well as the determination of fair values of certain financial instruments.

(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 into the functional currency on the basis of the ECB reference rate prevailing on the balance sheet date. Non-monetary items measured at amortised cost are translated using historical rates. Foreign exchange forward transactions are measured at the forward exchange rate prevailing on the balance sheet date.

Currency translation adjustments on monetary assets and liabilities must be recognised in income. Depending on the relevant measurement category, currency translation adjustments on non-monetary items are either recognised directly in equity (in the currency translation reserves), or recognised in income (in net trading income).

Financial statements of consolidated subsidiaries, which are presented in a currency other than the euro, are translated at the exchange rate prevailing at the reporting date. Translation differences are recognised in equity, in the currency translation reserves.

(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 a separate equity item.

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 based on the purchase method, in accordance with IFRS 3, whereby remeasured amounts must be used when recognising assets and liabilities (including any hidden reserves and hidden encumbrances) of an entity to be consolidated. This may lead to the recognition of new assets and liabilities 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 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.

Associates are companies in which the Group has an equity interest and may exercise significant influence, without exercising control. Associates are measured using the equity method. The Group's share in the profit or loss 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

Against the background of the deterioration of the financial markets crisis, the International Accounting Standards Board (IASB) adopted amendments to standards IAS 39 and IFRS 7 ("Reclassification of Financial Assets") on 13 October 2008. These amendments were approved by the EU, and published in the Official Journal on 16 October 2008.

It was permitted, until 1 November 2008, to opt for retrospective application of these amendments as at 1 July 2008. The amendments provide for additional options to reclassify certain non-derivative financial assets within the measurement categories pursuant to IAS 39, and subject to certain conditions.

The Aareal Bank Group opted for retrospective application of the amendments. The impact of the amended accounting rules on the Group's financial position and performance is explained in Note (68) "Reclassification of financial assets" included in Section (D) "Reporting on Financial Instruments".

In addition, 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 in the financial year 2008:

- Amendments to IAS 1 Presentation of Financial Statements: A Revised Presentation
- Amendment to IAS 23 Borrowing Costs
- Amendment to IFRS 2 Share-based Payment: Vesting Conditions and Cancellations
- IFRIC 13 Customer Loyalty Programmes
- IFRIC 14 IAS 19 The Limit of a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

In December 2008, these standards and interpretations were included in the group of standards and interpretations that are required to be applied for financial years beginning after 31 December 2008. The Aareal Bank Group has not exercised the option for early application of the above-mentioned standards and interpretations.

The first-time adoption of these new standards and interpretations in 2009 is not expected to have any material consequences on recognition and measurement in the Group.

IFRS 8 "Operating Segments", which was published by the IASB and endorsed by the European Commission in November 2007, is required to be applied for the first time for financial years beginning on or after 1 January 2009. IFRS 8 supersedes the previous IAS 14 "Segment Reporting". The Aareal Bank Group opted for early application of IFRS 8 and applied the standard for the first time in financial year 2008. Application of IFRS 8 had no material effects on recognition and measurement in the Group. Above all, there were no changes to the operating segments classified as reportable segments by the Aareal Bank Group.

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 value of derivative hedging instruments
- Trading assets
- Non-trading assets
- Income tax assets
- Other assets
- Liabilities to banks
- Liabilities to customers
- Certificated liabilities
- Negative market value of derivative hedging instruments
- Trading liabilities
- 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:

- Financial assets at fair value through profit or loss
- Held to maturity (htm)
- Loans and receivables (lar)
- Available for sale (afs)

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

- Held for trading (hft) and
- Designated as at fair value through profit or loss (dfvtpl)

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, subject to certain conditions, to irrevocably designate financial instruments as at fair value, irrespective of any intention to trade (fair value option).

The Aareal Bank Group uses the fair value option for certain structured financial instruments that comprise one or more embedded derivatives. This avoids separation of these products in a separate derivative and a host contract. Such designation is not permitted when the embedded derivative only insignificantly modifies the cash flows generated otherwise from the contract, or when it becomes obvious – with little or no analysis – that the separation of the derivative from the host contract is not permitted.

The fair value option has only been exercised with respect to the measurement of assets, and not to the measurement of liabilities.

Upon first-time recognition, financial instruments allocated to the sub-category ”Financial assets at fair value through profit and loss“ are recognised at fair value (excluding transaction costs), and subsequently measured at fair value, with gains or losses recognised in income.

”Held to maturity“ financial instruments are non-derivative 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 fair value (plus transaction costs which can be directly attributed), and subsequently measured at amortised cost.

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, or 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 any gains or losses 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, for example, a downgrade of an external credit rating to ”BBB“ or worse. Objective evidence of impairment also exists when the issuer or debtor faces significant financial difficulties, or in case of a breach of contract or an increased likelihood of the borrower’s insolvency. 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 the equity instrument concerned at the valuation date is below the average acquisition costs for more than one year.

In the event of impairment, the carrying amount of a financial asset is written down to its recoverable amount, i. e. the present value of the future cash flows expected to be generated from the financial asset (for "Loans and receivables" or "Held to maturity" financial assets), with a corresponding expense being recognised in the income statement. Where reasons for impairment cease to exist subsequently, the necessary reversals of impairments (write-ups) are generally recognised in income. The carrying amount after the reversal of an impairment loss may not exceed the asset's (amortised) cost. In case of an impairment of "Available for sale" financial instruments, the accumulated losses previously recognised directly in equity in the revaluation surplus are reclassified to the income statement. If the reasons for impairment cease to exist, a reversal (up to amortised cost) to be recognised in income is permitted only for debt securities. Amounts exceeding amortised cost, as well as reversals of impairment losses 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:

- Financial liabilities at fair value through profit or loss
- Financial liabilities measured at amortised cost (lac)

The "Financial liabilities at fair value through profit or loss" category corresponds to the same category for financial assets. Upon first-time recognition, financial liabilities allocated to the category "Financial liabilities 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 allocated to the category "Financial liabilities measured at amortised cost". Financial liabilities of that category are initially recognised at fair value (less transaction costs), and subsequently measured at amortised cost.

If, in accordance with IAS 39.11, embedded derivatives are required to be separated, the host contract is accounted for pursuant to the standards applicable for the financial instrument concerned, while the separated derivative is accounted for separately, or the entire contract is accounted for using the fair value option.

(6) Loans and advances

Loans and advances are disclosed under the line items "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 amortised 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) Allowance for credit losses

The allowance for credit losses comprises specific valuation allowances, as well as portfolio-based valuation allowances.

Where it is probable that the expected future cash flows fall below the carrying amount of a loan or an advance, specific valuation allowances 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, using the effective interest. Collateral is largely provided in the form of land charges or mortgages; these are measured in line with the measurement methods used for 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, which is determined in regular intervals. In the financial year 2008, an additional portfolio-based valuation allowance was recognised due to the weakening economy.

Recognition and reversal of allowances for credit losses are directly reflected in income. The balance of allowances for credit losses is shown in a separate allowance account. The increase in the present value over time of an impaired loan or advance (so-called unwinding) leads to a corresponding change of the allowance account: the change is recognised as interest income. Interest income is calculated using the original effective interest rate of the loan / advance concerned.

Uncollectable loans and advances are derecognised against specific valuation allowances previously recognised, or written off directly. Payments on loans and advances 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. In addition, receivables and liabilities from money-market transactions are reported under trading assets or trading liabilities, respectively. Financial instruments disclosed under these items are classified under the measurement category "At fair value through profit or loss". Net interest income / expense as well as measurement results, or realised gains or losses on trading assets or liabilities are reflected in net trading income. 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

Non-current assets and disposal groups including discontinued operations that are classified as held for sale in accordance with IFRS 5 are generally measured at the lower of carrying amount and fair value less costs to sell, and have to be reported in a separate item in the balance sheet. Gains or losses from discontinued operations have to be shown separately in the income statement as well.

(10) Hedging relationships

The bulk of Aareal Bank Group's portfolio of derivative financial instruments (derivatives) 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 hedging relationship 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 (hedged item). 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 results from hedging relationships). A fully effective hedging relationship results in offsetting measurement gains or losses. Interest on the underlying transaction and the hedge is recognised in net interest income.

The hedging relationship may result in adjustments in the carrying amount of the underlying transaction. Such adjustments will only be recognised in income at the end of the transaction term.

Derivatives used as hedging instruments for the purposes of a cash flow hedge serve to hedge future cash flows. 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 results from hedging relationships). When the hedging relationship 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.

Measurement gains or losses from stand-alone derivatives used to hedge economic market price risks, but which do not fulfil the formal criteria for applying hedge accounting, are reported in net trading income together with the effects from the measurement of the hedged risk. Current interest earned from such derivatives is reported in net interest income, together with interest from hedged underlying transaction.

(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 non-trading assets are recognised at cost, plus attributable transaction costs.

Premiums and discounts are amortised on a straight-line basis over the term, and recognised in income.

Debt and other fixed-income securities reported in non-trading assets are allocated to the measurement categories "Available for sale", "Loans and receivables", "Held to maturity" and "At fair value through profit or loss". 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 and management costs specific to the property. Methods used for determining the fair value are the income capitalisation approach or the discounted cash flow method. The interest rates used can be derived from the type and location of the property as well as from the current market situation. 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 non-current assets held for sale and discontinued operations, investment property and other assets.

Payments received or made under operating leases are amortised on a straight-line basis over the term of the lease and recognised in net other operating income / expenses in the income statement.

(15) Intangible assets

Intangible assets (except goodwill) are carried at cost, less accumulated amortisation and impairment losses.

All research costs for proprietary software are directly recognised as expenses. Development costs are capitalised from the time when the software development can be regarded as completed from a technical perspective, and the fulfilment of several other conditions. 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 (fair value) less accumulated impairments. Any negative goodwill arising upon acquisition is 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 to generate cash inflows largely independent of the cash inflows from other assets or groups of assets. The Aareal Bank Group defines cash-generating units either on the basis of a single subsidiary or on product level. The recoverable amount of an asset or a cash-generating unit is the higher of fair value less costs to sell, and value in use. Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset or cash-generating unit.

(16) Property and equipment

Property and equipment is measured at cost, less accumulated depreciation and impairment losses.

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 in 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).

The costs of purchasing low-value assets in the amount of up to € 150 are expensed as incurred.

Any assets with a cost of more than € 150, but not exceeding € 1,000, are combined in a collective account for the year, which is then depreciated on a straight-line basis over a period of five years.

(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 such existing tax loss carryforwards within three years following the reporting date.

Existing deferred tax assets are 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.

Deferred tax assets and deferred tax liabilities are offset in accordance with IAS 12.74 when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or tax group.

(18) Other assets

Properties reported under other assets are intended for short-term disposal, though the IFRS 5 criteria are not met. They are measured at fair value less costs to sell.

(19) Financial liabilities

(Non-derivative) 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.

Financial liabilities originated at a discount are initially recognised using the amount of consideration received; the carrying amount is subsequently increased using the 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 estimate of the expenditure required to settle the obligation, in accordance with IAS 37.36.

(21) Pension obligations

Aareal Bank Group maintains various defined benefit plans as defined in IAS 19. For the purposes 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 retirement benefit obligations of 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 discount factor used to determine the present value of the obligation is based on the capital market rate of corporate bonds with impeccable credit ratings 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 obligations, as recognised in the consolidated balance sheet, are based on company agreements on an employee pension scheme, individual agreements with executive staff, as well as individual agreements with 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 remuneration

The Aareal Bank Group currently maintains three share-based payment transactions subject to cash settlement in accordance with IFRS 2. Note (84) 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 three 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 2008 financial year.

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

Assets and liabilities assumed 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

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Interest income from		
Property loans	1,059	966
Public-sector loans	89	85
Other lending and money market operations	430	493
Fixed-income securities and debt register claims	408	347
Current dividend income	16	12
Other interest income	0	0
Total interest income	**2,002**	**1,903**
Interest expenses for		
Bonds issued	503	506
Borrowed funds	434	437
Subordinated equity	74	77
Term deposits taken	411	324
Overnight deposits taken	91	122
Other banking transactions	17	26
Total interest expenses	**1,530**	**1,492**
Total	**472**	**411**

Interest income from property loans includes income from impaired loans (so-called unwinding) in the amount of € 8 million (2007: € 13 million).

(26) Allowance for credit losses

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Additions	134	120
Reversals	55	125
Direct write-offs	11	84
Payments on loans and advances previously written off	10	2
Total	**80**	**77**

Apart from the standard amount required to be recognised in the allowance account for credit losses in 2008, we recognised additional valuation allowances of € 34 million as a result of the current difficult market environment.

(27) Net commission income

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Net commission income from		
Consulting and other services	109	107
Trustee loans and administered loans	9	14
Securities transactions	3	-1
Securitisation transactions	-6	-15
Other lending and capital market transactions	24	22
Net other commission income	11	15
Total	**150**	**142**

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 hedging relationships, within the context of hedge accounting. The total result from hedging instruments and their related underlying transactions of € 0 million (2007: € 1 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 generally accepted measurement methods, based on current market parameters.

(29) Net trading income / expenses

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Results from derivative financial instruments	-15	-3
Currency translation	2	2
Net income/expenses from other positions held for trading	-10	-25
Total	**-23**	**-26**

The results from derivative financial instruments primarily result from fair value measurement and realised gains or losses in connection with equity-related, credit-related and interest rate instruments.

Net income / expenses from other positions held for trading include the expenses from ongoing securitisation transactions, as well as the write-down of a bond issued by Lehman Brothers.

(30) Results from non-trading assets

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Results from securities sales	-61	39
Results from the measurement of securities	-34	0
Results from equity investments	0	167
Total	**-95**	**206**

The results from non-trading assets are generally attributable to financial instruments of the measurement category "Available for sale (afs)". In addition, the results from the measurement of securities comprise write-downs on structured financial instruments of the category "Designated as at fair value through profit or loss (dfvtpl)" in the amount of € 27 million.

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

The results from investments accounted for using the equity method, amounting to € 7 million (2007: € 68 million), was mainly the result of the investment in Deutsche Interhotel Holding GmbH & Co KG.

(32) Results from investment properties

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Rental income	1	3
Expenses for the operation of properties rented out	0	2
Expenses for the operation of properties not rented out	–	0
Results from the measurement of properties	-2	0
Results from the sale of properties	–	0
Total	**-1**	**1**

(33) Administrative expenses

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Staff expenses	212	230
of which: for pensions [1)]	11	12
Other administrative expenses	113	110
Depreciation, amortisation and impairment of property and equipment and intangible assets	22	21
Total	**347**	**361**

[1)] The figure for the previous year was restated (originally: € 17 million).

Administrative expenses include research and development costs not eligible for capitalisation in the amount of € 1 million (2007: € 2 million).

Other administrative expenses for the financial year 2008 include the following fees paid to the auditors of the consolidated financial statements:

Euro 000's	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Auditing fees	2,908	2,273
Other audit or valuation services	433	259
Tax advisory services	176	203
Other services	1,149	616
Total	**4,666**	**3,351**

(34) Net other operating income / expenses

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Income from properties	9	10
Income from the reversal of provisions	11	10
Income from goods and services	1	2
Miscellaneous	53	69
Total other operating income	**74**	**91**
Expenses for properties	7	11
Expenses for services used	0	0
Write-downs of trade receivables	1	4
Expenses for other taxes	1	3
Miscellaneous	31	55
Total other operating expenses	**40**	**73**
Total	**34**	**18**

Miscellaneous other operating income includes income from the waiver of claims in the amount of € 15 million, which was granted by the lending bank in the context of the restructuring of a property investment. The same item also includes income from refunds of other taxes of € 10 million, as well as income from agency agreements amounting to € 3 million.

Miscellaneous other operating expenses include provisions for settlement risks of € 10 million. In addition, miscellaneous other operating expenses include research and development costs of € 4 million (2007: € 5 million) which could not be capitalised, expenses for other taxes amounting to € 2 million as well as interest on liabilities from subsequent tax assessments amounting to € 3 million.

(35) Impairment of goodwill

In the financial year 2008, there was no significant impairment of goodwill (2007: € 3 million).

(36) Income taxes

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Current income taxes	39	27
Deferred taxes	0	45
Total	**39**	**72**

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

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Operating profit (before income taxes)	117	380
Applicable tax rate	31.2 %	39.8 %
Calculated income taxes	37	151
Reconciliation to reported income taxes		
Corporate income tax credit	-1	-1
Effect of different tax rates in other countries	15	-8
Tax-free income	20	-75
Non-deductible expenses	1	0
Taxes for previous years	-35	-4
Changes in tax rates for deferred taxes	1	13
Minority interests	-6	-7
Remeasurement of deferred taxes	4	1
Trade income tax	1	-1
Other differences	2	3
Reported income taxes	**39**	**72**

The tax rate used for Group companies in Germany was 31.2 % (2007: 39.8 %). Companies subject to corporation tax only were charged a tax rate of 15.8 % (2007: 26.4 %).

(37) Earnings per share

	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Consolidated net income / loss attributable to shareholders of Aareal Bank AG (Euro million)	60	290
Average number of shares outstanding	42,755,159	42,755,159
Earnings per share (Euro)	**1.41**	**6.77**

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 the Aareal Bank Group, diluted earnings per share correspond to undiluted earnings per share, since no convertible instruments were issued.

(C) Notes to the Consolidated Balance Sheet

(38) Cash funds

Euro mn	31 Dec 2008	31 Dec 2007
Cash on hand	0	1
Balances with central banks	693	1,050
Total	**693**	**1,051**

(39) Loans and advances to banks

Euro mn	31 Dec 2008	31 Dec 2007
Term deposits and current account balances	845	431
Public-sector loans	286	333
Receivables from securities repurchase transactions	0	1,377
Other loans and advances	34	104
Total	**1,165**	**2,245**

Loans and advances to banks are allocated to the measurement category ”Loans and receivables (lar)“.

(40) Loans and advances to customers

Euro mn	31 Dec 2008	31 Dec 2007
Property loans	22,813	22,550
Public-sector loans	1,875	1,738
Other loans and advances	83	697
Total	**24,771**	**24,985**

Loans and advances to customers are allocated to the measurement category ”Loans and receivables (lar)“.

A part of the risks in property loan portfolios is 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 € 24 million as at 31 December 2008 (2007: € 3,059 million). Synthetic securitisation does not result in a derecognition of the loans and advances concerned. First loss pieces are assumed up to an amount of € 21 million (2007: € 21 million).

(41) Allowance for credit losses

Euro mn	Specific valuation allowances 2008	Specific valuation allowances 2007	Portfolio-based valuation allowances 2008	Portfolio-based valuation allowances 2007	Total 2008	Total 2007
Balance at 1 January	**150**	**304**	**40**	**29**	**190**	**333**
Additions / transfers	75	86	45	11	120	97
Drawdowns	18	110	–	–	18	110
Reversals	60	130	–	–	60	130
Balance at 31 December	**147**	**150**	**85**	**40**	**232**	**190**

The allowance for credit losses is entirely related to loans and advances to customers. They are classified as ”Loans and receivables“.

Apart from the standard amount required to be recognised in the allowance account for credit losses in 2008, we recognised additional valuation allowances of € 34 million as a result of the current difficult market environment.

(42) Positive market value of derivative hedging instruments

Euro mn	31 Dec 2008	31 Dec 2007
Positive market value of fair value hedges	677	316
Positive market value of cash flow hedges	–	1
Pro rata interest receivable	579	582
Total	**1,256**	**899**

(43) Trading assets

Euro mn	31 Dec 2008	31 Dec 2007
Debt and other fixed-income securities	466	1,390
Positive market values of standalone derivatives	1,052	429
Other assets held for trading	650	–
Total	**2,168**	**1,819**

Trading assets are allocated to the measurement category ”Held for trading (hft)“.

The stand-alone derivatives reported are mainly used to hedge the economic market risk exposure.

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

Euro mn	31 Dec 2008	31 Dec 2007
Properties	8	15
Intangible assets	–	–
Other assets	–	5
Total	**8**	**20**

(45) Non-trading assets

Euro mn	31 Dec 2008	31 Dec 2007
Debt and other fixed-income securities	10,344	8,213
of which: Loans and receivables	4,153	955
Held to maturity	412	–
Available for sale	5,779	7,258
Equities and other non-fixed income securities	305	594
of which: Available for sale	213	594
Designated as at fair value through profit or loss	92	–
Interests in affiliated companies (afs)	–	–
Other investments (afs)	5	4
Total	**10,654**	**8,811**

The item "Debt and other fixed-income securities" mainly consists of securities and promissory note loans issued by public-sector entities as well as asset-covered bonds (Pfandbriefanleihen) and bank bonds. In addition, the item includes asset-backed securities in a nominal amount of € 590 million (2007: € 650 million).

The item "Equities and other non-fixed income securities" comprises structured financial instruments amounting to € 92 million, which are allocated to the category "Designated as at fair value through profit or loss (dfvtpl)".

Carrying amounts of negotiable non-trading assets:

	Listed		Unlisted	
Euro mn	2008	2007	2008	2007
Debt and other fixed-income securities	10,104	7,057	240	1,156
Equities and other non-fixed income securities	66	238	149	253
Total	**10,170**	**7,295**	**389**	**1,409**

(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 using the equity method during the financial year. There were no accumulated, unrecognised losses at the 2008 and 2007 reporting dates. The share of the Aareal Bank Group in gains and losses of associates taken into account in 2008 totalled € 7 million (2007: € 68 million).

The material companies accounted for using the equity method as at 31 December 2008 had assets of € 139 million (2007: € 491 million) and liabilities of € 123 million (2007: € 384 million) in aggregate.

The equity method was based on the most recent available financial statements prepared under local GAAP. The relevant reporting dates were 30 June 2008 and 30 September 2008, respectively.

(47) Investment properties

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

Euro mn	2008	2007
Carrying amount as at 1 January	**10**	**10**
Additions		
from the purchase of properties	89	–
from subsequent expenditure	5	–
from business combinations	–	–
Reclassification in accordance with IFRS 5	-8	–
Disposals	–	–
Net results from fair value measurement	-2	–
Carrying amount as at 31 December	**94**	**10**

(48) Intangible assets

Euro mn	31 Dec 2008	31 Dec 2007
Goodwill	39	29
Proprietary software	34	37
Other intangible assets	13	14
Total	**86**	**80**

The amount shown for proprietary software includes € 12 million (2007: € 14 million) for the BK@1 electronic payments system; the software is amortised over a remaining term of six years. The same item also includes € 9 million (2007: € 10 million) for the Blue Eagle property management software suite; the software is amortised over an average remaining term of seven years.

Intangible assets developed as follows:

Euro mn	2008 Proprietary software	2008 Goodwill	2008 Other intangible assets	2008 Total	2007 Proprietary software	2007 Goodwill	2007 Other intangible assets	2007 Total
Cost								
Balance at 1 January	**60**	**84**	**50**	**194**	**57**	**91**	**35**	**183**
Additions	5	10	4	19	7	114	80	201
Transfers	–	–	–	–	–	-7	12	5
Disposals	2	0	6	8	4	114	77	195
Balance at 31 December	**63**	**94**	**48**	**205**	**60**	**84**	**50**	**194**
Amortisation and impairment losses								
Balance at 1 January	**23**	**55**	**36**	**114**	**20**	**59**	**20**	**99**
Amortisation and impairment losses	7	0	4	11	7	3	5	15
of which: impairment losses	–	–	–	–	–	3	–	3
Write-ups	–	–	–	–	–	–	–	–
Transfers	–	–	–	–	–	-7	12	5
Disposals	1	–	5	6	4	0	1	5
Balance at 31 December	**29**	**55**	**35**	**119**	**23**	**55**	**36**	**114**
Carrying amount as at 1 January	**37**	**29**	**14**	**80**	**37**	**32**	**15**	**84**
Carrying amount as at 31 December	**34**	**39**	**13**	**86**	**37**	**29**	**14**	**80**

(49) Property and equipment

Euro mn	31 Dec 2008	31 Dec 2007
Land and buildings and construction in progress	79	84
Office furniture and equipment	17	17
Total	**96**	**101**

Property and equipment changed as follows:

	2008				2007			
Euro mn	Land and buildings	Office furniture and equipment	Construction in progress	Total	Land and buildings	Office furniture and equipment	Construction in progress	Total
Cost								
Balance at 1 January	**75**	**78**	**16**	**169**	**77**	**82**	**6**	**165**
Additions	18	9	0	27	0	8	10	18
Transfers	–	–	–	–	–	5	–	5
Disposals	5	20	16	41	2	17	–	19
Balance at 31 December	**88**	**67**	**0**	**155**	**75**	**78**	**16**	**169**
Amortisation and impairment losses								
Balance at 1 January	**7**	**61**	**0**	**68**	**6**	**66**	**0**	**72**
Amortisation and impairment losses	4	7	–	11	2	7	–	9
of which: impairment losses	–	–	–	–	–	–	–	–
Write-ups	–	–	–	–	–	–	–	–
Transfers	–	–	–	–	–	5	–	5
Disposals	2	18	–	20	1	17	–	18
Balance at 31 December	**9**	**50**	**0**	**59**	**7**	**61**	**0**	**68**
Carrying amount as at 1 January	**68**	**17**	**16**	**101**	**71**	**16**	**6**	**93**
Carrying amount as at 31 December	**79**	**17**	**0**	**96**	**68**	**17**	**16**	**101**

(50) Income tax assets

Income tax assets in a total amount of € 60 million as at 31 December 2008 (2007: € 32 million) include € 23 million (2007: € 24 million) expected to be realised after a period of more than 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 € 405 million (2007: € 465 million).

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

Euro mn	31 Dec 2008	31 Dec 2007
Loans and advances to banks/to customers	5	8
Trading assets and trading liabilities	0	0
Non-trading assets	0	1
Investments accounted for using the equity method	–	0
Investment properties	1	–
Intangible assets	0	–
Other assets/liabilities	165	168
Liabilities to banks/to customers, and certificated liabilities	276	269
Provisions	11	13
Minority interest	–	3
Tax loss carryforwards	82	64
Deferred tax assets	**540**	**526**

Deferred tax assets not recognised totalled € 20 million (2007: € 21 million). They entirely relate to unrecognised tax loss carryforwards, the realisation of which is no longer expected.

Deferred tax assets as at 31 December 2008 include € 108 million (2007: € 37 million) expected to be realised after a period of more than twelve months.

(52) Other assets

Euro mn	31 Dec 2008	31 Dec 2007
Properties	93	44
Trade receivables (lar)	38	34
Miscellaneous	71	108
Total	**202**	**186**

(53) Liabilities to banks

Euro mn	31 Dec 2008	31 Dec 2007
Payable on demand	697	203
Term deposits	329	1,223
Promissory note loans borrowed	923	1,366
Liabilities from securities repurchase transactions and open-market operations	6,606	1,546
Registered mortgage bonds	286	398
Other	136	217
Total	**8,977**	**4,953**

Liabilities to banks are allocated to the measurement category "Liabilities measured at amortised cost (lac)".

(54) Liabilities to customers

Euro mn	31 Dec 2008	31 Dec 2007
Payable on demand	2,846	3,570
Term deposits	4,464	5,547
Promissory note loans borrowed	8,591	8,472
Registered mortgage bonds	4,702	4,199
Other	2	2
Total	**20,605**	**21,790**

Liabilities to customers are allocated to the measurement category "Liabilities measured at amortised cost (lac)".

(55) Certificated liabilities

Euro mn	31 Dec 2008	31 Dec 2007
Medium-term notes	2,001	2,765
Bearer mortgage bonds	3,720	3,233
Other debt securities	703	1,864
Total	**6,424**	**7,862**

Certificated liabilities are allocated to the measurement category "Liabilities measured at amortised cost (lac)".

New issues of certificated liabilities during 2008 totalled € 2,923 million (2007: € 2,488 million). The amounts reported include accrued interest.

(56) Negative market value of derivative hedging instruments

Euro mn	31 Dec 2008	31 Dec 2007
Negative market value of fair value hedges	892	728
Negative market value of cash flow hedges	1	–
Pro rata interest payable	420	400
Total	**1,313**	**1,128**

(57) Trading liabilities

Euro mn	31 Dec 2008	31 Dec 2007
Negative market values of standalone derivatives	510	170
Other liabilities held for trading	139	825
Total	**649**	**995**

Trading liabilities are allocated to the measurement category ”Held for trading (hft)“.

(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:

Euro mn	31 Dec 2008	31 Dec 2007
Deferred tax liabilities	–	–
Provisions	–	–
Other liabilities	–	0
Total	**0**	**0**

(59) Provisions

Euro mn	31 Dec 2008	31 Dec 2007
Provisions for pensions and similar obligations	112	108
Other provisions	146	165
Total	**258**	**273**

Provisions for pensions and similar obligations

The provisions for pensions mainly arise 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 2008	31 Dec 2007
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	5.50
Development of salaries	2.25	2.25
Career trends	1.00	1.00
Pension increase	2.00	2.00
Rate of inflation	2.00	2.00
Staff turnover rate	3.20	3.00 bis 4.00

Pension liabilities developed as follows during the 2008 financial year:

Euro mn	2008	2007
Present value of pension liabilities as at 1 January	**117**	**136**
Actuarial losses as at 1 January	9	33
Reported provision for pensions as at 1 January	**108**	**103**
Service cost	3	4
Interest cost	6	6
Recognised actuarial losses	0	1
Pension benefits paid	5	6
Reported provision for pensions as at 31 December	**112**	**108**
Actuarial losses as at 31 December	10	9
Present value of pension liabilities as at 31 December	**122**	**117**

The present value of pension obligations developed as follows:

Euro mn	31 Dec 2008	31 Dec 2007	31 Dec 2006	31 Dec 2005	31 Dec 2004
Present value of pension liabilities	122	117	136	136	112

Expenses incurred under pension obligations during the financial year are shown in administrative expenses. Of the pension liabilities reported as at 31 December 2008, an amount of € 8 million (2007: € 5 million) is funded. The related fund assets amounted to € 11 million as at 31 December 2008 (2007: € 10 million), and were reported under non-trading assets.

Provisions for pensions carried at 31 December 2008 include € 107 million (2007: € 102 million) expected to be realised after a period of more than twelve months.

Other provisions

Other provisions developed as follows:

Euro mn	Restructuring provisions	Provisions for staff expenses and non-staff operating costs	Provisions in the lending business	Miscellaneous other provisions	Total
Carrying amount as at 1 Jan 2008	**1**	**73**	**46**	**45**	**165**
Additions	–	36	15	28	79
Utilisation	1	34	18	22	75
Reversals	0	9	5	9	23
Reclassifications	–	-1	–	1	0
Carrying amount as at 31 Dec 2008	**0**	**65**	**38**	**43**	**146**

Euro mn	Restructuring provisions	Provisions for staff expenses and non-staff operating costs	Provisions in the lending business	Miscellaneous other provisions	Total
Carrying amount as at 1 Jan 2007	**5**	**76**	**59**	**43**	**183**
Additions	0	49	23	24	96
Utilisation	3	41	30	17	91
Reversals	1	7	7	8	23
Reclassifications	–	-4	1	3	0
Carrying amount as at 31 Dec 2007	**1**	**73**	**46**	**45**	**165**

Provisions for staff expenses and non-staff operating costs include provisions set aside for bonuses and for anniversary bonuses.

An amount of € 18 million (2007: € 25 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 in a total amount of € 21 million as at 31 December 2008 (2007: € 18 million) include € 3 million (2007: € 13 million) expected to be realised after a period of more than 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 € 405 million (2007: € 465 million).

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

Euro mn	31 Dec 2008	31 Dec 2007
Loans and advances to banks/to customers	50	42
Positive and negative market value of derivative hedging instruments	48	53
Trading assets and trading liabilities	97	65
Non-trading assets	90	191
Investments accounted for using the equity method	–	–
Investment properties	1	–
Intangible assets	9	10
Property and equipment	12	12
Other assets/liabilities	151	145
Liabilities to banks/to customers, and certificated liabilities	0	–
Provisions	2	–
Minority interest	–	2
Deferred tax liabilities	**460**	**520**

An amount of € 55 million (2007: € 17 million) related to deferred taxes on measurement differences between the tax balance sheet and the consolidated balance sheet was directly recognised in the revaluation surplus. Deferred tax liabilities as at 31 December 2008 include € 115 million (2007: € 48 million) expected to be realised after a period of more than twelve months.

(62) Other liabilities

Euro mn	31 Dec 2008	31 Dec 2007
Liabilities from outstanding invoices	20	30
Deferred income	26	24
Liabilities from other taxes	18	22
Trade payables (lac)	8	11
Other liabilities (lac)	90	96
Other liabilities	**162**	**183**

(63) Subordinated equity

Euro mn	31 Dec 2008	31 Dec 2007
Subordinated liabilities	555	603
Profit-participation certificates	478	483
Contributions by silent partners	233	232
Total	**1,266**	**1,318**

Das Nachrangkapital ist der Bewertungskategorie „Liabilities measured at amortised cost (lac)“ zugeordnet.

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 all subordinated liabilities during 2008 totalled € 30 million (2007: € 32 million). Interest was paid on subordinated liabilities at an average rate of 5.42 % (2007: 5.40 %).

Profit-participation certificates

Profit-participation certificates issued comply with the provisions of section 10 (5) of the KWG and include the following profit-participation certificates issued by Aareal Bank AG:

	Nominal amount in Euro mn	Currency of issue	Interest rate (% p. a.)	Maturity
Bearer profit-participation certificates:				
	125.0	EUR	6.750	2002 - 2011
	100.0	EUR	6.375	2002 - 2011
	60.0	EUR	6.125	2003 - 2013
	285.0			
Registered profit participation certificates:				
	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
	138.0			

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 simultaneous claim for back-payment during the term of the certificates.

Repayment takes place at the nominal amount (subject to any loss sharing), on the day following the passing of resolutions by the Annual General Meeting 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 € 28 million (2007: € 30 million) in interest expenses was incurred with respect to profit-participation certificates issued.

Contributions by silent partners

Contributions by silent partners to the Aareal Bank Group totalled € 220 million (2007: € 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 (2007: € 220 million) in their full amount.

Total expenditure for silent participations totalled € 16 million (2007: € 15 million) in the year under review.

(64) Consolidated shareholders' equity

Euro mn	31 Dec 2008	31 Dec 2007
Subscribed capital	128	128
Capital reserves	511	511
Retained earnings	678	554
Other reserves		
Reserves from transactions under common control	-8	-26
Reserves from business combinations	–	–
Revaluation surplus	-184	69
Hedging reserves	-1	1
Currency translation reserves	1	0
Minority interest	244	243
Consolidated profits	60	147
Total	**1,429**	**1,627**

Subscribed capital

Aareal Bank AG's subscribed capital amounted to € 128 million as at the reporting date (2007: € 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 are no pre-emptive rights or constraints with respect to dividend payouts. There was no change in the number of shares issued during the year under review.

Treasury shares

The Company has been authorised by the Annual General Meeting held on 21 May 2008 to purchase and sell treasury shares, pursuant to section 71 (1) no. 7 of the AktG, until 20 November 2009. 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 20 November 2009. 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. In the event of a capital increase against cash contributions, the shareholders shall be granted a subscription right, unless the Management Board exercises its authority to exclude shareholders' pre-emptive subscription rights. The Management Board may exclude shareholders' subscription rights, subject to approval by the Supervisory Board and the conditions set out below:

a) in the event of a capital increase against cash contributions, provided that the issue price 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 exercise of said authorisation, in direct or analogous application of section 186 (3) sentence 4 of the AktG, shall count towards the above-mentioned threshold of ten per cent (10 %) of the issued capital. The 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, where such debt securities are issued pursuant to section 186 (3) sentence 4 of the AktG at the time of exercising said authorisation;

b) for fractional amounts arising from the determination of the applicable subscription ratio;

c) where this is necessary to grant subscription rights to the holders of bonds with warrants or convertible bonds issued (or to be issued) by the Company or its affiliated companies, which subscription rights are required to entitle these holders to the same extent as they would have been entitled to upon exercising their conversion or option rights or upon performance of a conversion obligation, if any, thus protecting such holders against dilution;

d) for an amount of up to € 4 million, to offer employees (of the Company or its affiliated companies) shares for subscription;

e) 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.

The Annual General Meeting held on 21 May 2008 resolved to approve additional 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 € 12,826,545.00 (Authorised Capital) by issuing new bearer shares for contribution in cash or in kind (where such contribution may represent the full contribution, or part thereof) through the issue of up to 4,275,515 bearer shares with a share in the Company's share capital of € 3.00 each, subject to the approval of the Supervisory Board; this authority will expire on 20 May 2013. In the event of a capital increase against cash contributions, the shareholders shall be granted a subscription right. However, the Management Board is authorised to exclude shareholders' subscription rights, subject to approval by the Supervisory Board and the conditions set out below:

a) in the event of a capital increase against cash contributions, provided that the issue price does not fall significantly below the prevailing stock exchange price of the exchange-listed shares of the same description and features, and the total pro-rata share of the new shares (for which the subscription right has been excluded) in the share capital does not exceed ten per cent (10 %) at the time of this authorisation entering into effect or – if this amount is lower – does not exceed the share capital existing at the time this authorisation is exercised. Any shares that were issued or sold during the term and prior to the exercise 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. The said ten per cent threshold shall also include shares which are required to be issued under the terms of debt securities with embedded conversion or option rights on shares, where such debt securities are issued pursuant to section 186 (3) sentence 4 of the AktG during the term of this authorisation;

b) for fractional amounts arising from the applicable subscription ratio;

c) where this is necessary to grant subscription rights to the holders of bonds with warrants or convertible bonds issued (or to be issued) by the Company or its affiliated companies, which subscription rights are required to entitle these holders to the same extent as they would have been entitled to upon exercising their conversion or option rights or upon performance of a conversion obligation, if any, thus protecting such holders against dilution;

d) for an amount of up to € 4 million, to offer employees (of the company or its affiliated companies) shares for subscription;

In the event of a capital increase against contributions in kind, the Management Board is authorised to exclude shareholders' subscription rights, subject to the approval by the Supervisory Board.

Conditional capital

The share capital is subject to a conditional capital increase of up to € 30 million by means of issuing up to 10 million new no-par value bearer shares, with a share in the Company's share capital of € 3.00 each. 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 21 May 2008. Said resolution authorised the Management Board, subject to the consent of the Supervisory Board, to issue, on one or more occasions until 20 May 2013, convertible bonds and / or bonds with 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 share capital of up to € 30 million.

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 reserves

The capital reserves contain premiums received upon the issuance of shares.

Retained earnings

Retained earnings are comprised of legal reserves (pursuant to section 150 of the AktG) of € 5 million (2007: € 5 million) and of other retained earnings of € 673 million (2007: € 549 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 comprises effects from fair value measurement of financial instruments of the measurement category ”Available for sale“.

Minority interest

€ 250 million (2007: € 250 million) in preference shares issued by a subsidiary were outstanding at the end of the 2008 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 (2007: € 18 million).

Dividend

No dividends will be paid for the financial year 2008 (2007: € 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 as part of the management report. The disclosures on the description and the extent of the risks resulting from financial instruments in accordance with IFRS 7 are also included in the risk report. The disclosures in accordance with IFRS 7.36(a) and (d) as well as IFRS 7.37 are now made in the notes to the consolidated financial statements, while in the previous year, they were included in the risk report.

(65) Fair value of financial instruments

Fair value of financial instruments within the meaning of IFRS 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.

The Aareal Bank Group determines the fair value of financial instruments in accordance with the hierarchy specified in IAS 39.48 et seq.

The existence of published (i.e. observable) price quotations in an active market is the best evidence of fair value, and when they exist they are used to measure the financial asset or financial liability involved. In order to determine the quoted market price of a financial instrument in an active market, a transaction involving the financial instrument concerned on the reporting date or the last trade date must be used as the basis. If no transaction has occurred in the financial instrument on the reporting date, the reporting entity shall rely on transaction prices applicable shortly before the reporting date. Listed financial instruments (such as equities, bonds, or other debt securities) are generally measured on the basis of applicable market prices, if there is an active market.

If the market for a financial instrument is not (or no longer) active, the fair values of these products are established by using valuation techniques. In this context, the fair values are derived from market prices of recent transactions in the corresponding financial instrument or currently observable market prices of comparable financial instruments using a particular valuation technique.

If past or comparable market prices are not available for certain products, we use proven valuation models or indicative prices for pricing financial instruments. The pricing using proven valuation models is based on parameters observable in the market (such as interest rates, volatilities, credit spreads). Cash flows are determined on the basis of the contractual arrangements until the expected end of the term, and discounted using the interest rate curve of the relevant market, taking into account mark-ups based on credit quality and liquidity. The application of such valuation methods is partially associated with estimates made by the management.

In accordance with this approach, the fair value of securities for which no active market exists is determined as the present value of the expected future cash flows, taking into account issuer-specific credit and liquidity spreads, or on the basis of indicative prices.

Essentially, the measurement of asset-backed securities (predominantly CMBS and RMBS) is based on indicative prices, given the absence of a generally-accepted valuation model to date (as indicated in a memorandum issues by the Institute of Public Auditors in Germany on 10 December 2007, dealing with accounting and measurement issues raised by the sub-prime crisis). Such indicative prices are first validated against other source of price data. In addition, Aareal Bank's analysis takes into account factors such as tranche-specific collateralisation status and collateral structures; analyses of underlying receivables ("look-through" analysis of ABS), primarily regarding redemption schedules and (payment) defaults of securitised receivables; as well as trigger events and rating changes.

The fair value of over-the-counter (OTC) derivatives is determined using valuation methods that are commonly accepted in the financial markets, such as the present value technique and option pricing models.

The fair value of foreign exchange forwards is generally based on current forward exchange rates. Structured interest rate transactions are measured using appropriate option pricing models or numerical procedures. The measurement model used for options included in the transaction is the commonly used Black-Scholes model, or appropriate numerical procedures.

Price data and parameters used in the measurement procedures applied are generally reviewed carefully and adjusted, if necessary – particularly in view of the current market developments.

In case the fair value of unlisted equity instruments cannot be determined reliably, the instruments are accounted for using amortised cost.

The fair value for loans and advances as well as liabilities to banks and customers are determined using a present value model on the basis of contractually agreed cash flows, taking into account credit quality, liquidity and costs.

The fair values of contingent liabilities and irrevocable loan commitments correspond to their carrying amounts.

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:

Euro bn	31 Dec 2008 Carrying amount	31 Dec 2008 Fair value	31 Dec 2007 Carrying amount	31 Dec 2007 Fair value
Cash on hand and balances with central banks	**0.7**	**0.7**	**1.1**	**1.1**
Loans and advances to banks lar	1.2	1.1	2.2	2.2
Loans and advances to customers lar	24.5	24.8	24.8	25.1
Non-trading assets lar	4.2	3.9	1.0	1.1
Other assets lar	0.1	0.1	0.1	0.1
Total Loans and receivables	**30.0**	**29.9**	**28.1**	**28.5**
Non-trading assets Held to maturity	**0.4**	**0.4**	**–**	**–**
Non-trading assets Available for sale	**6.0**	**6.0**	**7.8**	**7.8**
Non-trading assets Designated as at fair value through profit or loss	**0.1**	**0.1**	**–**	**–**
Positive market value of derivative hedging instruments	**1.3**	**1.3**	**0.9**	**0.9**
Assets Held for trading	**2.2**	**2.2**	**1.8**	**1.8**
Liabilities to banks lac	9.0	9.0	5.0	5.0
Liabilities to customers lac	20.6	19.7	21.8	21.8
Certificated liabilities lac	6.4	6.3	7.9	7.9
Other liabilities lac	0.1	0.1	0.1	0.1
Subordinated equity lac	1.3	1.0	1.3	1.3
Total Liabilities measured at amortised cost	**37.4**	**36.1**	**36.1**	**36.1**
Negative market value of derivative hedging instruments	**1.3**	**1.3**	**1.1**	**1.1**
Liabilities Held for trading	**0.6**	**0.6**	**1.0**	**1.0**
Financial guarantee contracts	**0.6**	**0.6**	**0.7**	**0.7**
Irrevocable loan commitments	**3.0**	**3.0**	**4.6**	**4.7**

(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:

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Result from Loans and receivables	263	-118
Result from financial instruments Held for trading	-25	-28
Result from financial instruments Designated as at fair value through profit or loss	-27	–
Result from financial instruments Available for sale	85	-187
of which: directly recognised in equity	-405	5
Result from derivative hedging instruments	224	-204
Result from Liabilities measured at amortised cost	-1,040	480

The amount reclassified from equity into the income statement in the year under review is € -74 million (2007: € 33 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 hedging relationships 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 measurement category during the year under review:

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Loans and advances to customers lar	130	184
Non-trading assets afs	66	0
Other assets lar	1	4
Total	**197**	**188**

(68) Reclassification of financial assets

As a result of the financial market crisis, in accordance with amendments to IAS 39 and IFRS 7 issued by the IASB in October 2008, Aareal Bank AG reclassified securities to the measurement category "Loans and receivables (lar)". This reclassification takes account of the fact that an active market no longer existed for these securities and that the Aareal Bank Group now assumes a longer holding period. The criteria used for the existence of an inactive market were lack of trading volume (at the stock exchange), widening of bid-ask spreads, and arbitrage possibilities between various brokers.

The securities reclassified are mainly securities of public-sector issuers, securities issued by banks and securities included in Aareal Bank's ABS portfolio. The reclassification for the securities issued by banks and Aareal Bank's ABS portfolio was made retrospectively as at 1 July 2008. Securities issued by public-sector entities and mortgage bonds were reclassified as at 31 October 2008. Reclassification was based on the fair value applicable as at the date of reclassification. The financial assets had been measured at fair value until the date of reclassification. The securities are now measured at amortised cost.

The reclassification effects are shown in the following table:

				Result from fair value measurement			
Euro mn	Carrying amount at the time of re-classification	Current carrying amount 31 Dec 2008	Current fair value 31 Dec 2008	Effect on the income statement 1 Jan-31 Dec 2008	Effect on the income statement 1 Jan-31 Dec 2007	Effect on the revaluation surplus 1 Jan-31 Dec 2008	Effect on the revaluation surplus 1 Jan-31 Dec 2007
Reclassified assets							
from afs to lar category	**2,743**	**2,924**	**2,748**	**–**	**–**	**-143**	**-7**
Asset-backed securities	52	53	45	–	–	-1	-1
Bank bonds	393	396	327	–	–	-10	-4
Mortgage bonds	351	369	363	–	–	-8	-5
Government bonds	1,947	2,106	2,013	–	–	-124	3
from htm to lar category	**511**	**508**	**452**	**-20**	**-16**	**–**	**–**
Asset-backed securities	504	501	445	-19	-15	–	–
Bank bonds	7	7	7	-1	-1	–	–
Total	**3,254**	**3,432**	**3,200**	**-20**	**-16**	**-143**	**-7**

No impairment losses had to be recognised for the reclassified financial assets in 2008. There were also no significant disposals of such assets in the reporting period.

If the bank had not opted for reclassification, the fair value measurement of the reclassified assets would have led to additional losses being recognised in the income statement of € 56 million, and in the revaluation surplus of € 129 million (after taxes), in the financial year 2008.

Aareal Bank AG expected cash flows from the reclassified assets in the amount of € 5,457 million.

(69) Transfer of financial assets without derecognition

Aareal Bank Group has entered into securities repurchase agreements as a 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.

The following table shows the carrying amounts, as at the balance sheet date, of the securities that are part of repurchase agreements:

Euro mn	31 Dec 2008	31 Dec 2007
Bonds and notes lar	–	–
Bonds and notes afs	1,711	175
Total	**1,711**	**175**

In connection with these securities, Aareal Bank recognised obligations resulting from genuine repurchase agreements in an amount of € 1,606 million (2007: € 196 million) under liabilities from banks.

(70) 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.

Euro mn	31 Dec 2008	31 Dec 2007
Loans and advances to banks	438	135
Loans and advances to customers	–	499
Non-trading assets	4,768	2,534
Total	**5,206**	**3,168**

The carrying amount of financial assets pledged as collateral, where the protection buyer has the right to sell or re-pledge the assets, is € 1,711 million (2007: € 175 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 € 15 million (2007: € 1,616 million) as at the balance sheet date.

No securities of these collateral accepted had been re-sold or re-pledged (2007: € 63 million). Therefore, there is no redemption obligation for securities (2007: € 63 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.

(71) Disclosures on maximum credit risk exposure

The following overview shows the carrying amount of all financial assets less impairment, without taking into account any collateral:

Euro mn	31 Dec 2008	31 Dec 2007
Loans and advances to banks	**1,165**	**2,245**
Term deposits and current account balances	845	431
Public-sector loans	286	333
Other loans and advances	34	1,481
Loans and advances to customers	**24,624**	**24,835**
Property loans	22,667	22,431
Public-sector loans	1,875	1,738
Other loans and advances	82	666
Positive market value of derivative hedging instruments	**1,256**	**899**
Trading assets	**2,168**	**1,819**
Non-trading assets lar	**4,153**	**955**
Fixed-income securities	4,153	955
Non-trading assets afs	**5,997**	**7,856**
Fixed-income securities	5,779	7,258
Equities and other non-fixed income securities	213	594
Other investments	5	4
Non-trading assets htm	**412**	**–**
Fixed-income securities	412	–
Non-trading assets dfvtpl	**92**	**–**
Equities and other non-fixed income securities	92	–
Other assets	**62**	**186**
Trade receivables	38	34
Other loans and advances	24	152
Financial guarantee contracts	**560**	**733**
Irrevocable loan commitments	**2,959**	**4,600**
Total	**42,944**	**44,128**

(72) Financial assets that are past due but not impaired

The following overview shows the amount of property loans past due but not impaired (by age of the loans past due) as well as the value of related collateral:

Euro mn	31 Dec 2008	31 Dec 2007
more than 9 days up to 1 month	5	n/a [1]
more than 1 month up to 3 months	28	n/a [1]
more than 3 months up to 6 months	78	18
more than 6 months up to 1 year	44	23
more than 1 year	136	177
Total	**291**	**218**
Fair value of property collateral received (land charges)	276	203

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, the amount of further loans and advances past due but not impaired was € 2 million (2007: –). They are mainly past due for a period of up to one month. There were no other financial assets that were past due as at the reporting date but not impaired.

(73) Impaired financial assets

The following overview indicates the amount of impaired property loans under management [2], together with the related allowance for credit losses and the value of related collateral:

Euro mn	31 Dec 2008	31 Dec 2007
Exposure before allowance for credit losses	452	362
Allowance for credit losses	176	184
Fair value of property collateral received	**276**	**178**

Furthermore, the amount of impaired trade receivables as at the reporting date was € 3 million (2007: € 2 million). The related impairment amounts to € 2 million (2007: € 2 million).

The carrying amount of assets acquired upon realisation of collateral during the 2008 financial year, and recognised in the financial statements as at 31 December 2008, was € 0 million (2007: € 10 million). The carrying amount of loans for which terms were renegotiated subsequently was € 13 million (2007: € 7 million) as at 31 December 2008.

[1] The disclosure is made for the first time as at 31 December 2008. Retrospective calculation of the corresponding comparable figures is impossible for technical reasons.
[2] The figure for property finance under management includes property loans managed on behalf of DEPFA Deutsche Pfandbriefbank AG.

(74) Maturities of financial liabilities

The following two overviews show the future undiscounted cash flows of non-derivative financial liabilities:

Maturities as at 31 December 2008

Euro mn	payable on demand	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Liabilities to banks	579	3,756	3,763	700	290	**9,088**
Liabilities to customers	2,859	4,303	1,503	4,428	11,869	**24,962**
Certificated liabilities	–	812	1,464	3,990	561	**6,827**
Subordinated equity	–	6	63	760	986	**1,815**
Financial guarantee contracts	495	5	57	4	–	**561**
Irrevocable loan commitments	2,939	–	3	12	4	**2,958**

Maturities as at 31 December 2007

Euro mn	payable on demand	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
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**
Certificated liabilities	38	497	1,481	5,381	2,482	**9,879**
Subordinated equity	–	6	116	569	790	**1,481**
Financial guarantee contracts	681	–	21	31	0	**733**
Irrevocable loan commitments	4,535	–	2	0	–	**4,537**

(75) Derivative financial instruments

The Aareal Bank Group enters into derivative financial instruments primarily in order to hedge market risks as well as for refinancing purposes. Derivatives which are designated for hedging purposes, and which 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 market risk exposure. Spot and forward foreign exchange transactions are almost exclusively used within the context of refinancing. Credit derivatives are used both to hedge the Aareal Bank Group's existing credit risk exposure and to assume credit risks for the purposes 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 using ratings from 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 result from fair value hedges in the year under review:

	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Euro mn		
Result from hedging transactions	222	-206
Result from hedged items	-222	208
Total	**0**	**2**

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 2008

Euro mn	up to 3 months	3 months to 1 year	a year to 5 years	more than 5 years	Total
Cash flows from hedged assets	–	–	–	–	**–**
Cash flows from hedged liabilities	0	1	2	–	**3**

Cash flows from hedged items – Cash flow hedges as at 31 December 2007

Euro mn	up to 3 months	3 months to 1 year	a year to 5 years	more than 5 years	Total
Cash flows from hedged assets	–	–	–	–	**–**
Cash flows from hedged liabilities	1	2	4	0	**7**

In 2008, 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 € 2 million (2007: € 0 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:

Euro mn	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Net interest income/loss	–	-1
Net result on hedge accounting	0	-1
Total	**0**	**-2**

In the year under review, € 0 million (2007: 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.

Euro mn	Fair value 31 Dec 2008 positive	Fair value 31 Dec 2008 negative	Fair value 31 Dec 2007 positive	Fair value 31 Dec 2007 negative
Stand-alone derivatives				
Interest rate instruments				
OTC products				
Interest rate swaps	364	288	131	125
Swaptions	0	0	–	–
Caps, floors	17	16	14	14
FRAs	–	–	5	5
Total interest rate instruments	**381**	**304**	**150**	**144**
Currency-related instruments				
OTC products				
Spot and forward foreign exchange transactions	210	46	84	7
Cross-currency interest rate swaps	438	94	165	–
Total currency-related instruments	**648**	**140**	**249**	**7**
Other forward transactions				
OTC products				
Credit default swaps [1]	–	60	14	5
Credit-linked notes [1]	–	–	–	2
Other forward transactions	23	6	6	3
Exchange-listed contracts				
Futures	–	–	–	0
Total other forward transactions	**23**	**66**	**20**	**10**
Total stand-alone derivatives	**1,052**	**510**	**419**	**161**
Derivatives from fair value hedges				
Interest rate instruments				
OTC products				
Interest rate swaps	1,230	1,260	853	1,127
Swaptions	–	1	0	1
Total interest rate instruments	**1,230**	**1,261**	**853**	**1,128**
Currency-related instruments				
OTC products				
Spot and forward foreign exchange transactions	7	–	2	–
Cross-currency interest rate swaps	19	51	43	0
Total currency-related instruments	**26**	**51**	**45**	**0**
Total derivatives from fair value hedges	**1,256**	**1,312**	**898**	**1,128**
Derivatives from cash flow hedges				
Interest rate instruments				
OTC products				
Interest rate swaps	–	1	1	0
Total interest rate instruments	**–**	**1**	**1**	**0**
Total derivatives from cash flow hedges	**–**	**1**	**1**	**0**
Total	**2,308**	**1,823**	**1,318**	**1,289**

[1] excluding financial guarantees

Derivatives have been entered into with the following counterparties:

	Fair value 31 Dec 2008		Fair value 31 Dec 2007	
	positive	negative	positive	negative
Euro mn				
OECD banks	2,039	1,812	1,278	1,224
Companies and private individuals	269	11	40	65
Total	**2,308**	**1,823**	**1,318**	**1,289**

The overview on pages 172 / 173 shows the future undiscounted cash flows of derivative financial liabilities.

31 December 2008

Euro mn	up to 3 months	3 months to 1 Year	1 year to 5 years	more than 5 years	Total 31 Dec 2008
Interest rate instruments					
Interest rate swaps					
Cash inflows	491	1,091	3,973	1,538	7,093
Cash outflows	494	986	3,601	1,420	6,501
Forward rate agreements					
Cash inflows	–	–	–	–	–
Cash outflows	–	–	–	–	–
Swaptions					
Cash inflows	–	0	–	–	0
Cash outflows	0	0	1	0	1
Caps, floors					
Cash inflows	1	3	15	3	22
Cash outflows	1	3	15	3	22
Currency-related instruments					
Spot and forward foreign exchange transactions					
Cash inflows	3,273	1,131	20	–	4,424
Cash outflows	3,127	1,098	20	–	4,245
Cross-currency interest rate swaps					
Cash inflows	380	1,409	3,697	621	6,107
Cash outflows	357	1,259	3,444	617	5,677
Other transactions					
Credit default swaps					
Cash inflows	2	3	10	4	19
Cash outflows	1	3	4	–	8
Options, futures					
Cash inflows	20	–	2	–	22
Cash outflows	4	–	2	–	6
Other derivative transactions					
Cash inflows	–	–	–	–	–
Cash outflows	–	–	–	–	–
Total cash inflows	**4,167**	**3,637**	**7,717**	**2,166**	**17,687**
Total cash outflows	**3,984**	**3,349**	**7,087**	**2,040**	**16,460**

31 December 2007

Euro mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total 31 Dec 2007
Interest rate instruments					
Interest rate swaps					
Cash inflows	307	1,291	5,186	9,379	16,163
Cash outflows	310	1,328	5,337	8,732	15,707
Forward rate agreements					
Cash inflows	–	–	5	–	5
Cash outflows	–	–	5	–	5
Swaptions					
Cash inflows	–	–	–	–	–
Cash outflows	–	–	1	0	1
Caps, floors					
Cash inflows	–	–	1	0	1
Cash outflows	0	0	8	5	13
Currency-related instruments					
Spot and forward foreign exchange transactions					
Cash inflows	4,483	195	22	–	4,700
Cash outflows	4,405	196	22	–	4,623
Cross-currency interest rate swaps					
Cash inflows	546	1,046	1,900	627	4,119
Cash outflows	509	988	1,774	468	3,739
Other transactions					
Credit default swaps					
Cash inflows	0	0	2	2	4
Cash outflows	1	2	8	7	18
Options, futures					
Cash inflows	–	5	–	–	5
Cash outflows	1	–	–	–	1
Other derivative transactions					
Cash inflows	–	–	–	–	–
Cash outflows	–	–	–	–	–
Total cash inflows	**5,336**	**2,537**	**7,116**	**10,008**	**24,997**
Total cash outflows	**5,226**	**2,514**	**7,155**	**9,212**	**24,107**

(E) Segment Reporting

In the financial year 2008, segment reporting by Aareal Bank was prepared for the first time in accordance with IFRS 8 ”Operating Segments“, using the early application option.

In accordance with the ”Management approach“ set out in IFRS 8, the segment report discloses, on a segment-specific basis, financial information which is relevant for internal control of an entity and which is also used by such entity’s management to make decisions on the allocation of resources, as well as to measure the financial performance of segments.

The methodological approaches to segment reporting in accordance with IFRS 8 are consistently applied to the comparative figures for the prevoius year.

Operating segments of Aareal Bank

Two operating segments are defined within Aareal Bank in line with internal management reporting, based on the organisational structure established according to the various products and services offered.

The **Structured Property Financing** segment combines all domestic and international property financing and refinancing activities. These include structured commercial property finance, portfolio financing of various types of properties, and related advisory services.

Refinancing via the capital market is of crucial significance for the bank as an international provider of property finance. Aareal Bank offers a wide range of refinancing instruments, including the issue of German asset-covered bonds (Pfandbriefe).

The **Consulting/Services** segment offers comprehensive services for managing residential property portfolios and processing payment flows for the institutional housing sector. Close cooperation between the two subsidiaries Aareon AG and Aareal First Financial Solutions AG, as well as with the bank’s Institutional Housing Sector division, is the basis of this segment. Aareon AG focuses its business activities on optimising IT-based business processes of companies in the property sector. The range of services comprises consulting, software, IT services and support.

The Institutional Housing Sector division, together with the subsidiary Aareal First Financial Solutions AG, offers dedicated banking services for process optimisation for bulk payments.

Management reporting of Aareal Bank is generally based on IFRS accounting policies. These reports are used to define the segment information to be disclosed in the segment report.

Income and expenses within the Aareal Bank Group are predominantly attributable to transactions with third parties, and are directly allocated to the responsible operating segment. The transactions between operating segments are always executed in line with prevailing market conditions, allocated to the relevant segment and consolidated. Significant sales revenue generated from transactions between Aareal Bank’s segments did not occur.

Administrative expenses not directly attributable to any of the operating segments are segmented in line with the internal cost allocation, based on the principle of causation.

The segment information disclosed is fully reconciled with the figures in the consolidated financial statements. Apart from the reclassification of income from deposits taken in connection institutional housing, the column ”Consolidation / Reconciliation“ only includes consolidation items. The results of the operating segments are determined by the operating profit as well as by the return on equity (RoE) and the cost / income ratio (CIR). RoE, which indicates a segment's profitability, is calculated as the ratio of segment result (after minority interest) and the portion of shareholders' equity allocated to that segment on average. The cost / income ratio – determined as the ratio of input to output of resources – is used as an indicator for the cost efficiency of operating segments.

Aareal Bank generates its sales revenue mainly through interest income. As management reporting is based on the measure ”Net interest income“, interest income and interest expenses are not reported separately in the segment report.

Information about geographical areas

In addition to the disclosure requirements set out in IFRS 8, Aareal Bank discloses a full income statement by geographical areas. The 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 operating unit

Euro mn	Structured Property Financing 2008	Structured Property Financing 2007	Consulting/ Services 2008	Consulting/ Services 2007	Consolidation / Reconciliation 2008	Consolidation / Reconciliation 2007	Aareal Bank Group 2008	Aareal Bank Group 2007
Net interest income	403	347	0	0	69	64	472	411
Allowance for credit losses	80	77					80	77
Net interest income after allowance for credit losses	**323**	**270**	**0**	**0**	**69**	**64**	**392**	**334**
Net commission income	29	24	193	186	-72	-68	150	142
Net result on hedge accounting	0	1					0	1
Net trading income/expenses	-23	-26					-23	-26
Results from non-trading assets	-95	52	0	154			-95	206
Results from investments accounted for using the equity method	7	63		5			7	68
Results from investment properties	-1	1			0	0	-1	1
Administrative expenses	200	212	151	154	-4	-5	347	361
Net other operating income/expenses	33	25	2	-6	-1	-1	34	18
Impairment of goodwill		1	0	2			0	3
Operating profit	**73**	**197**	**44**	**183**	**0**	**0**	**117**	**380**
Income taxes	25	61	14	11			39	72
Consolidated net income/loss	**48**	**136**	**30**	**172**	**0**	**0**	**78**	**308**
Allocation of results								
Consolidated net income/loss attributable to minority interests	16	16	2	2			18	18
Consolidated net income/loss attributable to shareholders of Aareal Bank AG	32	120	28	170	0	0	60	290
Allocated shareholders' equity	964	926	72	67	295	163	1,331	1,156
Cost/income ratio (%)	56.6	43.6	77.5	45.5			63.8	44.0
RoE after taxes (%)	3.4	12.9	38.5	252.2			4.5	25.0
Employees (average)	**1,085**	**1,100**	**1,397**	**1,446**			**2,482**	**2,546**
Segment assets	**36,782**	**35,644**	**4,660**	**4,839**	**-283**	**-281**	**41,159**	**40,202**
Investments accounted for using the equity method	2	91	1	1			3	92
Segment investments	36	15	17	204			53	219
Segment depreciation/amortisation	8	7	14	14			22	21
Impairments/reversals of impairments	-1	-5					-1	-5

Segment reporting by operating unit (quarterly comparison)

	Structured Property Financing		Consulting/ Services		Consolidation / Reconciliation		Aareal Bank Group	
	Quarter 4 2008	Quarter 4 2007	Quarter 4 2008	Quarter 4 2007	Quarter 4 2008	Quarter 4 2007	Quarter 4 2008	Quarter 4 2007
Euro mn								
Net interest income	117	91	0	0	17	18	134	109
Allowance for credit losses	20	14					20	14
Net interest income after allowance for credit losses	**97**	**77**	**0**	**0**	**17**	**18**	**114**	**95**
Net commission income	13	4	53	53	-18	-20	48	37
Net result on hedge accounting	-3	-3					-3	-3
Net trading income/expenses	-23	-20					-23	-20
Results from non-trading assets	-59	18	0	0			-59	18
Results from investments accounted for using the equity method	4						4	
Results from investment properties	-1	0				0	-1	0
Administrative expenses	46	48	41	42	-1	-2	86	88
Net other operating income/expenses	18	-7	-1	-2	0	0	17	-9
Impairment of goodwill		1	0	2			0	3
Operating profit	**0**	**20**	**11**	**7**	**0**	**0**	**11**	**27**
Income taxes	-1	3	4	2			3	5
Consolidated net income/loss	**1**	**17**	**7**	**5**	**0**	**0**	**8**	**22**
Allocation of results								
Consolidated net income/loss attributable to minority interests	4	4	0	0			4	4
Consolidated net income/loss attributable to shareholders of Aareal Bank AG	-3	13	7	5	0	0	4	18
Allocated shareholders' equity	964	926	72	67	295	163	1,331	1,156
Cost/income ratio (%)	70.9	59.0	76.8	82.0			73.5	67.1
RoE after taxes (%)	-1.3	5.8	39.0	27.1			1.3	6.1

Segmentation by geographical region

	Germany		International		Consolidation / Reconciliation		Aareal Bank Group	
	2008	2007	2008	2007	2008	2007	2008	2007
Euro mn								
Net interest income	172	147	300	264			472	411
Allowance for credit losses	15	72	65	5			80	77
Net interest income after allowance for credit losses	**157**	**75**	**235**	**259**			**392**	**334**
Net commission income	122	122	28	20			150	142
Net result on hedge accounting	0	1	0	0			0	1
Net trading income/expenses	-11	-17	-12	-9			-23	-26
Results from non-trading assets	-75	198	-20	8			-95	206
Results from investments accounted for using the equity method	7	68					7	68
Results from investment properties	-1	1	0	0			-1	1
Administrative expenses	238	270	109	91			347	361
Net other operating income/expenses	43	17	-9	1			34	18
Impairment of goodwill	0	2		1			0	3
Operating profit	**4**	**193**	**113**	**187**			**117**	**380**
Allocated shareholders' equity	354	379	682	614	295	163	1,331	1,156
Cost/income ratio (%)	92.6	50.2	38.0	32.3			63.8	44.0
RoE before taxes (%)	1.3	50.9	16.5	30.4			8.8	32.8
Employees (average)	**1,835**	**1,958**	**647**	**588**			**2,482**	**2,546**
Segment assets	**18,810**	**19,233**	**22,349**	**20,969**			**41,159**	**40,202**

Reconciliation of the segment result from an "industrial enterprise" classification of the income statement to the "bank" classification, which is the basis for segment reporting

Euro mn			Income statement classification – bank									
			Net interest income	Net commission income	Results from non-trading assets	Results from investments accounted for using the equity method	Administrative expenses	Net other operating income/expenses	Impairment of goodwill	**Operating profit**	Income taxes	**Segment result**
	2008		0	193	0		151	2	0	**44**	14	**30**
	2007		0	186	154	5	154	-6	2	**183**	11	**172**
Income statement classification – industrial enterprise												
Sales revenue	2008	229		229								
	2007	223		222				1				
Own work capitalised	2008	1					1					
	2007	2		0			2					
Changes in inventory	2008	0						0				
	2007	0						0				
Other operating income	2008	12			0		2	10				
	2007	162			154		1	7				
Cost of materials purchased	2008	36		36								
	2007	36		36				0				
Staff expenses	2008	99					99					
	2007	102					102					
Amortisation and impairment losses	2008	14					14		0			
	2007	16					14		2			
Results from investments accounted for using the equity method	2008											
	2007	5				5						
Other operating expenses	2008	49					41	8				
	2007	55					41	14				
Interest and similar income/expenses	2008	0	0									
	2007	0	0									
Results from ordinary activities	**2008**	**44**	**0**	**193**	**0**		**151**	**2**	**0**			
	2007	**183**	**0**	**186**	**154**	**5**	**154**	**-6**	**2**			
Income taxes	2008	14									14	
	2007	11									11	
Segment result	**2008**	**30**										
	2007	**172**										

(F) Other Explanatory Notes

(76) 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 € 13,380 million (2007: € 9,716 million); the euro equivalent of aggregate liabilities denominated in foreign currency amounted to € 13,354 million (2007: € 9,687 million). Amounts in material foreign currencies can be broken down into the following amounts:

Euro mn	31 Dec 2008	31 Dec 2007
Foreign currency assets		
USD	6,858	2,861
GBP	2,519	2,547
Foreign currency liabilities		
USD	6,847	2,849
GBP	2,511	2,546

(77) 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:

Euro mn	31 Dec 2008	31 Dec 2007
Loans and advances to banks	–	3
Loans and advances to customers	3	80
Total	**3**	**83**

(78) 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

Euro mn	31 Dec 2008	31 Dec 2007
Aareal Bank Group as lessee		
up to one year	15	12
longer than one year, and up to five years	41	31
longer than five years	27	15
Gesamt Mindest-Leasing-Zahlungen	**83**	**58**
Aareal Bank Group as lessor		
up to one year	2	2
longer than one year, and up to five years	4	5
longer than five years	–	2
Total minimum lease payments	**6**	**9**

None of the properties subject to an operating lease are classified as investment property in accordance with IAS 40 and measured at fair value (2007: properties with a carrying amount of € 10 million).

In the financial year, lease payments of € 13 million (2007: € 14 million) were recognised as expenses in the financial year.

(79) Trust business

Aareal Bank Group's trust business at the reporting date is analysed below:

Euro mn	31 Dec 2008	31 Dec 2007
Trust assets		
Loans and advances to customers	1,172	1,417
Non-trading assets	2	2
Total trust assets	**1,174**	**1,419**
Trust liabilities		
Liabilities to banks	480	498
Liabilities to customers	694	921
Total trust liabilities	**1,174**	**1,419**

(80) Contingent liabilities and irrevocable loan commitments

Euro mn	31 Dec 2008	31 Dec 2007
Contingent liabilities on guarantees and indemnity agreements	560	733
Irrevocable loan commitments	2,959	4,600

Contingent liabilities on guarantees include € 81 million (2007: € 82 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. € 18 million (2007: € 25 million) in provisions related to these capital guarantees was recognised as at 31 December 2008.

Disclosures in accordance with IAS 37.86 and IAS 37.89 are waived for reasons of practicability in accordance with IAS 37.91.

(81) 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 2008, Aareal Bank AG acquired 25 % of the shares in Main Triangel GmbH, Wiesbaden, for a consideration of € 1. The bank's total shareholding thus increased from 50 % to 75 %. Please see our explanations on the reporting entity structure in Section (A) "Basis of Accounting".

At the time of acquisition, the acquired company did not hold material cash or cash equivalents.

(82) 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 bi-weekly 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. Since 1 January 2008, the Group has calculated its risk exposure in accordance with the German Solvability Ordinance (Solvabilitätsverordnung). 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.

Quantitative disclosures

Euro mn	31 Dec 2008 [1]	31 Dec 2007 [1]
Core capital ratio (Tier 1)		
Paid-in capital	279	253
Reserves	1,695	1,543
Contributions by silent partners	220	220
Carrying amounts of investments	-718	-580
Tier 1 model	250	250
Other	137	74
Total core capital	**1,863**	**1,760**
Supplementary capital (Tier 2)		
Profit-participation rights	418	428
Subordinated liabilities	507	528
Other	-10	-14
Total supplementary capital	**915**	**942**
Liable equity capital pursuant to Section 10a of the KWG	**2,778**	**2,702**
Qualifying Tier 3 capital	0	0
Qualifying equity capital	**2,778**	**2,702**
Risk-weighted assets [2]	**23,238**	**22,050**
of which: assets exposed to market risks	50	88
%		
Regulatory indicators pursuant to KWG		
Core capital ratio	8.0	8.0
Total capital ratio	12.0	12.3

[1] After confirmation of the financial statements of Aareal Bank AG, subject to the approval of the Annual General Meeting
[2] As at 31 December 2008 pursuant to the Solvability Ordinance, as at 31 December 2007 pursuant to the KWG (Grundsatz I)

(83) Related party disclosures in accordance with IAS 24

Throughout the financial year 2008, 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:

Euro mn	31 Dec 2008	31 Dec 2007
Management Board	–	–
Supervisory Board	1.5	3.3
Other related parties	2.1	2.6
Total	**3.6**	**5.9**

Loans extended generally have a term between 10 and 16 years, and bear interest at (nominal) rates between 3.06 % and 7.29 %. Collateral was provided in line with usual market practice.

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

(84) Remuneration report

Remuneration for members of the Management Board

The Supervisory Board determines the structure of remuneration for the members of the Management Board, whilst the actual amount of remuneration is determined by the Executive Committee of the Supervisory Board.

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

The disclosures included in the remuneration report have been restructured, if necessary, and the previous year's figures have been adjusted accordingly, to take account of German Accounting Standard 17 (GAS 17), which was issued in 2008.

Total remuneration of the members of the Management Board comprises fixed salary components, which are paid in twelve identical monthly instalments, other awards and benefits, as well as a variable remuneration component consisting of a cash bonus and a long-term component.

The long-term component consists of a cash-settled share-based payment (so-called phantom shares), awarded as Long-term Component I (LC I) and Long-term Component II (LC II). LC I may be exercised – after a waiting period of three years – in the three years following such waiting period. LC II represents an entitlement to phantom shares, which 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 payments resulting from allocated phantom shares are taxable. For information related to the additional terms of cash-settled share-based payments, please refer to the explanations included in the corresponding section of the remuneration report.

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

The fixed salary components, the cash bonus and the other awards and benefits can be broken down as follows to the individual Management Board members:

	Year	Fixed remuneration	Cash bonus	Other	Total
Euro					
Dr Wolf Schumacher	2008	725,000.04	712,500.00	22,864.84	1,460,364.88
	2007	500,000.00	900,000.00	22,377.26	1,422,377.26
Norbert Kickum	2008	562,500.03	243,750.00	25,018.20	831,268.23
	2007	300,000.00	435,000.00	23,091.84	758,091.84
Hermann J. Merkens	2008	592,500.03	243,750.00	33,288.31	869,538.34
	2007	420,000.00	375,000.00	30,875.28	825,875.28
Thomas Ortmanns	2008	562,500.03	243,750.00	20,595.74	826,845.77
	2007	300,000.00	435,000.00	20,512.80	755,512.80
Total	**2008**	2,442,500.13	1,443,750.00	101,767.09	**3,988,017.22**
	2007	1,520,000.00	2,145,000.00	96,857.18	**3,761,857.18**

[1] Other remuneration includes payments (in particular for company cars) in the amount of € 58,233.74 (2007: € 53,772.86) as well as benefits related to social security contributions totalling € 42,794.40 (2007: € 43,084.32).

As a result of the agreement concluded with the German Special Fund for Financial Market Stabilisation (Sonderfonds Finanzmarktstabilisierung – "SoFFin"), the fixed salary components of the Management Board members for the financial years 2009 and 2010 will be capped at € 500,000 per annum for each member. Management Board members are not entitled to receive a cash bonus in these financial years.

As part of the long-term components, the Management Board members received phantom shares in accordance with the terms and conditions for cash-settled share-based payment transactions, as follows:

		Long-term component I		Long-term component II		Total	
	Year	Value at award date	Number	Value at award date	Number	Number	Value at award date
Dr Wolf Schumacher	2008	375,000.00	65,217.39 [1]	0.00	0.00	65,217.39	375,000.00
	2007	735,000.00	32,666.67 [2]	1,000,000.00 [3]	44,444.44	77,111.11	1,735,000.00
Norbert Kickum	2008	375,000.00	65,217.39 [1]	0.00	0.00	65,217.39	375,000.00
	2007	720,000.00	32,000.00 [2]	1,000,000.00 [3]	44,444.44	76,444.44	1,720,000.00
Hermann J. Merkens	2008	375,000.00	65,217.39 [1]	0.00	0.00	65,217.39	375,000.00
	2007	660,000.00	29,333.33 [2]	1,000,000.00 [3]	44,444.44	73,777.77	1,660,000.00
Thomas Ortmanns	2008	375,000.00	65,217.39 [1]	0.00	0.00	65,217.39	375,000.00
	2007	720,000.00	32,000.00 [2]	1,000,000.00 [3]	44,444.44	76,444.44	1,720,000.00

[1] The conversion was made on the basis of the share price as at 31 December 2008 (€ 5.75), since the allocation price can be determined only after publication of the 2008 financial statements.

[2] In the remuneration report for 2007, the conversion of granted euro amounts into a certain number of phantom shares was based on the share price as at 31 December 2007 (€ 31.30). However, the actual share price upon the allocation of phantom shares after publication of the 2007 financial statements was € 22.50. As a result, the number of phantom shares shown in the 2007 remuneration report was adjusted to reflect the actual allocation.

[3] In the years 2007 and 2008, the Management Board members were granted a Long-term Component II to reward the performance for the respective previous years in the amount of € 1 million each. This component is allocated to the year to which it can be attributed from an economic perspective.

As a consequence of the bank's agreement with the German Financial Markets Stabilisation Fund ("SoFFin"), no phantom shares will be awarded for the financial years 2009 and 2010.

Additional pension provisions were recognised in an amount of € 1,688,796.00 (2007: € 643,690.05). The total of pension provisions for active and former members of the Management Board and their surviving dependants amounts to € 10,640,242.00 (2007: € 8,951,446.00). 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 to former Management Board members of Aareal Bank AG and their surviving dependants totalled € 510,059.46 (2007: € 571,790.11) .

The agreements concluded with members of the Management Board do not include any 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 approx. 45 % (2007: 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 approx. 30 % (2007: 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.

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 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 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 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 the 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 2008 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 the 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 an unchanged fixed remuneration for the financial year 2008 in the amount of € 559,300.00. Provided that the Annual General Meeting approves the proposal of the Management Board not to distribute any dividends for the 2008 financial year, no variable remuneration (2007: € 202,300.00) will be paid to the members of the Supervisory Board.

The individual amount of the remuneration for the Supervisory Board is shown in the following table. The figures in the table include the reimbursement for VAT at the legally applicable rate (19 %).

Euro	Fixed remuneration Total	Variable remuneration Total	Total remuneration
Hans W. Reich, Chairman	107,100.00	–	107,100.00
Erwin Flieger, Deputy Chairman	59,500.00	–	59,500.00
York-Detlef Bülow, Deputy Chairman	59,500.00	–	59,500.00
Tamara Birke	35,700.00	–	35,700.00
Thomas Hawel	23,800.00	–	23,800.00
Helmut Wagner	23,800.00	–	23,800.00
Christian Graf von Bassewitz	47,600.00	–	47,600.00
Manfred Behrens	23,800.00	–	23,800.00
Joachim Neupel	59,500.00	–	59,500.00
Dr Herbert Lohneiß	35,700.00	–	35,700.00
Prof Dr. Stephan Schüller	47,600.00	–	47,600.00
Wolf R. Thiel	35,700.00	–	35,700.00
Total	**559,300.00**	**–**	**559,300.00**

The members of the Supervisory Board did not provide any consulting or agency services, or other personal services in 2008. Therefore, no additional remuneration was paid.

Remuneration for key executives

The definition of executives in key positions within Aareal Bank Group includes members of management or supervisory bodies of Aareal Bank AG and its subsidiaries, plus first-level managers (Heads of Divisions) of Aareal Bank AG.

Total remuneration of executives in key positions is analysed below:

Euro 000's	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Salaries and other short-term benefits	21,050	20,069
Severance pay	406	5,378
Post-employment benefits	1,198	2,007
Other long-term benefits	258	839
Share-based remuneration	2,504	4,902
Total	**25,417**	**33,195**

Cash-settled share-based payment

a) Description of the cash-settled share-based payment transactions

Key executive staff members were granted cash-settled share-based remuneration (so-called phantom shares or virtual shares) as a variable remuneration component. 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 of Aareal Bank AG / Long-term Component I

In the years 2007 and 2008, 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 2007 and 2008 share plans, the conversion is based on the weighted average price during the five (Xetra) trading days following publication of the annual financial statements adopted by the Supervisory Board.
- The phantom shares are subject to a holding period of three years, during 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.
- With respect to phantom shares that have not been exercised, beneficiaries receive for each phantom share not yet exercised a cash payment equivalent to the amount of the approved dividend.
- Under the 2007 and 2008 share plans, phantom shares may be exercised during the three years following the holding period, four times per year, within five days following publication of a quarterly report.

Phantom share plan for members of the Management Board of Aareal Bank AG / Long-term Component II

The following regulations apply for LC II phantom shares additionally awarded to members of the Management Board in the years 2007 and 2008:

- 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 publication of the annual report (subscription price).
- Phantom shares may be exercised within five business days following publication of a quarterly report in the years 2007 to 2010 and 2008 to 2011, respectively, 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 the form of a minimum stock appreciation target or other market or performance-related criteria.
- With respect to phantom shares that have not been exercised, beneficiaries receive for each phantom share not yet exercised a cash payment equivalent to the amount of the approved dividend.

Phantom share plan (virtual shares) for the key executive staff (excluding members of the Management Board of Aareal Bank AG)

Key executive staff members, excluding members of the Management Board of Aareal Bank AG, are granted virtual shares in accordance with the following rules:

- 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 the form of a minimum stock appreciation target or other market or performance-related criteria.
- With respect to virtual shares that have not been exercised, beneficiaries receive for each virtual share not yet exercised a cash payment equivalent to the amount of the approved dividend.

b) Valuation model and valuation assumptions

Valuation model

The cash-settled share-based payment transactions have the following structure: an option may be exercised during a pre-determined exercise period at pre-determined dates, subject to a holding period, if applicable. The exercise period varies according to the relevant payment transaction. For example, the exercise period for the 2007 and 2008 plans for the Management Board amounts to three years, following a holding period of three years.

According to the terms and conditions of the equity-settled share-based payment transactions, a dividend will be paid for each phantom or virtual 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 cash settlement in the amount of the dividend. Therefore, there is no reason for an earlier exercise of an option due to cash settlement. As can be demonstrated, it may always make sense to hold an option until the end of the exercise period. Therefore, the phantom or virtual share is held until final maturity. The Black-Scholes valuation model can be applied.

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 0.0 % 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 0.0 % p. a. (executive staff)

The vesting of the rights is based on the individual equity-settled share-based payment transactions. 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 cash-settled share-based payment transaction is nil, since the beneficiary receives the full equivalent of a share upon exercise. There is no cash settlement in the amount of the dividend payment with respect to the phantom or virtual shares upon exercise, since cash settlements for 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 daily by the Deutsche Bundesbank applicable at the valuation date, will be used to discount future payments.

c) Volume of cash-settled share-based payment transactions of key executive staff

The number of phantom or virtual shares outstanding for key executive staff has changed as follows:

	2008	2007
Quantity (number)		
Balance at 1 January	**305,077.34**	**145,813.21**
granted (+)	363,268.88	224,080.14
expired (-)	7,412.33	24,535.58
exercised (-)	44,057.87	40,280.43
Balance at 31 December	**616,876.02**	**305,077.34**
of which: exercisable	92,402.79	35,968.55

The phantom or virtual shares granted in the year under review have a weighted average fair value of € 6,503,881.84 (2007: € 7,245,246.60) as at the balance sheet date.

The weighted average share price of the phantom or virtual shares exercised in the year under review amounted to € 21.39 (2007: € 34.99).

The phantom or virtual shares outstanding at 31 December 2008 have a limited contract term. The weighted average remaining contract term of these phantom or virtual shares amounts to 1,355.17 days (2007: 1,534.47 days).

d) Effects on financial position and performance

The effect in the financial year 2008 on the consolidated income statement was a profit of € 0.3 million (2007: loss of € 2.3 million). The liability from share-based payments amounts to € 0.9 million (2007: € 2.2 million) as at 31 December 2008.

(85) Events after the balance sheet date

On 15 February 2009, the Aareal Bank Group entered into an agreement with the German Special Fund for Financial Market Stabilisation ("SoFFin") on a comprehensive set of measures to ensure the long-term future of the bank's sustainably profitable business, and in order to be well positioned to manage the very difficult market environment. In accordance with this agreement, SoFFin will make € 525 million in capital available to Aareal Bank by way of an unlimited silent participation. In addition, SoFFin will grant Aareal Bank a guarantee facility for new, unsecured issues with a maximum maturity of 36 months for a total volume of up to € 4 billion. The agreement is subject to the conclusion of the final contracts, and approval by the European Commission.

Taking into account the silent participation by SoFFin, which is fully recognised as Tier 1 capital, Aareal Bank's Tier 1 ratio is increased significantly.

This recapitalisation in form of a silent participation protects the interests of shareholders, since it avoids a dilution of existing shares. Aareal Holding Verwaltungsgesellschaft mbH announced that it will not reduce its 37.23 % stake during the entire term of the silent participation. A voting agreement will be concluded between Aareal Holding and SoFFin, to maintain Aareal Holding's blocking minority. This will ensure stability of the shareholder structure and the independence of the Aareal Bank Group, with Aareal Holding as an anchor shareholder.

Beyond the applicable legal provisions, SoFFin has not imposed additional conditions on the Aareal Bank Group. In particular, there will be no state influence on the Group's corporate governance, nor will any changes be required to its proven business model. In the interests of achieving a quick repayment of the silent participation, Aareal Bank will not distribute dividends for the 2008 and 2009 financial years.

On 25 February 2009, Fitch Ratings affirmed our Long Term Issuer Default Rating of "A-" (stable outlook). The Bank Individual Rating was changed from "C" to "C/D". The Short Term Issuer Default Rating was upgraded from "F2" to "F1". At the same time, the "AAA" ratings of our mortgage bonds and our public-sector covered bonds were affirmed.

(86) 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 on the internet at http://www.aareal-bank.com.

(87) 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 million, Aareal Bank AG has call commitments of up to € 6 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 million.

(88) Notice pursuant to section 21 (1) of the WpHG

In accordance with the German Securities Trading Act (Wertpapierhandelsgesetz – "WpHG"), any investor must notify a company and the German Federal Financial Services Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin), when its share of voting rights in such company exceeds or falls below certain thresholds by acquisition, disposal or otherwise. The lowest threshold for this notification requirement is 3 %. 62.77 % of the shares of Aareal Bank AG are held in free float. The largest shareholder of the Company is Aareal Holding Verwaltungsgesellschaft mbH with an interest of 37.23 %. BT Pension Scheme Trustees Limited, London, UK reduced its shareholding in the year under review to below 10 % of voting rights. We are not aware of any direct or indirect shareholdings of 10 % or more of the voting rights.

(89) 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.

(90) Employees

The number of Aareal Bank Group employees as at 31 December 2008 is shown below:

	31 Dec 2008	31 Dec 2007
End-of-year numbers		
Number of employees in the banking business	1,113	1,161
Number of employees in other businesses	1,389	1,375
Total	**2,502**	**2,536**
of which: part-time employees	355	359

The average number of Aareal Bank Group employees during 2008 is shown below:

	1 Jan-31 Dec 2008	1 Jan-31 Dec 2007
Yearly average		
Number of employees in the banking business	1,137	1,151
Number of employees in other businesses	1,345	1,395
Total	**2,482**	**2,546**
of which: part-time employees	358	438

(G) List of Shareholdings

Selected Participating Interests of Aareal Bank AG as at 31 December 2008

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).

No.	Company name	Registered office	Interest held (% of capital)	Shareholders' equity (Euro mn)	Results (Euro mn)	
1	Aareal Bank AG	Wiesbaden				
	I. Consolidated companies					
2	Aareal Bank Asia Limited	Singapore	100.0	4.7 mn S $	1.1 mn S $	2)
3	Aareal Bank France S.A.	Paris	100.0	47.4	2.9	
4	Aareal Capital Corporation	Wilmington	100.0	172.6 mn USD	-4.4 mn USD	2)
5	Aareal Estate AG	Wiesbaden	100.0	2.8	0.0	1) 5)
6	Aareal-Financial Service, spol. s r.o.	Prague	100.0	27.9 mn CZK	-1.8 mn CZK	3)
7	Aareal First Financial Solutions AG	Wiesbaden	100.0	3.2	0.0	1)
8	Aareal Valuation GmbH	Wiesbaden	100.0	0.5	0.0	1)
9	Aareon AG	Mainz	100.0	66.4	15.0	5)
10	Deutsche Bau- und Grundstücks-Aktiengesellschaft	Berlin	100.0	0.6	-3.1	
11	Deutsche Structured Finance GmbH	Frankfurt	100.0	13.2	0.3	
	II. Associated companies accounted for at equity					
12	Innovative Banking Solutions AG	Wiesbaden	49.0	2.8	1.3	4)

1) Controlling and profit transfer agreement
2) Preliminary figures as at 31 December 2008
3) Shareholders' equity and profit/loss as at 31 December 2007
4) Financial year ending 31 March 2008
5) Indirect shareholding

(H) 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 Public Limited Companies Act (AktG)

Supervisory Board

Hans W. Reich
Chairman Public Sector Group, Citigroup

Aareal Bank AG	Chairman of the Supervisory Board	
Citigroup Global Markets Deutschland AG & Co.KGaA	Chairman of the Supervisory Board	since 01 Sep 2008
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 Supervisory Boards of Bayerische Beamten Lebensversicherung Gruppe

Aareal Bank AG	Deputy Chairman of the Supervisory Board	
Bayerische Beamten Lebensversicherung a.G.	Chairman of the Supervisory Board	
Bayerische Beamten Versicherung AG	Chairman of the Supervisory Board	
BBV Holding AG	Chairman of the Supervisory Board	
BBV Krankenversicherung AG	Chairman of the Supervisory Board	until 31 Aug 2008
DePfa Holding Verwaltungsgesellschaft mbH	Chairman of the Supervisory Board	
Neue Bayerische Beamten Lebensversicherung AG	Chairman of the Supervisory Board	
MEAG MUNICH ERGO Kapitalanlagegesellschaft mbH	Member of the Supervisory Board	since 01 Jul 2008

York-Detlef Bülow*, Deputy Chairman of the Supervisory Board
Aareal Bank AG

Aareal Bank AG	Deputy Chairman of the Supervisory Board	

Christian Graf von Bassewitz,
Banker (ret'd.); former Spokesman of the General Partners of Bankhaus Lampe KG

Aareal Bank AG	Member of the Supervisory Board	
Balance Vermittlungs- und Beteiligungs-AG	Deputy Chairman of the Supervisory Board	since 27 Nov 2008
Bank für Sozialwirtschaft Aktiengesellschaft	Member of the Supervisory Board	
Deutscher Ring Krankenversicherungsverein a.G.	Member of the Supervisory Board	
Deutscher Ring Krankenversicherungsverein a.G.	Deputy Chairman of the Supervisory Board	since 06 Jun 2008
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	until 31 Oct 2008
Swiss Life Insurance Solutions AG	Chairman of the Supervisory Board	until 30 Jun 2008

Tamara Birke*
Aareal Bank AG

Aareal Bank AG	Member of the Supervisory Board	
SIRWIN AG	Member of the Supervisory Board	

* Employee representative member of the Supervisory Board of Aareal Bank AG

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		
Former Chief Executive Officer of Siemens Financial Services GmbH (ret'd.)		
Aareal Bank AG	Member of the Supervisory Board	
Siemens Kapitalanlagegesellschaft	Chairman of the Supervisory Board	until 19 Dec 2007
UBS Real Estate Kapitalanlagegesellschaft mbH	Deputy Chairman of the Supervisory Board	until 18 Mar 2008
UBS Global Asset Management (Deutschland) GmbH	Member of the Supervisory Board	since 01 Jul 2008
Joachim Neupel, Chairman of the Accounts and Audit Committee		
Certified Accountant and Tax Advisor		
Aareal Bank AG	Member of the Supervisory Board	
Prof Dr Stephan Schüller		
Spokesman of the General Partners of Bankhaus Lampe KG		
Aareal Bank AG	Member of the Supervisory Board	
Condor / Optima Versicherungen AG	Deputy Chairman of the Supervisory Board	until 30 Sep 2008
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	
NANORESINS AG	Chairman of the Supervisory Board	
PONAXIS AG	Chairman of the Supervisory Board	until 22 Sep 2008
Universal-Investment-Gesellschaft mbH	Member of the Supervisory Board	
hanse chemie AG	Chairman of the Supervisory Board	
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 Estate AG	Deputy Chairman of the Supervisory Board	
Aareal Valuation GmbH	Chairman of the Supervisory Board	
Aareon AG	Member of the Supervisory Board	
Leica AG	Member of the Supervisory Board	since 11 Apr 2008
Leica AG	Chairman of the Supervisory Board	since 18 Jun 2008

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 Capital Corporation	Member of the Board of Directors	since 21 Feb 2008
Aareal Capital Corporation	Chairman of the Board of Directors	since 21 Feb 2008
Aareal Financial Services USA, Inc.	Chairman of the Board of Directors	until 31 Mar 2008
Aareal-Financial Service spol. s r.o.	Member of the Supervisory Board	
Aareon AG	Member of the Supervisory Board	
Deutsche Structured Finance GmbH	Member of the Advisory Board	

Hermann J. Merkens, Member of the Management Board		
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 Capital Corporation	Member of the Board of Directors	since 21 Feb 2008
Aareal First Financial Solutions AG	Member of the Supervisory Board	
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	
RMS Risk Management Solutions GmbH	Member of the Supervisory Board	

Thomas Ortmanns, Member of the Management Board		
Aareal Bank France S.A.	Member of the Board of Directors	since 25 Jan 2008
Aareal First Financial Solutions AG	Chairman of the Supervisory Board	
Aareal Financial Services USA, Inc.	Member of the Board of Directors	until 31 Mar 2008
Aareon AG	Chairman of the Supervisory Board	
Innovative Banking Solutions AG	Member of the Supervisory Board	

(J) Offices held

by employees of Aareal Bank AG pursuant to section 340a (4) no. 1 of the HGB

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		
Aareal Valuation GmbH	Member of the Supervisory Board	
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	
Dr Stefan Lange, Bank Director		
Aareal Estate AG	Member of the Supervisory Board	
Aareal First Financial Solutions AG	Member of the Supervisory Board	
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Deputy Chairman of the Supervisory Board	until 25 Jul 2008
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Member of the Supervisory Board	since 23 Feb 2009
Terrain-Aktiengesellschaft Herzogpark	Chairman of the Supervisory Board	
Peter Mehta, Bank Director		
Innovative Banking Solutions AG	Member of the Supervisory Board	
Markus Schmidt		
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Member of the Supervisory Board	until 25 Jul 2008
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Deputy Chairman of the Supervisory Board	25 Jul 2008 until 23 Feb 2009
Christine Schulze Forsthövel, Bank Director		
Aareal Bank France S.A.	President of the Board of Directors	until 22 Dec 2008
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	
Mansart Conseil S.A.S.	Chairman of the Supervisory Board	until 22 Dec 2008
Martin Vest, Bank Director		
Aareal Bank France S.A.	Member of the Board of Directors	

Composition of Supervisory Board committees

Executive Committee	
Hans W. Reich	Chairman
Erwin Flieger	Deputy Chairman
York-Detlef Bülow	Deputy Chairman
Prof Dr Stephan Schüller	
Wolf R. Thiel	

Committee for Urgent Decisions	
Hans W. Reich	Chairman
Christian Graf von Bassewitz	
Erwin Flieger	
Dr Herbert Lohneiß	
Joachim Neupel	

Accounts and Audit Committee	
Joachim Neupel	Chairman
Prof Dr Stephan Schüller	Deputy Chairman
Christian Graf von Bassewitz	
York-Detlef Bülow	
Hans W. Reich	

Nomination Committee
Hans W. Reich
Erwin Flieger

Credit and Market Risk Committee	
Hans W. Reich	Chairman
Dr Herbert Lohneiß	Deputy Chairman
Christian Graf von Bassewitz	
Tamara Birke	
Erwin Flieger	
Joachim Neupel	

Wiesbaden, 10 March 2009

The Management Board

Dr Wolf Schumacher   Norbert Kickum   Hermann J. Merkens   Thomas Ortmanns

Responsibility Statement

Statement pursuant to section 37 Y of the WPHG in conjunction with section 37 V (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, den 10 March 2009

The Management Board

Dr Wolf Schumacher   Norbert Kickum   Hermann J. Merkens   Thomas Ortmanns

Auditors' Report

After the results of our audit, we issued the following unqualified audit opinion dated 10 March 2009:

Auditors' Report

We have audited the consolidated financial statements prepared by the Aareal Bank AG, Wiesbaden, comprising the balance sheet, the income statement, statement of changes in equity, cash flow statement and the notes to the consolidated financial statements, together with the group management report for the business year from 1 January to 31 December 2008. 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 § (Article) 315a Abs. (paragraph) 1 HGB ("Handelsgesetzbuch": German Commercial Code) and articles of incorporation is the responsibility of the parent Company's Board of Managing Directors. 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 § 317 HGB and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW) and additionally observed the International Standards on Auditing (ISA). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the 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 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 reservations.

In our opinion based on the findings of our audit the consolidated financial statements comply with the IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB and articles of incorporation 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 and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Frankfurt / Main, 10 March 2009

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Christian F. Rabeling	ppa. Thorsten Mohr
Wirtschaftsprüfer	Wirtschaftsprüfer
(German Public Auditor)	(German Public Auditor)

Further Information

Offices

Wiesbaden Head Office

Aareal Bank AG
Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3480
Fax: +49 611 3482549

Structured Property Financing

Amsterdam
Byzantium Building
Stadhouderskade 14e
1054 ES Amsterdam, The Netherlands
Phone: +31 20 5898660
Fax: +31 20 5898666

Berlin
Wallstrasse 9-13
10179 Berlin, Germany
Phone: +49 30 880990
Fax: +49 30 88099470

Brussels
7, rue Guimard
1040 Brussels, Belgium
Phone: +32 2 5144090
Fax: +32 2 5144092

Copenhagen
Frederiksgade 7, 1
1265 Copenhagen K, Denmark
Phone: +45 70 109090
Fax: +45 70 109091

Hamburg
Pelzerstrasse 7
20095 Hamburg, Germany
Phone: +49 40 33316546
Fax: +49 40 33316599

Helsinki
Aleksanterinkatu 44, 4th floor
00100 Helsinki, Finland
Phone: +358 9 6961010
Fax: +358 9 69610111

Istanbul
Ebulula Mardin Caddesi
Maya Meridyen Iş Merkezi · D:2 Blok
Kat. 11 · 34335 Akatlar-Istanbul, Turkey
Phone: +90 212 3490200
Fax: +90 212 3490299

London
38 Lombard Street
London EC3V 9BS, United Kingdom
Phone: +44 20 74569200
Fax: +44 20 79295055

Madrid
Paseo de la Castellana, 60 - 4D
28046 Madrid, Spain
Phone: +34 917 454160
Fax: +34 917 450775

Milan
Via Paolo Andreani, 6
20122 Milan, Italy
Phone: +39 02 76419001
Fax: +39 02 764190211

Moscow
Business Centre "Mokhovaya"
4/7 Vozdrizhenka Street · Building 2
125009 Moscow, Russia
Phone: +7 495 6638626
Fax: +7 495 6638627

Munich
Prinzregentenstrasse 22
80538 Munich, Germany
Phone: +49 89 51270
Fax: +49 89 5127211

New York
Aareal Capital Corporation
250 Park Avenue · Suite 820
New York NY 10177, USA
Phone: +1 212 5084080
Fax: +1 917 3220285

Paris
Aareal Bank France S.A.
5, rue Scribe
75009 Paris, France
Phone: +33 1 44516630
Fax: +33 1 42669794

Prague
Aareal Financial Service spol. s r.o.
FORUM Building
Václavské námestí 19
11000 Prague 1, Czech Republic
Phone: +420 234656000
Fax: +420 234656011

Wiesbaden
Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3483166
Fax: +49 611 3482833

Rome
Via Mercadante, 12/14
00198 Rome, Italy
Phone: +39 06 83004200
Fax: +39 06 83004250

Shanghai
Suite 2902 · Tower 2 Plaza 66
No. 1366 Nanjing Xi Road
Jing An District
Shanghai 200040, P.R. of China
Phone: +86 21 62889908
Fax: +86 21 62889903

Singapore
Aareal Bank Asia Limited
3 Church Street
17-03 Samsung Hub
Singapore 049483, Singapore
Phone: +65 6372 9750
Fax: +65 6536 8162

Stockholm
Hamngatan 11
11147 Stockholm, Sweden
Phone: +46 8 54642000
Fax: +46 8 54642001

Warsaw
RONDO 1 · Rondo ONZ 1
00-124 Warsaw, Poland
Phone: +48 22 5449060
Fax: +48 22 5449069

Zurich
Rennweg 52
8001 Zurich, Switzerland
Phone: +41 43 8887575
Fax: +41 43 8887576

Aareal Estate AG
Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3482025
Fax: +49 611 3482775

Aareal Valuation GmbH
Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3482134
Fax: +49 611 3482640

Deutsche Structured Finance GmbH
Westendstrasse 24
60325 Frankfurt/Main, Germany
Phone: +49 69 9714970
Fax: +49 69 97149715

Consulting/Services

Aareal Bank AG
Institutional Housing Unit
Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3482967
Fax: +49 611 3482499

Institutional Housing Unit
Berlin Branch
Wallstrasse 9-13
10179 Berlin, Germany
Phone: +49 30 88099444
Fax: +49 30 88099470

Institutional Housing Unit
Essen Branch
Huyssenallee 48
45128 Essen, Germany
Phone: +49 201 81008100
Fax: +49 201 81008200

Institutional Housing Unit
Hamburg Branch
Pelzerstrasse 7
20095 Hamburg, Germany
Phone: +49 40 33316810
Fax: +49 40 33316399

Institutional Housing Unit
Leipzig Branch
Neumarkt 2-4
04109 Leipzig, Germany
Phone: +49 341 2272160
Fax: +49 341 2272101

Institutional Housing Unit
Munich Branch
Prinzregentenstrasse 22
80538 Munich, Germany
Phone: +49 89 5127265
Fax: +49 89 51271264

Institutional Housing Unit
Rhine-Main Branch
Paulinenstrasse 15
65189 Wiesbaden, Germany
Hotline: +49 611 3482000
Fax: +49 611 3483002

Institutional Housing Unit
Stuttgart Branch
Kriegerstrasse 3
70191 Stuttgart, Germany
Phone: +49 711 2236116
Fax: +49 711 2236160

Aareon AG
Im Münchfeld 1-5
55122 Mainz, Germany
Phone: +49 6131 3010
Fax: +49 6131 301419

Aareal First Financial Solutions AG
Peter-Sander-Strasse 30
55122 Mainz-Kastel, Germany
Phone: +49 6134 560201
Fax: +49 6134 560401

Deutsche Bau- und Grundstücks-Aktiengesellschaft
Chlodwigplatz 1
53119 Bonn, Germany
Phone: +49 228 5180
Fax: +49 228 518298

Deposit-taking

Dublin
4 Custom House Plaza · I.F.S.C.
Dublin 1, Ireland
Phone: +353 1 6369220
Fax: +353 1 6702785

Financial Calendar

7 May 2009	Annual General Meeting – Kurhaus, Wiesbaden
12 May 2009	Presentation of interim report as at 31 March 2009
August 2009	Presentation of interim report as at 30 June 2009
November 2009	Presentation of interim report as at 30 September 2009

Imprint
Contents:
Aareal Bank AG, Corporate Communications
Photographs:
Photographie Alexandra Lechner, Darmstadt, Germany
Other sources:
Cover picture: Denkou Images, Getty Images
P. 14/15, below: laif Agentur für Photos & Reportagen GmbH, Cologne, Germany
P. 18/19, below: Oracle Advertising Services Limited, London, United Kingdom
P. 20/21, above: Getty Images
P. 22/23 and 24/25, above: Corbis
P. 29, left: Peter Stumpf Fotografie, Dusseldorf, Germany
P. 31, right: European Business School (EBS), Oestrich-Winkel, Germany
Design / Layout:
s/company GmbH, Fulda, Germany
Kuhn, Kammann & Kuhn AG, Cologne, Germany
Production:
Druckerei Chmielorz GmbH, Wiesbaden-Nordenstadt. Germany

Aareal Bank AG
Corporate Communications
Paulinenstrasse 15
65189 Wiesbaden, Germany

Phone: +49 611 348 2963
Fax: +49 611 348 2548
E-mail: aareal@aareal-bank.com
www.aareal-bank.com

03/2009

Aareal Bank
Group