QUALITY Ⓐ made by AAREAL

#Thinking ahead.
Shaping the future.

Annual Report 2016

Aareal Bank Group

Aareal Bank Group in 60 seconds

Aareal Bank Group is a leading provider of smart financing, software products and digital solutions for the property sector and related industries.

Whether it is office buildings, hotels, shopping centres or logistics and residential properties, whether in North America, Asia or Europe, our customised and flexible solutions support our customers in financing their international property investments.

We offer our clients in the European property and energy industries a unique combination of specialised banking services and innovative digital products and services – designed to optimise their business processes, enhancing efficiency.

Our digital platforms also integrate property management with adjacent sectors.

The basic factors driving our success are our global expertise and many years of close cooperation with the target sectors, with local experts and with clients. Because we look beyond the scope of traditional banking and IT services, we are able to reliably assess material developments, opportunities and risks at an early stage, implementing the insights gained particularly quickly.

Aareal 2020 – Adjust. Advance. Achieve.

Protecting the base whilst unlocking new potential

"With our Aareal 2020 programme, we are taking on the challenges of the future. In an environment characterised by technological evolution, changing customer needs and tougher competition, we are protecting our strong foundation and, at the same time, unlocking new revenue potential. Leveraging our successful business model, we are expanding the market position of both Group segments."

Hermann J. Merkens
Chairman of the Management Board

Contents

Aareal Bank Group

Key Indicators

	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Results[1]		
Operating profit (€ mn)	366	470
Consolidated net income (€ mn)	234	374
Consolidated net income allocated to ordinary shareholders (€ mn)[2]	199	339
Cost/income ratio (%)[3]	41.2	43.2
Dividend per share (€)[4]	2.00	1.65
Earnings per ordinary share (€)[2]	3.33	5.66
RoE before taxes (%)[2]	13.2	18.6
RoE after taxes (%)[2]	8.1	14.7

	31 Dec 2016	31 Dec 2015
Statement of financial position		
Property finance (€ mn)[5]	27,928	30,894
of which: international (€ mn)	23,423	25,243
Equity (€ mn)	3,129	3,044
Total assets (€ mn)	47,708	51,948
Regulatory indicators[6]		
Risk-weighted assets (€ mn)	14,540	16,709
Common Equity Tier 1 ratio (CET 1 ratio) (%)	16.2	13.8
Tier 1 ratio (T1 ratio) (%)	19.9	17.2
Total capital ratio (%)	27.5	23.8
Common Equity Tier 1 ratio (CET1 ratio) (%) – fully phased –	15.7	13.1
Employees	2.728	2.861

	31 Dec 2016	31 Dec 2015
Fitch Ratings		
Issuer rating long-term	BBB+ (outlook: stable)	BBB+ (outlook: stable)
short-term	F2	F2
Pfandbrief rating	AAA	AAA
Moody's[7]		
Issuer rating long-term	Baa1 (outlook: stable)	n/a
short-term	P-2	n/a
Pfandbrief rating	AAA	n/a
Sustainability[8]		
MSCI	AA	AA
oekom	prime (C)	prime (C)
Sustainalytics	71	68

[1] The previous year's figures include the negative goodwill of € 150 million from the acquisition of Westdeutsche ImmobilienBank AG (WestImmo).

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

[3] Structured Property Financing segment only

[4] Proposal to be submitted to the Annual General Meeting

[5] Excluding € 1.1 billion in private client business (31 December 2015: € 1.5 billion) and € 0.6 billion in local authority lending business by WestImmo (31 December 2015: € 0.6 billion)

[6] The calculation of regulatory capital takes into account the Management Board's proposal for the appropriation of profits for the financial year 2016. The appropriation of profits is subject to approval by the Annual General Meeting.

[7] Published on 12 January 2017

[8] Please refer to our Sustainability Report for more details.

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

In order to achieve our goals, we launched our strategic ”Aareal 2020“ programme in the spring of 2016. It consists of three parts:

Adjust.

Establishing structures and processes, which allow us not only to keep up with growing and rapidly changing requirements, but to also shape these changes.

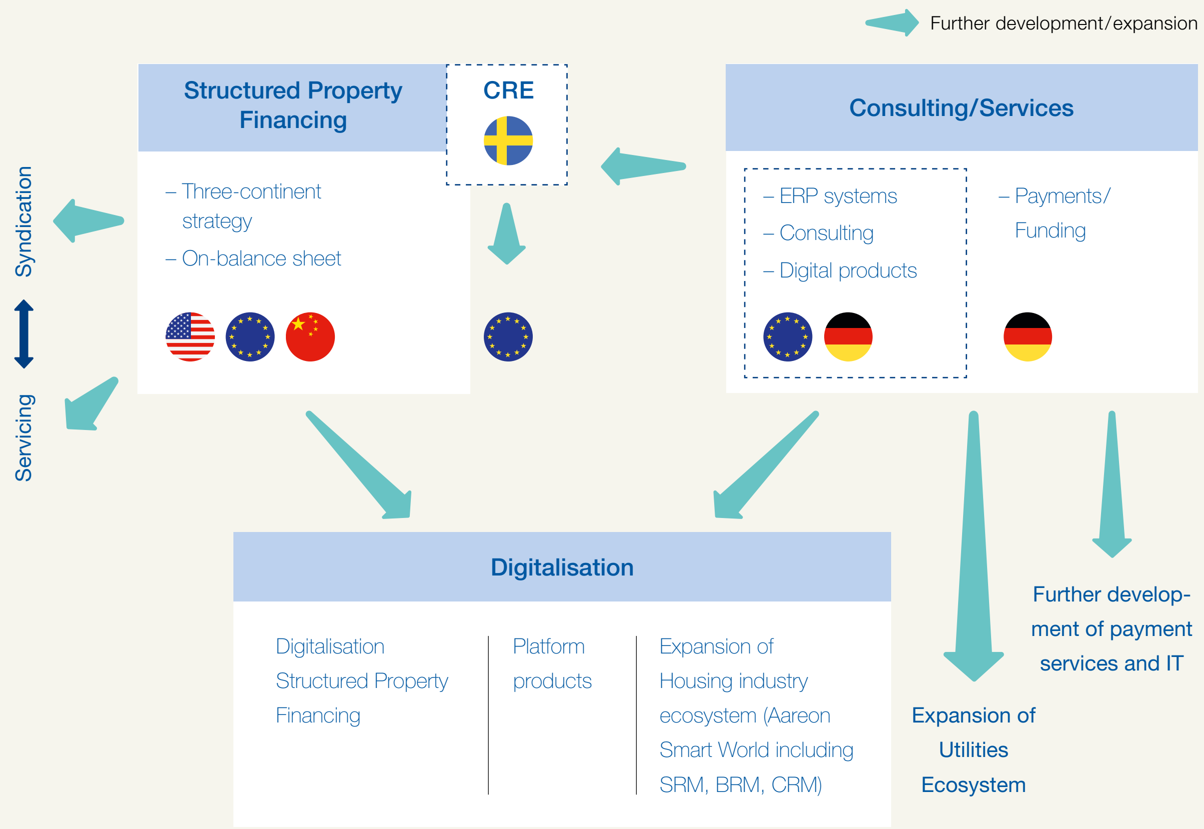
Advance.

Further developing the existing service portfolios with a consistent focus on clients – by gaining new customer groups and tapping new markets, and thus new revenue potential as well.

Achieve.

Creating sustainable values for clients, shareholders and investors, as well as for employees.

Implementing the strategy within the segments, and as a Group – leveraging our strengths



CRE: Commercial Real Estate; SRM: Supplier Relationship Management; BRM: Building Relationship Management; CRM: Customer Relationship Management

Foundation laid. Milestones achieved.

We developed an extensive strategic roadmap for the implementation of Aareal 2020, including various initiatives and projects for the further development of our Group. One of our top priorities is unlocking new revenue potential in both segments; another is to adapt structures and processes to our stakeholders' requirements in a digital world.

In 2016, we were able to complete all the preparations necessary for the implementation of our programme for the future. Not only did we define the strategic thrusts for the further development of our business model, initiate corresponding projects and implement first specific initiatives; we also drove numerous structural changes forward, e.g. by readjusting our IT architecture, making our organisational structure more flexible, and further developing our corporate culture.

We have already reaped the first fruits of success by unlocking new revenue potential: for example, we have expanded the US business, expedited our syndication activities in new business and successfully launched innovative digital solutions that provide significant additional value for our clients.

In 2017, we will intensify our activities for the further development of the business model. Taking into account the stable foundation of our core business, it is our aim to gain new customer groups and enter new ecosystems, starting from the housing industry, consistently exploiting opportunities arising from the digitalisation of the finance and property industries. For this purpose, we will expand into attractive markets, make our balance sheet more flexible and reduce non-core assets, At the same time, we continue optimising our processes, in order to make Aareal Bank even more attractive – to clients and shareholders alike.

Our programme for the future

A digital tomorrow

Thinking ahead. Shaping the future.

Digitalisation has already changed our world lastingly – and will continue doing so. It is all-encompassing, omnipresent, and has a significant influence upon the economy and society. It creates new client needs as well as new business models, breaking up value creation chains and revolutionising the way we communicate.

In fact, it was several years ago that Aareal Bank Group began bracing itself for the disruptive force of the upcoming digitalisation. Thanks to our unique combination of banking and IT services, we are pioneers of the digital age within our sector – in many areas. For us, the constant technological change presents an opportunity to create additional value for our clients, while at the same time achieving new revenue potential. It is our aim to accompany and advise our clients in their use of new digital opportunities, to provide pioneering solutions, tailor-made to their needs, and to shape the future – together with our clients.

We are optimally positioned to capitalise on technological change in the best way possible on the one hand, and to implement the strategic thrusts of Aareal 2020 on the other: by combining our decades of experience in financing solutions and services (especially in the housing industry) with our outstanding technological expertise, which we have gained – not least thanks to our own market-leading IT subsidiary Aareon. With numerous innovative digital products, our range of services is already setting standards. In order to anticipate new developments and trends at an early stage, we are intensifying our collaboration with start-ups and continuously investing in technological know-how. We also attach great importance to innovative freedom within the Group. Our customer relationships are characterised by a high level of mutual trust and long-standing cooperation.

Our digital roadmap within the Group

Within Aareal 2020, it is our aim to develop the best possible solutions for our clients Group-wide by exploiting the advantages of digitalisation. At the same time, we want to expand our pioneering role as a provider of innovative digital solutions for our clients. We have developed a digital roadmap with four strategic thrusts, enabling us to structure the many innovative ideas we have:

The four dimensions of digitalisation

Aareal Bank Group

Optimise organisational performance

- Digital client communications
- Digital client service and maintenance
- Optimise database systems
- Enhance flexibility of sales organisation

Develop new financing and payment solutions

- Building a centralised online platform
- Launch a variety of apps, such as Aareal Sign
- Payments and data processing solutions

Continue developing the existing product portfolio

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

Develop new digital solutions

- Range of new CRM, BRM, and SRM solutions
- Implement the platform strategy
- Cooperations with start-ups

Development of new digital solutions
We want to provide innovative solutions in the areas of customer relationship management (CRM), business relationship management (BRM) and supply relationship management (SRM) – based on a digital platform strategy. Close cooperation with start-up companies ensures our solutions are as innovative as possible, and at the same time benefit our clients as much as possible.

Development of new financing and payment transaction solutions
We are extending our range of services with tailor-made apps, together with payment transaction and data processing solutions. Simultaneously, we are creating a new platform for our digital products with an online portal.

Further development of our existing product portfolio
We are engaged upon further systematic development of our existing products, creating solutions which set technological standards. Our ERP portfolio and our BK 01 product family are especially important. We will also transfer solutions, which have only been used nationally until now, into other countries.

Optimisation of organisational performance
We are using the opportunity that digitalisation offers us to further develop and improve our customer communication channels. Hence we are expanding our digitally supported customer service offers, optimising our customer care and database systems, and organising our sales network in a more flexible way. We are also aiming at generating new potential synergies for product development.

We support our customers with new products and services, optimising their business processes and enhancing the latter's efficiency. By digitalising their processes, companies can increase customer satisfaction and thus also the level of customer loyalty. Another opportunity that digitalisation provides is to be able to create the foundation of a modern infrastructure with a comfortable interface, and to enable a system-integrated electronic data interchange with optimised processing operations for our clients and their business models.

Our digital roadmap also encompasses the expansion of activities into new countries, as well as extending the range of activities in countries where we are already active. Our scheduled new products serve as promising market entry and differentiation opportunities. Therefore, our digital roadmap acts as a central pillar of our growth strategy, in which the three specific thrusts – Adjust. Advance. Achieve. – are firmly rooted.

> ”Our aim: Aareal Bank Group will be the leading provider of smart financing, software products and digital solutions for the property sector and related industries.“
>
> **Hermann J. Merkens**
> Chairman of the Management Board

Creating value – our segments

The backbone: Structured Property Financing

"We are the provider of smart financing solutions for commercial property – especially office buildings, hotels, shopping centres as well as logistics properties and residential property – in Europe, North America and Asia. We focus on financing existing buildings. Our particular strengths are structuring expertise, our reliability, cross-border financing and supporting local markets.

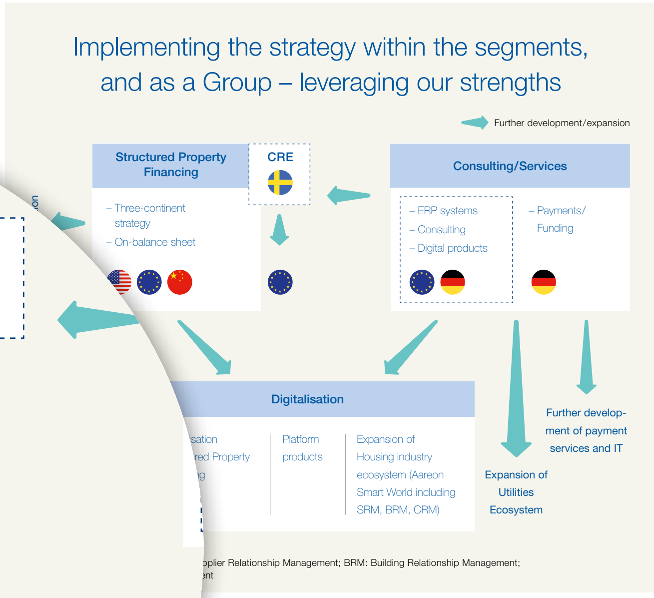
Our 90 years of experience as specialist in the property sector and the high demands we place on quality have reaped us trusting partnerships with our customers, and these are the foundations of our activity. Therefore, we focus on cultivating and expanding our client relationships.

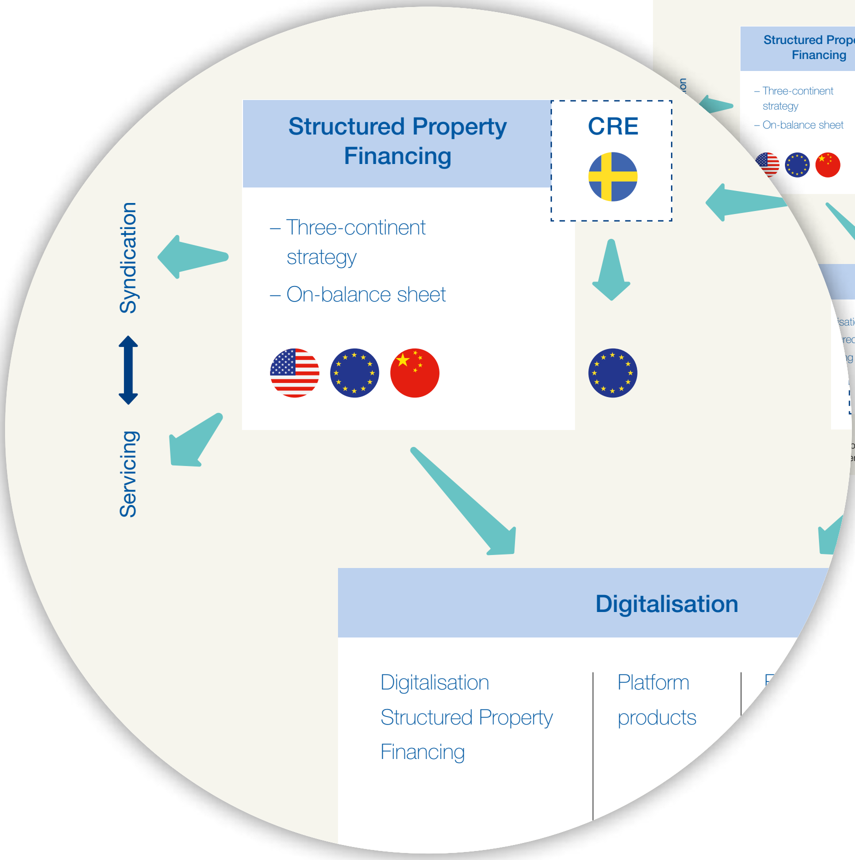
Continuing our growth story, we will be expanding our presence on markets and in asset classes that have an attractive risk / yield profile. That includes for example expanding the North America portfolio. We are going to run our portfolio management more actively and lend more flexibility to our balance sheet by expanding our outplacement opportunities. Especially in this regard, our partners place trust in our structuring expertise and our international network.

To open up new markets and client groups, we take advantage of the potential presented by digitalisation in our interactions with clients and identify new digital business opportunities. We are also reviewing the supply of extra services along the value chain in commercial property financing. Servicing in particular still has great potential for us."

"We are the provider of smart financing solutions for commercial property – especially office buildings, hotels, shopping centres as well as logistics properties and residential property – in Europe, North America and Asia."

Christof Winkelmann
Member of the Management Board of Aareal Bank





Focus:
Structured Property Financing segment

Structured Property Financing
Our USPs as key success factors

Unique selling propositions

Structuring expertise | Cross-border financing | Local markets

”Sector expertise“

”Reliable partner“

We are sector experts and partners on an equal footing

”Partner on an equal footing“

”Syndication partner“

Strategic blueprint

– Efficient utilisation of the balance sheet, and active portfolio management
  – Enhanced flexibility
  – Increased net commission income
  – Selective origination as a USP

– Digitalise processes

– Organic and inorganic growth

'Quality made by Aareal' makes the difference

A milestone in cross-border financing transactions

Severin Schöttmer is delighted with the professional and trustful cooperation with Invesco Real Estate, a long-standing customer of the Bank. In December 2016 Aareal Bank was mandated by Invesco Real Estate to arrange a credit facility of up to € 1 billion. Schöttmer, Managing Director Special Property Finance at Aareal Bank AG, says: "What we have assembled with this project, together with our client, is a milestone in financing large-volume cross-border transactions. The project points the way ahead for the sector. Demands were very complex because it is a credit facility that crosses frontiers in financing a portfolio of first-class properties in top locations of 27 cities, across seven countries. The financing will run for 10 years. What was called for was great flexibility in regard of currencies, fungibility of the diversified property portfolio and solutions in respect of growth potentials"

We have been able to meet all the stringent requirements" says Schöttmer. "But it has been our structuring expertise and our "local footprint" that tipped the scales for us. That is because we have specialist teams with cross-border expertise, our strong regional presence in Europe through the combined use of market and sector experts and an excellent track record through various benchmark transactions in the last few years. Our big network, many years of know-how and efficient processes permitted us to make a success of this transaction, together with the client."

Andy Rofe, Invesco Real Estate's Managing Director – Europe commented: "We are delighted to announce the partnership with Aareal Bank AG, with whom we have worked for many years now. For us, this is a ground-breaking project in our industry, which creates a loan facility that fits both the profile and nature of our European mandate. This tailor-made facility means stability and reliability for our diversified portfolio with its high-quality properties in some of the best locations in Europe over the next ten years. Furthermore, it gives us the necessary flexibility to further expand our European mandate or to sell properties, thus optimising our performance for the benefit of our investors."

Severin Schöttmer,
Managing Director
Special Property Finance

"The remarkable thing about this financing is the focused collaboration, combined with the high degree of professionalism and expertise on both Aareal Bank's and the client's part."

Dagmar Knopek
Member of the Management Board of Aareal Bank

"The remarkable thing about this financing is the focused collaboration, combined with the high degree of professionalism and expertise on both Aareal Bank's and the client's part. Needless to say that we use digital data rooms for the communication with our partners, in order to accelerate processes. The financing comprises seven countries and two currencies. To manage that successfully, it is not only Aareal Bank's Sales units who carry out their acquisition and analysing activities in a targeted manner, Credit Management is also extensively involved with various risk management, transaction management and transaction advisory (i.e. supervision of contract documentation) teams The Treasury division supports this type of financing with a high level of expertise, and so do the valuers of our subsidiary, Aareal Valuation GmbH, and the circle is completed by the experts in our syndication team who successfully structured and implemented the syndication. This shows that the knowledge needed for a successful transaction must be broadly diversified."

Invesco Real Estate Portfolio

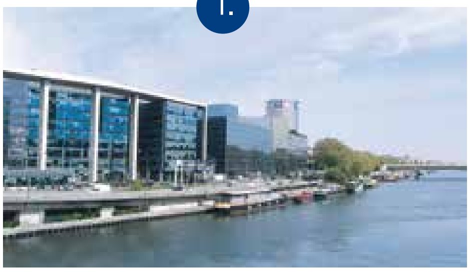
Project: portfolio of 27 prime properties in seven European countries
Credit volume: € 1 billion
Role of Aareal Bank: Arranger and Underwriter

Invesco

from left: Jens Engemann, Senior Manager Credit Management
Michael Eisenkolb, Director Special Property Finance
Johannes Kupers, Vice President Special Property Finance
Elvira Valiullina, Manager Credit Management
Christof Teichmann, Director Business & Syndication Management

Christian Schmid,
Managing Director
Business & Syndication Management

Our syndication competence provides customers with genuine added value

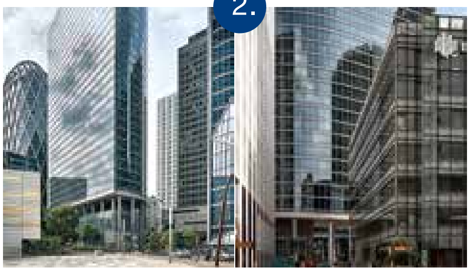


1.

Cégereal

Project: Portfolio of three office properties in prime locations in Paris, France
Credit volume: € 525 million
Role of Aareal Bank: Co-Mandated Lead Arranger and Co-Underwriter

CeGeREAL



2.

Tour CBX

Project: Office property in Paris, France
Credit volume: € 215 million
Role of Aareal Bank: Arranger, Agent and Lender

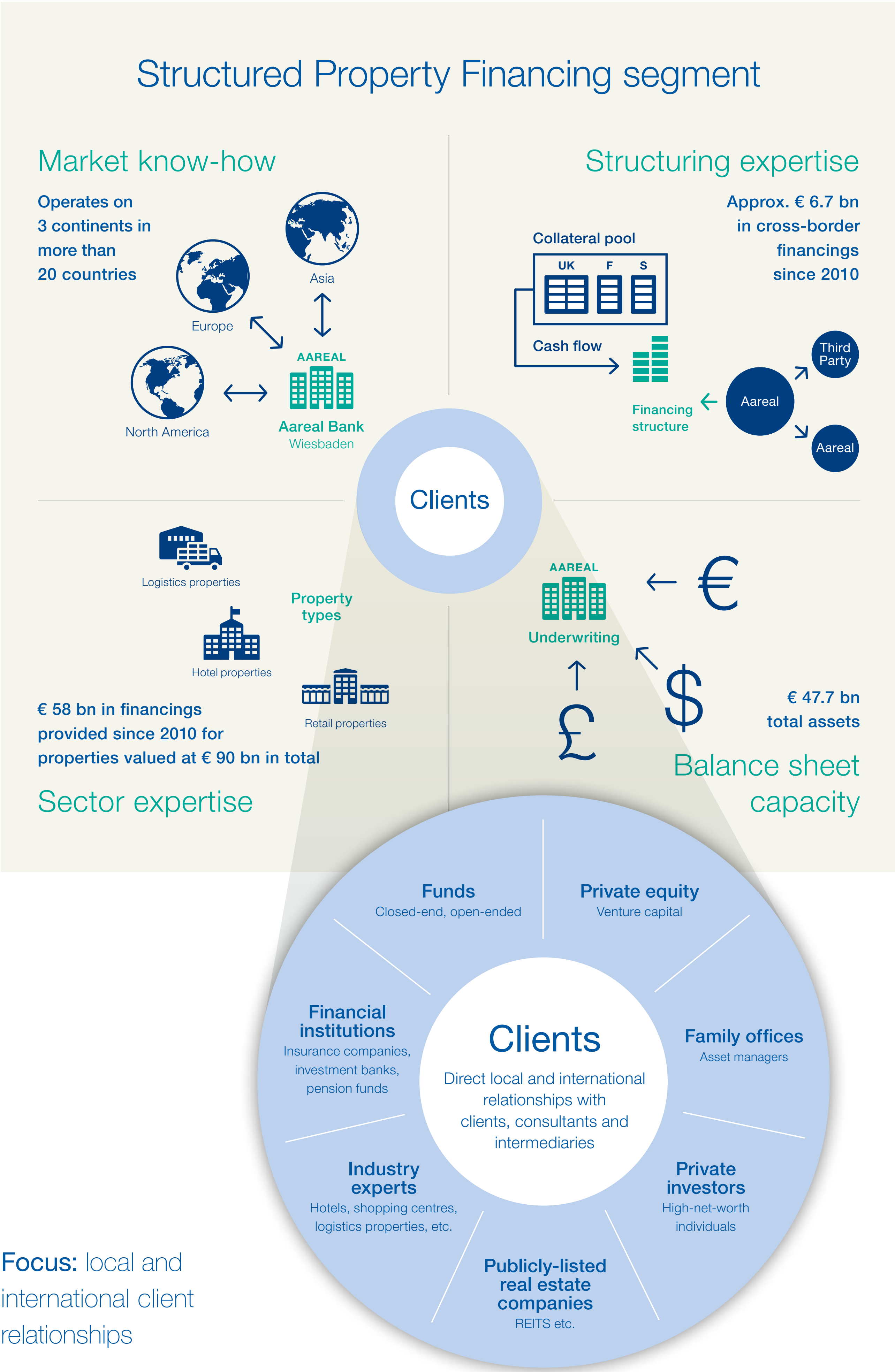
TISHMAN SPEYER

"Competence and experience in syndicating are becoming all the more critical for success in our market" says Christian Schmid, Managing Director Business & Syndication Management at Aareal Bank. "The arrangement of a resilient and established syndication network has become increasingly important to be in the position to offer our clients maximum flexibility."

Schmid welcomes this trend: "That is only positive for us because we are good at meeting the increased demands on syndication competence. Our syndication team has many years of expertise as well as intensive and complex contacts to well-known syndication partners from various sectors. The transactions agreed in 2016 with Invesco Real Estate, Cégereal and Périsud show this. Over the last few years we have been able to strengthen our relationships through high-volume financing and by continuously involving our contacts in on-going transactions, particularly in the insurance area. We expect an enhancement of our syndication competence and related processes from the strategic partnership we have just concluded with London-based Mount Street, a corporation specialised in servicing and credit management of commercial and residential property portfolios in particular."

Schmid says: "Customers profit from our syndication competence in two ways. Firstly we are a one-stop contact that structures the transaction and then takes on the syndication. Secondly, we are the interface to the syndication partner so that the clients can look after their core business. We offer our clients genuine added value and increase their agility and flexibility."

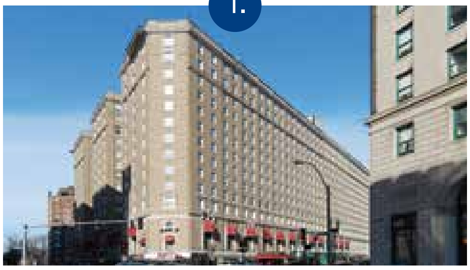
Interview with Christian Schmid, gb2016.aareal-bank.com/syndication


Structured Property Financing segment
Market know-how
Operates on 3 continents in more than 20 countries
Asia
Europe
North America
AAREAL
Aareal Bank
Wiesbaden
Structuring expertise
Approx. € 6.7 bn in cross-border financings since 2010
Collateral pool
UK
F
S
Cash flow
Financing structure
Third Party
Aareal
Aareal
Clients
Logistics properties
Property types
Hotel properties
Retail properties
€ 58 bn in financings provided since 2010 for properties valued at € 90 bn in total
Sector expertise
AAREAL
Underwriting
€
$
£
€ 47.7 bn total assets
Balance sheet capacity
Funds
Closed-end, open-ended
Private equity
Venture capital
Financial institutions
Insurance companies, investment banks, pension funds
Clients
Direct local and international relationships with clients, consultants and intermediaries
Family offices
Asset managers
Industry experts
Hotels, shopping centres, logistics properties, etc.
Private investors
High-net-worth individuals
Publicly-listed real estate companies
REITS etc.
Focus: local and international client relationships

Our success in expanding the US business is encouraging

”The US is a very attractive market for us”, says Christof Winkelmann, member of the Management Board of Aareal Bank. ”We have being doing successful business in the US for many years now and have a good market footing with our range of services. As part of Aareal 2020 we want to expand our US business further. It is a great success that we were able to extend our presence in the US already in 2016. Especially the transactions: 'Park Square Boston', '462 Broadway Retail and Office Building' and 'Beverly Hilton/Waldorf Astoria Beverly Hills' are good examples for this. The confidence our customers place in us is further motivation.“

1.

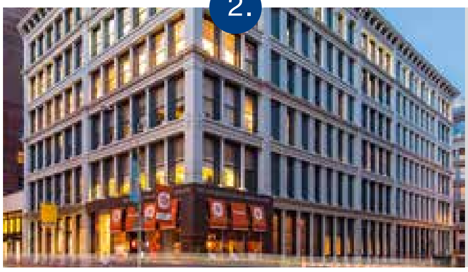


Park Square Boston

Project: Office property in Boston, Massachusetts, USA
Credit volume: USD 133 million
Role of Aareal Bank: Sole Administrative Agent and Lender

CAPITAL PROPERTIES

2.

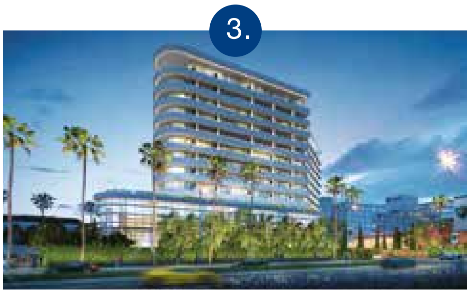


462 Broadway Retail and Office Building

Project: Retail and office premises in New York, USA
Credit volume: USD 135 million
Role of Aareal Bank: Sole Administrative Agent and Lender

MERINGOFF PROPERTIES
THE SHIDLER GROUP

3.



Beverly Hilton/ Waldorf Astoria Beverly Hills

Project: Hotels in Beverly Hills, USA
Credit volume: USD 294 million
Role of Aareal Bank: Administrative Agent and Lender

Oasis West Realty LLC

Our growth driver: the Consulting/Services segment

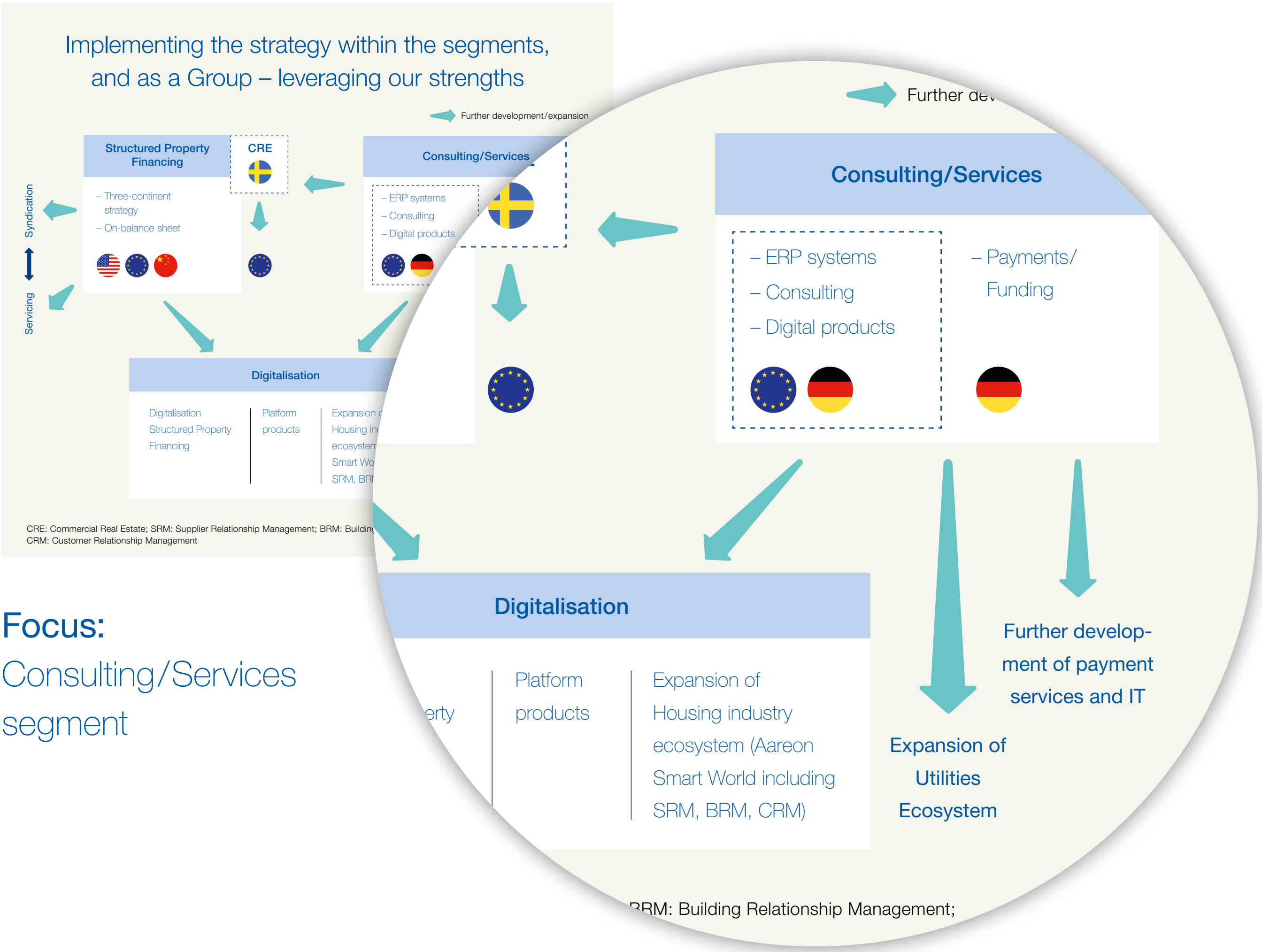
"We offer our clients in the property and energy sectors a unique combination of specialised banking services, software products and digital solutions."

Thomas Ortmanns
Member of the Management Board of Aareal Bank

“We offer our clients in the property and energy sectors a unique combination of specialised banking services, software products and digital solutions. Our subsidiary Aareon AG is the leading international consultancy and IT systems house for the property sector in Europe.

In the years to come, we will systematically expand our dynamic Consulting/Services business segment, by using our position as the leading ERP provider in Europe. Thus, we will be able to grow in the digital housing industry ecosystem. We will also extend our cross-border sales activity, launch additional products for the ERP systems we provide, and continuously expand our range of new digital solutions.

We will not only offer our products and services to the housing industry, but increasingly also to related sectors, in particular to utilities. We especially recognise potential in the payments transaction service business, IT service and IT consulting. The next steps will be to continue developing our existing platform products that facilitate management tasks for housing companies. We will also expand our range of payments transaction services and IT products, to also include our customers’ customers (B2B2C) as well as smaller housing companies and managers.”

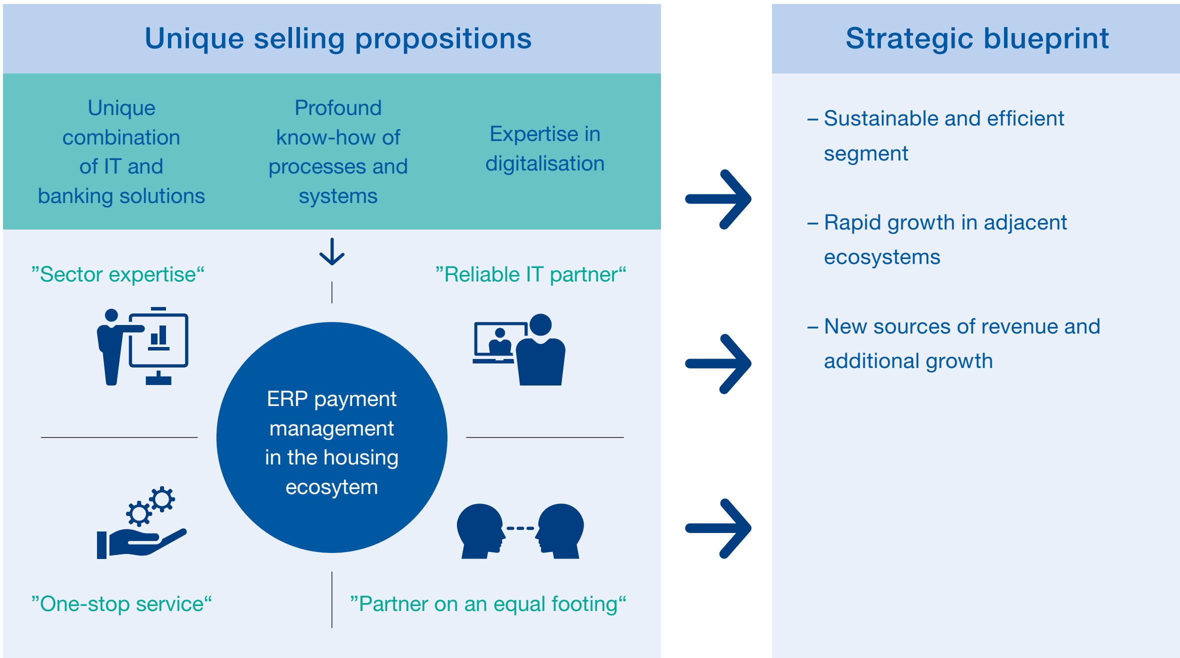


Focus:
Consulting/Services segment

Aareal Bank Group's Smart World – New digital solutions

Possessing our unique combination of IT and banking solutions, deep know-how of our customers' processes and systems, their payment transaction and ERP systems, and thanks to our digitalisation skills, we are in a position to partner our customers into their digital future.

Consulting/Services: Our USPs as key success factors



Our product pipeline is very well-stocked with digital solutions:

Aareon Smart World Cockpit

The Aareon Smart World Cockpit is being developed on the basis of the British Aareon solution ”360° Field Worker”, which is already on the market in the United Kingdom. With Aareon Smart World Cockpit, we want to offer German housing companies a complete solution with a comprehensive, cross-application view of all relevant information, including a graphical depiction of the properties (showing, e.g., impending maintenance work and current occupancy rates) as well as a comprehensive overview of the tenant profiles. The solution can be adjusted according to user preferences. Adding further information and data is also easily done. Users can choose whether they want to access the application via their desktop computer or their mobile phone, and can also gather and edit data in real time.

Solution strategically pays into **platform products, digital solutions,** and the **expansion of the Housing Industry ecosystem** (BRM, CRM)

→ See graphic on page 17

Digital customer communication in B2B

After 2015 saw the implementation of all the necessary statutory regulations, Aareal Bank’s first step towards complete digitalisation of client communication was the development of electronic bank statements. The advantages are not just a simplified automated processing of account information and reduced effort for preserving and archiving bank statements; electronic bank statements as a medium also provide the opportunity of exchanging a large volume of information and data about the processes with the customer, thus allowing us to offer them tailor-made new products and solutions. Further means of electronic communication will now be developed along the lines of the established structure.

Solution strategically pays into **platform products, the development of the payment transaction service business** and the **expansion of the Housing Industry ecosystem** (CRM)

→ See graphic on page 17

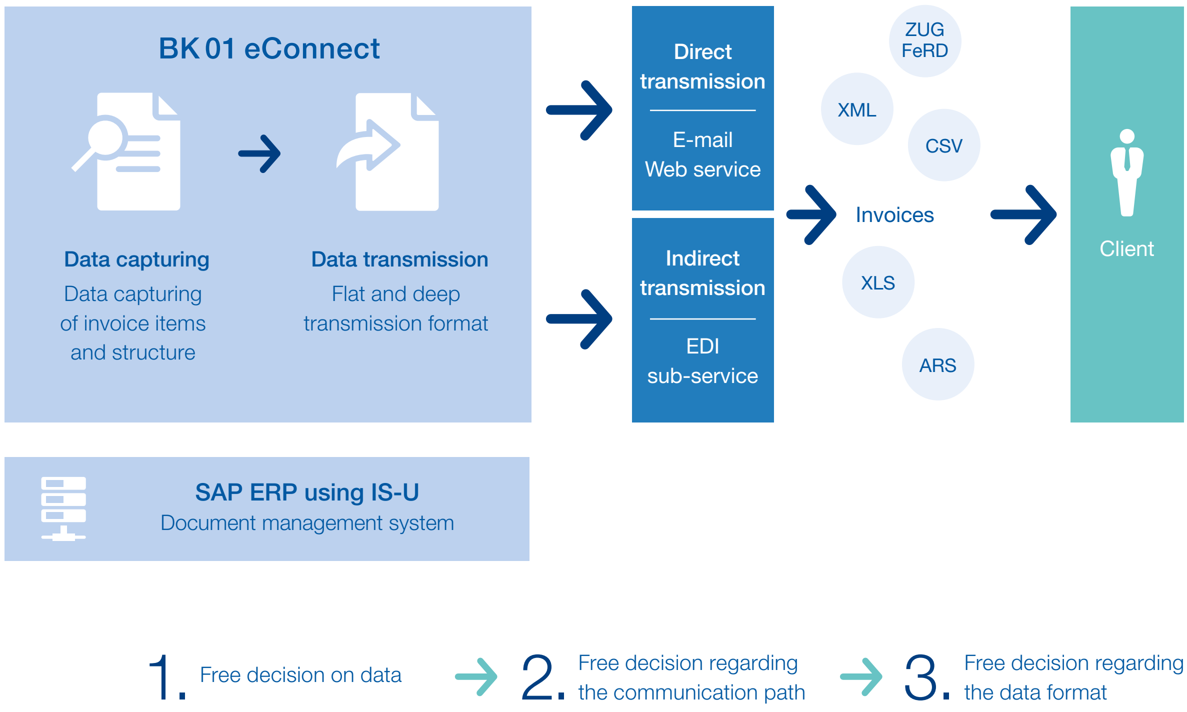
Solution strategically pays into the **expansion of further ecosystems** (utilities)

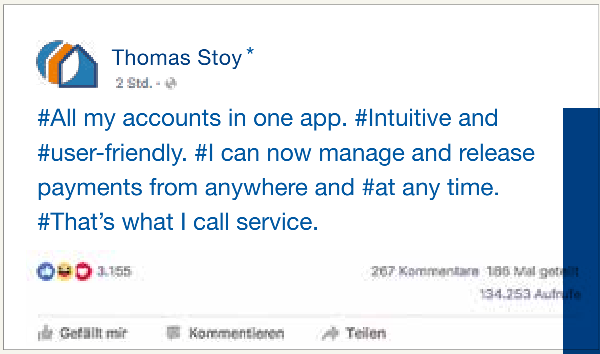
→ See graphic on page 17

Expansion BK 01 eConnect

We pay particular attention to an efficient cooperation between energy utilities and their partner industries. Thus, we are expanding BK 01 eConnect, our solution for automated and customer-individual provision of invoice and other data, creating a multi-format application that allows companies to issue invoices in various file formats, e.g. ZUGFeRD, XML, Excel etc. Energy utilities can thus substantially increase their service quality for bundle clients, chains, the property industry and other commercial clients.

BK 01 eConnect at a glance





* Management Board member at the housing corporation Duisburg-Hamborn eG

Solution strategically pays into **platform products** and **the development of the payment transaction service business**

→ See graphic on page 17

Aareal Sign

Aareal Sign is a multi-bank app which allows companies' authorised signatories to check the balance of company accounts – at any time and from anywhere – and to release payments carried out by employees – in a secure and legally binding manner. Users can also incorporate accounts from other banks via the app, thus creating a transparent overview of all their accounts with Aareal Sign. The application is based on the EBICS standard and uses the method of Distributed Electronic Signature (VEU).

Solution strategically pays into **platform products** and the **expansion of the Housing Industry ecosystem** (CRM)

→ See graphic on page 17

Tenant app

A smartphone application designed as a daily companion for tenants is about to be launched in Germany. In France and the UK, tenant apps like this are already in use, enabling users to take care of rental and general living matters anytime, anywhere. This includes, for example, handing in notifications of claims, keeping track of the processing status of requests, downloading forms and certificates or reviewing contracts and master data. A calendar informs the users about important events, e.g. impending construction work, when an electricity meter reading has to be taken, or any other kind of upcoming event. Lastly, the app also offers a 'community function' with which neighbours can exchange information.

Solution strategically pays into the **expansion of the Housing Industry ecosystem**

→ See graphic on page 17

Trace & Treasury

Trace & Treasury is an integrated cloud computing solution for managing and appraising assets and liabilities. Used as part of a treasury management system, the software also supports your daily cash management. All data can be transferred into scenarios, in order to carry out a complete economic planning. The software has already been launched in the Netherlands and is currently being adapted to the requirements of other countries.

Aareal Bank Group's Smart World

Aareon Group

Consultancy and systems house
to the European property industry

The number one **ERP provider** for the institutional housing industry in Europe, for example in France and Germany

€ 210.7
million sales revenues

(Residential) units managed by clients
>10 million

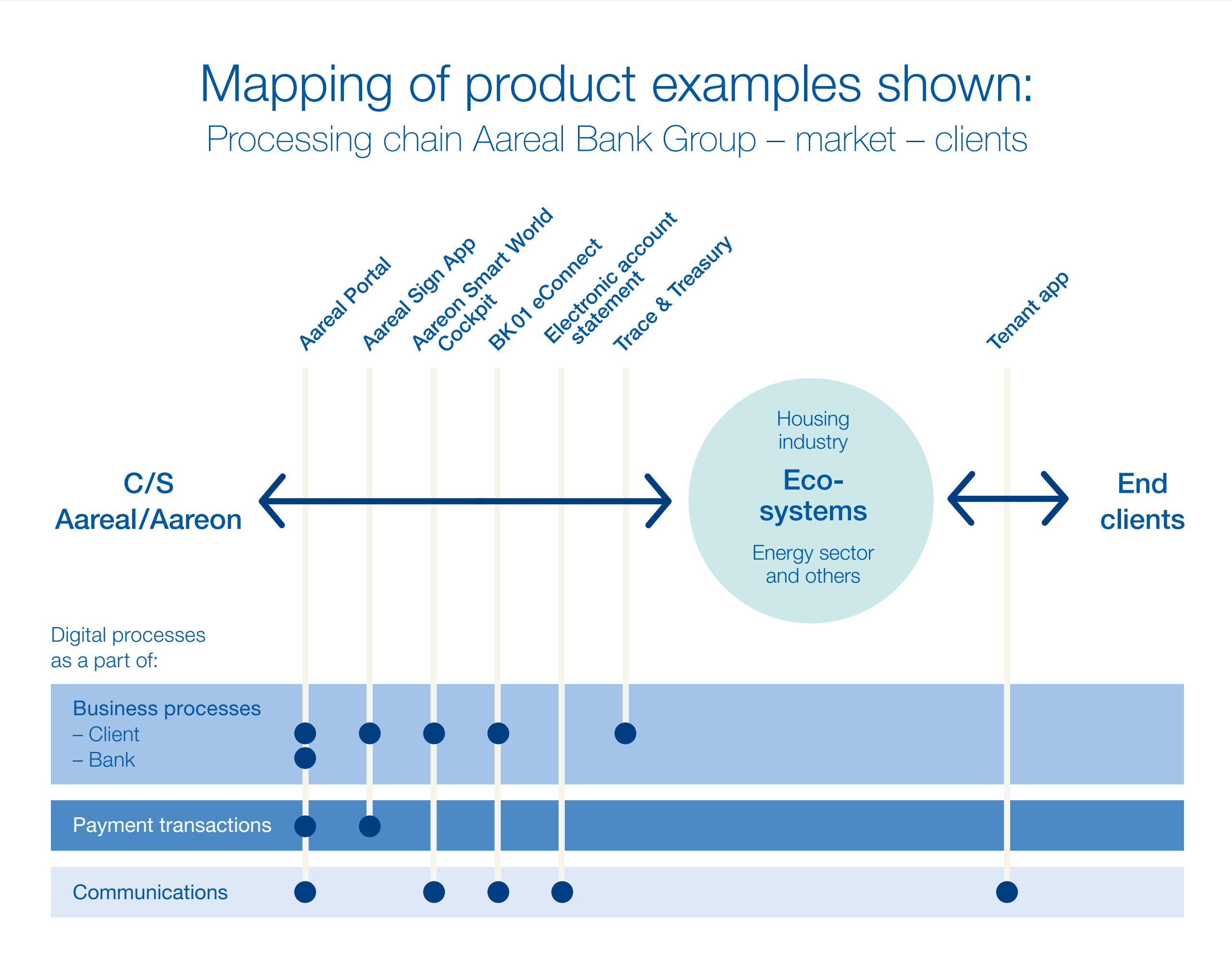
Aareal Bank
Bank division Housing Industry

Banking services
for the German housing and property industries, and for the energy utility and waste disposal industries

The number one provider for **integrated payment transaction and booking systems** for the institutional housing industry in Germany

€ 9.6
billion in deposits (2016 avg.)

Membership dues from cooperative members
Ancillary costs
Rents
140 million postings per year
Cash deposits
Building management fees
Wages
Rental deposits



We develop these products and solutions with modern, agile working methods, such as the joint development of solutions with our clients in the

Aareon DesignLab

The key to finding new and innovative ideas is to seek unconventional ways. And using so-called ‘design thinking’ is one such way. This method is a structured process for the development of new digital – and, most importantly, user-oriented – solutions. However, an environment that really gets your creative juices flowing is indispensable if you want to use the entire potential of design thinking. Thus, in 2016, we created the DesignLab at Aareon. Since then, we have already hosted numerous innovation workshops using the principle of 'design first, develop later'.

Rolf Hammesfahr, Head of IT at LEG Immobilien AG, says: "While design thinking was not a completely new experience for us, actually developing a specific new digital solution with this agile method in Aareon’s DesignLab was a first. The workshop wasn’t just exciting, it was also productive, user- and target-oriented."

Interview with Prof. Dr Dr-Ing. Jivka Ovtcharova
gb2016.aareal-bank.com/en/designlab
available in German only

from left: **Christoph Hinsken,** Business Unit Manager, Development Java, Aareal First Financial Solutions AG; **Göran Gutberlet,** Marketing & Communication Specialist, Processes & Organisation, Aareal First Financial Solutions AG; **Simona Degreif,** Business Consultant, Product Management Banking, Aareal First Financial Solutions AG; **Christoph Hoffmann,** Director Wohnungswirtschaft, Business Development, Aareal Bank AG; **Dagmar Lippert,** Business Consultant, Product Management Banking, Aareal First Financial Solutions AG; **Lars Ernst,** Group Managing Director, Group Business Consulting & Services; **Oliver Schimmel,** Business Architect, Development Cobol, Aareal First Financial Solutions AG; **Kai Riedl,** Application Architect, Product Management Banking, Aareal First Financial Solutions AG

Bank portal strategy

”More quality, more efficiency, more flexibility, more functions” – When Lars Ernst, Group Managing Director, Group Business Consulting & Services, talks about the future platform strategy with his Housing Industry team at Aareal Bank, his excitement is palpable. “With our envisaged Portal 2.0, we are creating a comfortable and technologically leading infrastructure for our clients, an infrastructure with numerous advantages: it provides them with a bank-independent overview of all balances and transactions, a simple payment release (adaptable according to individual authorisation concepts), and access from any device – wherever the users are, and whenever they wish. Our new portal doesn’t only grant our clients more flexibility, but also allows significantly less time-consuming transactions.”

Currently, a team of developers from different disciplines is working hard on finishing this project. ”It is our goal to create a base platform for every digital product, thus giving our clients an optimal overview and enabling a simplified administration of their tasks. We intend it to not only incorporate multi-bank capabilities, but also a single sign-on (i.e. signing on once, having access to all services), self-service functions for all basic banking processes, and the use of individually bookable, innovative add-on services – e.g. the Aareal Sign App – obviously with highest security standards and state-of-the-art signature media”, Ernst says. “Thus, the platform creates a considerably higher level of flexibility.”

Project manager Oliver Schimmel, Business Architect at Aareal First Financial Solutions AG, explains: ”We use the SCRUM procedure for the development of this portal solution. In other words, we proceed empirically, incrementally and iteratively, creating preliminary results and improving them as we go. This agile software development framework enables us to work much faster than with traditional methods. In addition, coordination is far easier because we discuss new project statuses and mock-ups on a near-daily basis. This approach also makes sense considering the functionality of the portal we are developing, as the preliminary results lead to its constant review and improvement.

Start-up strategy

"Cooperating with start-ups is of great strategic importance, as it allows us to offer clients optimal solutions", says Lars Ernst, Group Managing Director Group Business Consulting & Services. "That's why we specifically look for collaborations with start-ups, working together closely throughout the Group. Start-ups often view things from a different perspective, have unconventional ideas, and their problem-solving strategies also differ from ours, making such a cooperation extremely rewarding."

Naming an example is easy for Dr Manfred Alflen, Chairman of the Management Board at Aareon AG: "The cooperation between Aareon and KIWI. KI is a perfect case. We entered into a sales cooperation agreement with this Berlin-based start-up in November 2016, and both parties are already benefiting strongly. KIWI. KI has developed an intelligent, keyless entry access system, which simplifies our customers' property maintenance, as the digital access system allows owners to pass on key privileges to – for example – tradesmen, without anyone having to be at home. Thus, we interconnect housing companies, tradesmen and tenants or owners in an even simpler and more efficient way than before."

"As we want to establish further cooperations like this one in order to find forward-looking ideas for our clients, we monitor the start-up market closely and systematically", Ernst remarks. "Our start-up strategy doesn't only include market monitoring and analysis, but also partnerships, participations, product integration, and taking part in start-up events. The newest project is our involvement in the first German PropTech accelerator, which we support alongside other established companies from the property industry. This six-month accelerator programme promotes innovative digital business models within the property industry. We are already looking forward to the results, which will be presented this summer."

"Aareal Bank Group sees itself as a kind of 'gravitational field' for start-ups. Our aim is an in-depth exchange with the start-up community, as this enables us to benefit from each other's capabilities and experience, thus promoting the innovation power of our industry", Holger Spielberg, Group Managing Director Group Technology, adds.

Dr Ing. Christian Bogatu, co-founder and Managing Director Business Development at KIWI. KI, comments: "As a young and innovative company, we are delighted to have entered into a partnership with Aareon, the established, market-leading consultancy and systems provider. Aareon is a particularly interesting partner since our KIWI solution is an ideal fit for Aareon Smart World. This means that our partnership, which has been designed for the long term, offers additional potential."

from left: Holger Spielberg, Group Managing Director Group Technology; **Dr Manfred Alflen,** Chairman of the Management Board of Aareon AG; **Lars Ernst,** Group Managing Director Group Business Consulting & Services

blackprint BOOSTER

KIWI® Opening Doors

'KIWI – The keyless access system'
gb2016.aareal-bank.com/en/kiwi

Digital enablers

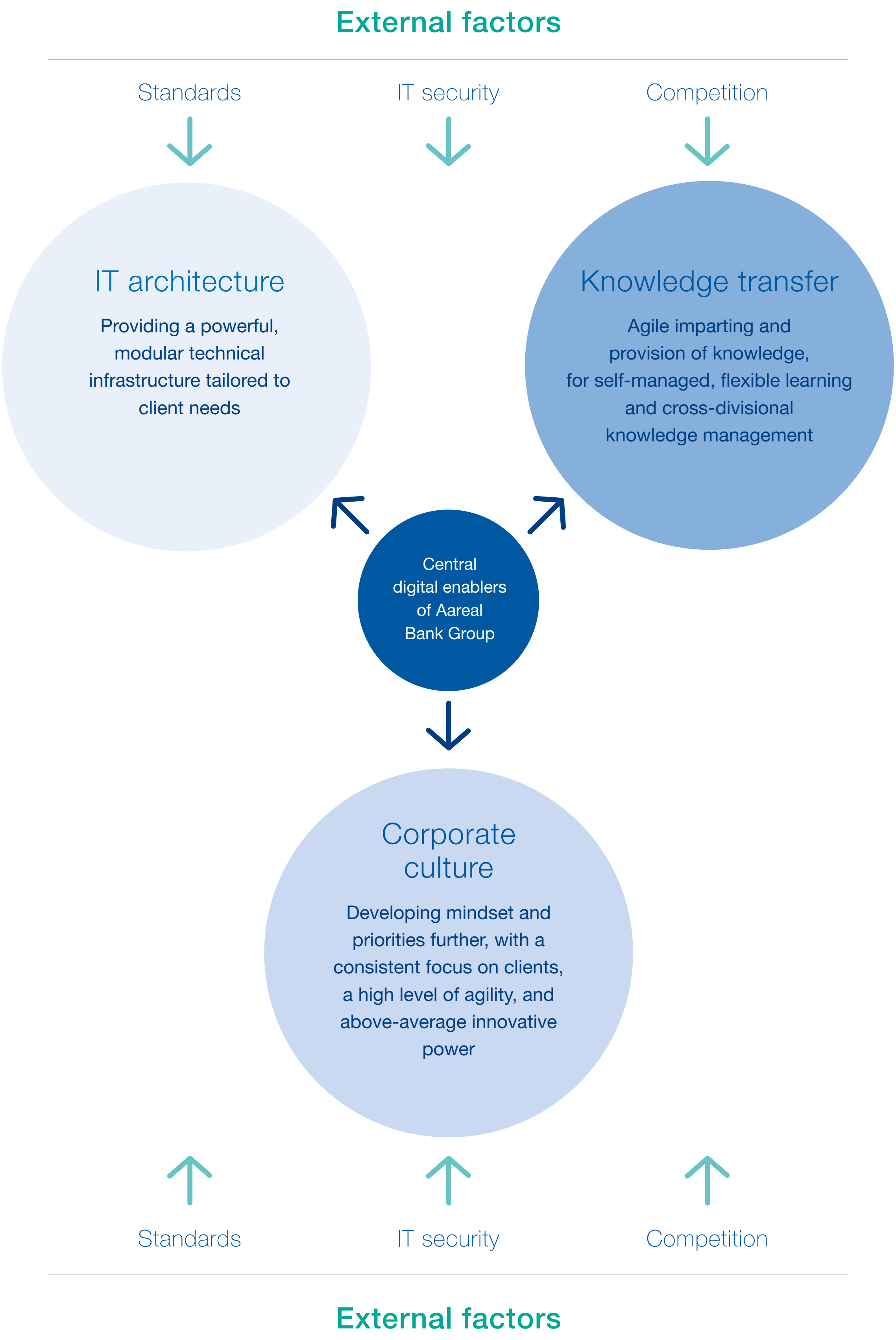
A framework for future success

With our Structured Property Financing and Consulting/Services business segments, we are one of the leading international property specialists, and recognised the opportunities presented by digitalisation at an early stage. Our unique combination of financial institution and IT company has made us a pioneer of digital development in our industry, a role we want to further enhance. With our innovative and forward-looking solutions, we want to set market standards and be a forward-looking, competent partner for our customers in the digital age. Thus we strive to improve and strengthen those structures, processes and values within our Group which give us optimal support in our aim to identify and realise digital opportunities. IT architecture, transfer of knowledge and corporate culture are especially important pillars of this goal.

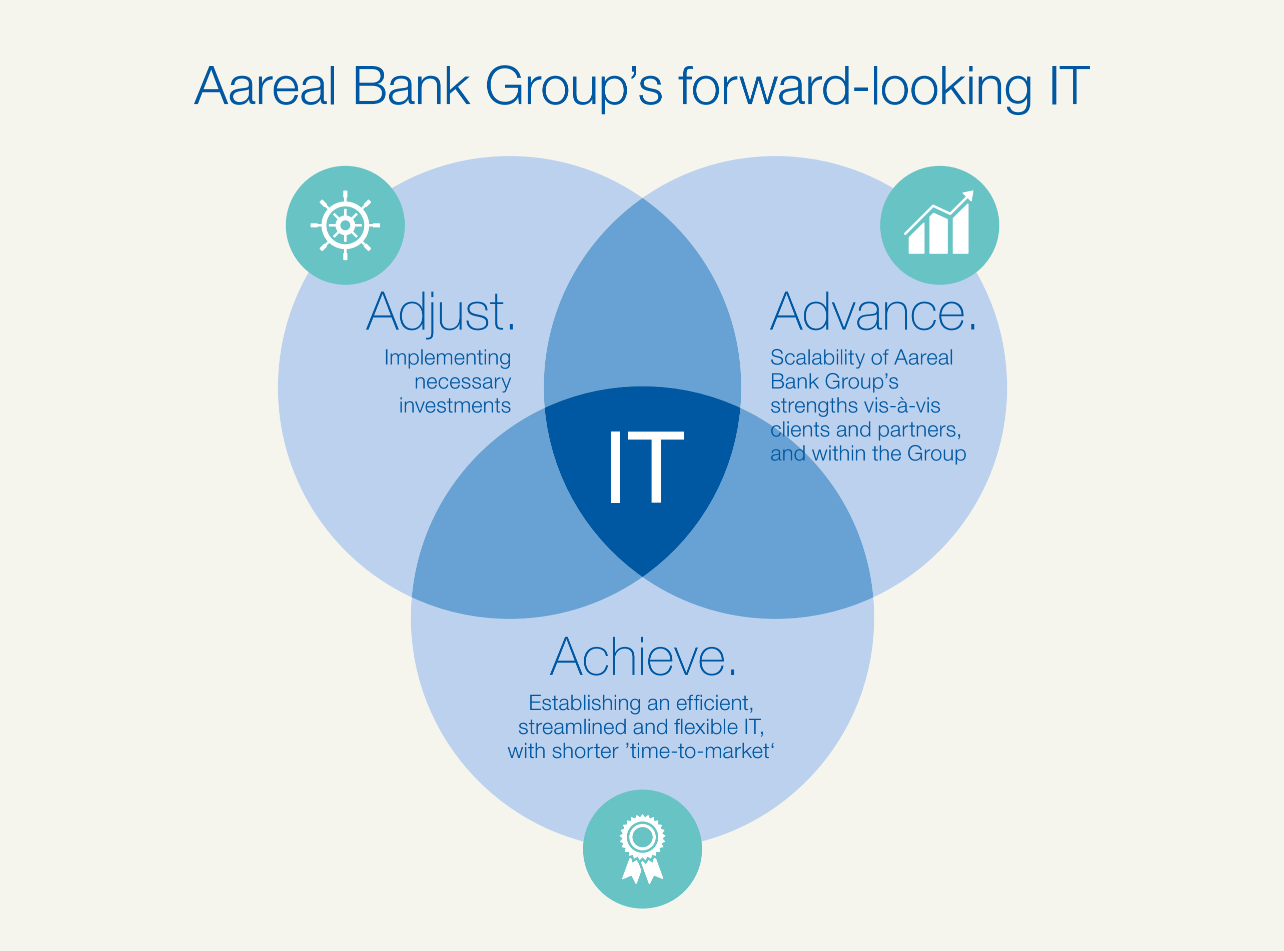
"Our corporate structure benefits customers in two ways: firstly, they know they can expect digital solutions which adhere to strict banking regulations as well as data protection and compliance requirements. Secondly, our customers can count on us offering them the necessary know-how, and complying with high demands regarding intelligent safety concepts."

Christiane Kunisch-Wolff
Member of the Management Board of Aareal Bank

Central digital enablers



above, from left: **Holger Spielberg,** Group Managing Director Group Technology; **Norbert Janzen**, Director IT & Organisation Services, Information Engineering; **Frank Höfling,** Managing Director IT & Organisation Services, Data Office



IT architecture an interview with Holger Spielberg, Group Managing Director Group Technology

Mr Spielberg, how important is a company's IT infrastructure in today's digital age?
IT is definitely very important if a company not only wants to embrace the challenges presented by digitalisation, but also wishes to use them for establishing its own pioneer role. IT has to support agile work, and drive innovation processes, it has to be customer-focused and allow a high degree of variability in its interfaces, while, at the same time, being extremely flexible itself. Thus, a modern IT infrastructure is characterised by modules with low interdependence. It goes without saying that such an IT infrastructure also has to be developed according to the newest technical requirements.

How will Aareal Bank position its IT for the upcoming years?
Our goal is to further increase the agility of Aareal Bank Group. Therefore, we continuously align our IT architecture with that objective. We establish new cross-divisional cooperation models, support autonomous results orientation, enable the anticipation of our clients' needs and behaviour and, with the help of our structures, encourage our employees to collaborate with each other. The IT structure design is developed to fit these strategic goals.

Where do you currently see room for improvement?
A modern IT architecture is never complete, but rather in a state of constant change. Within the scope of Aareal 2020, we thus decided on a strategic realignment and further development of our IT. Three dimensions are especially important. Firstly, we want to dissolve existing technical complexities, e.g. the dependency of system components. Secondly, we want the IT architecture to support our Group's business strategy even better, e.g. with higher data quality, improved data exchange, and higher modularity. And thirdly, we want to increase the speed of adjustment in IT itself – in order to be able to respond even faster to any changes.

Daniel Höfelmann,
Director Group Technology, Innovation Management

Agility at its best: the Bankathon

The Aareal Bank Group team

Pizza cartons, energy drinks and lots of bankers in hoodies: 85 participants in 24 teams competed in the Bankathon programming contest (9-11 October 2016), including three teams from Aareal Bank Group. "I never would have thought that so many innovative ideas and prototypes can be developed in only 30 hours", Daniel Höfelmann, team Innovation Management, says. "That was agility at its best: no extensive planning, just doing. The ideas just came gushing out, non-stop."

This year's Bankathon topic was Payment Services Directive 2. In groups of four, the participants' goal was to develop prototypes of a digital product within 30 hours of continuous work and then to present their product in a live demo. Aareal Bank Group's employees developed three prototypes: an integrated administration, control and projection solution for rental contracts and cash flows of commercial properties with numerous rental units ("Block Mall", based on blockchain technology and "Mall 4.0") as well as an application for the cash management optimisation of different accounts ("OneTouchCash-Management").

"What fascinated me most about the Bankathon – in addition to the actual 'speed prototyping' – was trying out new application programming interfaces (API) and technologies as well as discussing them with other coders", Höfelmann adds. "A programming contest like this makes people bond; we have already discussed continuing our collaboration with other participating teams from fintechs and start-up companies. But the best thing is that these prototypes we developed have potential. They can be refined, and can generate additional value for Aareal Bank Group. That motivates us to come back next year."

Knowledge transfer

An interview with Katja Hennig, Senior Manager Housing Industry, Sales and Sven Robin, Senior Manager Human Resources, Consulting/Development

Ms Henning, which specific challenges do you see for the knowledge transfer within your area of responsibility in the digital world?

In the case of Aareal Bank's Housing Industry division, the speed with which change occurs nowadays has made the transfer and provision of knowledge clearly more challenging than in the past. The time span we have for providing new contents and updating already existing information is getting more limited each day. From a technical perspective, it isn't really a problem, it's more of a complexity issue, as the actual provision of knowledge is less of a challenge than finding the correct information.

How do you deal with these challenges in your division?

In 2016, we developed a digital knowledge pool for the Housing Industry division and published it on our intranet. In 2017, we will systematically expand knowledge management and establish a platform for a Group-wide exchange. In addition, Aareon also offers its clients numerous webinars, which enable the digital knowledge transfer for the use of its products.

Mr Robin, from the perspective of Human Resources, what are the most important elements of modern knowledge transfer?

First of all, it is essential that employees and executives understand the rapidly growing importance of knowledge management and act accordingly. Those who don't use knowledge management systems on a regular basis, who don't constantly educate themselves further, and who don't provide their own knowledge to the benefit of others, will quickly be left by the wayside. Search and structuring features, links and shortcuts are of utmost importance. Modern knowledge management systems have to be very agile and should evolve constantly. Above all, however, they have to be intuitive and strictly user-focused in their structure and functionality.

What will Aareal Bank Group's knowledge management look like in future?

We want our knowledge management to be structured in form of a knowledge dialogue and less in form of pure knowledge retrieval. Our knowledge management is to act as a basis for autonomous and flexible learning, thus serving the purpose of an improved client focus, agility, and innovative capacity within Aareal Bank Group.

Interview with
Katja Hennig and
Sven Robin
gb2016.aareal-bank.com/en/knowledge-transfer
available in German only

Agile working methods

In order to develop client-focused digital solutions with a high degree of flexibility and speed, Aareal Bank Group deploys new, 'agile' working methods, including the ones shown on the right:

from left: **Jens Huchting,** Group Managing Director Group Human Resources, **Brigitte Butz,** Managing Director Human Resources, **Claudia Schmidt,** Human Resources Service Center

Corporate culture

An interview with Jens Huchting, Group Managing Director, Group Human Resources

Mr Huchting, why is everyone talking about the development of corporate culture?

In this digital age, certain behavioural standards are crucial and imperative for success if a company wants to gain a competitive edge. For us at Aareal Bank Group, a consistent focus on our clients, a high level of agility and an above-average innovative capability are central factors which support us in strengthening our market position and enhancing our role as a digital pioneer. Such behavioural standards and priorities cannot simply be mandated, and they don't just change overnight either. They have to be incorporated into the corporate culture – and from there, impact on the actual behaviour of all employees and executives.

So, when talking about client focus, agility and innovative capabilities, what exactly does that mean?

Focusing on our clients means making them the centre of our attention, it means knowing and understanding our clients and establishing trusting partnerships with them. Being able to react swiftly and implement changes in a dynamic environment with complex requirements – that is our understanding of agility. It is reflected, for example, in the way we proceed: we think and act with an entrepreneurial spirit, we engage in cross-divisional and cross-company collaboration, and work fast and efficiently. And, last but not least, being innovative means continuously searching for new impulses to enhance our work and our clients' success, having the courage to question the status quo, and giving each and every one of our employees the flexibility and personal freedom they need to learn and develop new ideas.

How do you implement these goals in Aareal Bank Group's corporate culture?

First of all, we check to see in which areas we ourselves don't comply with these behavioural standards yet, and what is keeping us from doing so. At the same time, we provide impulses for a cultural change – with flagship projects and the creation of an appropriate framework, e.g. with Creative Boxes, new workflows and working methods and with the help of Agile Coach Pools (short explanation of terms via drop down text boxes and mouse hovers). Within this context, the executives play an important role, as they have to live up to the expectations of their role model function. In order to be able to measure our progress, we have launched a change monitoring process, which surveys the general mood at regular intervals.

SCRUM

Project management method characterised by a high degree of flexibility and only a few simple rules: the cross-functional project team organises itself, working using empirical evidence, incremental results and iterative approaches.

Design Thinking

Approach to develop new solutions in a creative environment. A cross-functional team views client needs from different perspectives, employgin various methods akin to those used by designers.

Lean Startup

Method to develop products and business models: prototypes are used within the scope of empirical studies to evaluate the success of innovations. In this context, prototypes are being gradually developed into a final product that is market-ready.

”A culture for the digital age“

Please excuse us, we would like to ask you a brief question: what is the status quo of the digital transformation? Let us perform a simple test: let us close our eyes for ten seconds and let our imagination go wild. Most people will probably see robots, computers, user interfaces, tablets, smartphones, antennae, and cable clutter. You know, all that stuff to do with technology.

You might even have enough time for a little future scare: will artificial intelligence come to replace us, we humans being the naturally intelligent? These and other images wouldn't be surprising. They have always been a part of change.

A person, however, who thinks about everything that is about to come and how it will fit together with the current state of affairs in a rational and calm manner, will probably pull the plug on such fears pretty quickly. Pessimism gives bad advice. And, in fact, we aren't really talking about ”stuff to do with technology and the internet”. We are talking about us, about human beings and our relationships, about what we can do for each other. In other words, we are talking about our culture.

Of course digital transformation is a part of technical evolution. It is, however, not a revolution – it doesn't break with the entire status quo. The history of civilisation has always been about automation, about the simplification of routine processes. Imagine the first tools and methods: their obvious objective was to improve things in life. Often that also means making life easier. Improvement serves the purpose of disburdening humans from monotonous, hard, annoying, repetitive work – or even liberating them from it.

250 years ago, with the dawn of industrialisation came machines which were used in factories and on farms, leading to plenty of prosperity and free time, releasing energy and potential for the creation of even better, more precise and more individual solutions. In today's digital transformation, it is exactly the same.

People who don't understand it think automation only serves automation, meaning that robots take over the work humans have been doing. This, however, would make no sense, as it would only lead to the automation of processes that already exist. But that is not what it is about. No, it is about progress, about improvement.

Hard work and discipline were an important part of the early industrial society. Competence, punctuality and accuracy were necessary character traits. In today's knowledge society, created by digital transformation, creativity and empathy are sought after. Businesses need to know what the customer wants. Thus, individuality and empathy are not only the foundation of today's digitally-driven ”industry 4.0”, but of every service and all knowledge-based work. But does that mean that all former virtues are redundant, that a new culture just wipes out the old one?

No, it doesn't. To use the words of German philosopher Odo von Marquard: ”The future needs a heritage.” Transferring this to the concept of digital transformation means that one should not think in an either-or way – either as a start-up, or as an efficient organisation with harmonised processes – but synthetically combine both aspects. We need to simultaneously get a grip on the spirit of a new beginning and individuality, and on the spirit of manageable routine.

Until now, the concept of culture has always referred to something uniform and explicit. With the arrival of this new culture, that is no longer valid. In fact, it doesn't ask us for an ”either-or”, it requires an ”as-well-as”. Transformation means open innovation. The success of a business is based on diversity and distinction, or, in other words: successful digital transformation opens up the doors and floors of a company. Digital transformation wants to know the client, the human being, and their needs. Diversity as such does not, however, mean ”anything is possible”. Not at all. Openness to a large number of issues also requires contours and clear boundaries. In this new digital world, reliability and recognition will become even more valuable than in the old culture.

Therefore, all the knowledge that has accumulated in the past decades isn't a burden – certainly not. In fact, it acts as the foundation for this new era. A culture of diversity for this digital age is a culture which encourages the seeking out of new opportunities. This virtue is the basis of all entrepreneurship: wanting to know what is possible, and wanting to know how to solve problems. Thus, the core of the culture of digital transformation is identical to that of former entrepreneurship, of the ”analogue world”: being curious about and interested in people. It is about transparency and contours, carrying us through whatever change may bring.

Wolf Lotter,
Business journalist and book author

Foto: Wolfgang Schmidt

To our Shareholders

Thinking ahead. Shaping the future.

from left:

Thomas Ortmanns
Member of the Management Board

Christiane Kunisch-Wolff
Member of the Management Board

Hermann J. Merkens
Chairman of the Management Board

Dagmar Knopek
Member of the Management Board

Christof Winkelmann
Member of the Management Board

Letter from the Management Board

Dear shareholders,
business associates and staff members,

2016 was yet another very eventful year indeed – not just for the banking sector overall, but also for Aareal Bank. Persistent volatility once again shaped the year under review, both on the capital markets and in the political environment. As in previous years, we worked against the background of an interest rate environment at historical lows, as well as regulatory uncertainty. Yet Aareal Bank Group not only pursued the goal of maintaining the successful business performance of previous years in both business segments in this demanding environment, which was also characterised by further intensified competition. We also faced the challenge of finding the right answers to the process of change that our sector is undergoing as a consequence of progressive digitalisation. Today, we can say that we were successful on both counts.

From an operating perspective, the 2016 financial year was another strong year for Aareal Bank Group. Once again, we delivered on our promises. With consolidated operating profit of € 366 million, we achieved another set of very good results, matching our forecast – which we had raised during the course of the year. When adjusting the results of the two previous years for non-recurring negative goodwill from the acquisitions of Corealcredit Bank and Westdeutsche ImmobilienBank, Aareal Bank Group even achieved its best operating profit to date in the 2016 financial year. Consolidated net income of € 234 million was also higher than the previous year's adjusted figure, reaching a new high on this basis.

We would like you, our valued shareholders, to participate appropriately, through a further marked dividend increase. In line with our dividend policy communicated a year ago, the Supervisory Board and the Management Board will therefore propose to the Annual General Meeting on 31 May 2017 a significant 21 per cent increase in the dividend, from € 1.65 to € 2.00 per share. The proposed distribution is equivalent to a distribution ratio of 60 per cent, and thus fully in line with the dividend policy, communicated in February 2016, according to which we strive to supplement the (unchanged) ordinary dividend payment of approximately 50 per cent of earnings per ordinary share (EPS) by an additional dividend of 10 per cent for the year 2016, rising to between 20 to 30 per cent for the years 2017 and 2018. In accordance with this intention, we continue to envisage a distribution ratio of 70 to 80 per cent for the current year.

During 2016, we remained true to our business policy – with a sense of perspective – whereby consistently exploiting opportunities as they arise. This is evident in the volume of new business originated in the Structured Property Financing segment: at € 9.2 billion, it almost matched the high level of the previous year – moreover, it exceeded our original projections of between € 7 billion and € 8 billion. Especially remarkable was the fact that we succeeded in keeping gross margins on new business stable, compared with the previous year – whilst maintaining our conservative risk policy in an environment of persistently intense competition – by allocating new business to attractive markets such as the US, in line with our strategy.

Net interest income declined nonetheless, as expected: this was largely attributable to the planned reduction of non-strategic portfolios. Lower one-off income from early loan repayments also had an impact on the net figure. Net interest income continues to be burdened by a lack of attractive investment opportunities, due to the persistent low interest rate environment.

In the Consulting / Services segment, our IT subsidiary Aareon markedly increased results, as projected: during the financial year under review, Aareon boosted sales revenue by a remarkable € 24 million, to € 211 million. As a result, its contribution to consolidated operating profit was up strongly, by around a quarter, to € 34 million. This was due in particular to Aareon's outstanding market positions in its core business with the domestic housing industry, which it further stabilised during the year under review – but also thanks to successful internationalisation and the targeted development of its digital offerings. We further strengthened the market position of the Bank's Housing Industry division in the 2016 financial year, and significantly increased the revenue from payment transaction services through acquiring new customers – as well as intensifying business relationships with our existing customers. Moreover, we also invested in product development, simplifying and automating processes, with a focus on enhancing cooperation between our target industries of housing and energy.

Despite these successes, segment results remained clearly negative, on account of the historically low interest rate environment, which burdens margins in our deposit-taking business. Nevertheless, deposits from the housing industry will remain a strategically important additional low-cost source of funding for our property financing business, and one that is largely independent of developments on the capital markets. Despite the burden on segment results, the fact that we were able to raise the volume of housing industry deposits to an average of € 9.6 billion in the 2016 financial year – already very closely approaching our medium-term target of € 10 billion – is good news for us.

Our other funding activities during 2016 also continued to be successful. Aareal Bank's liquidity position remains very solid indeed – and the same applies to our capitalisation. Our Tier I ratio was a very comfortable 19.9 per cent as at 31 December 2016. Even assuming full implementation of Basel III, the Bank's Common Equity Tier I (CET I) ratio would be 15.7 per cent. Thanks to this capital base and our pronounced operating profitability, we are not only well-prepared for any regulatory contingencies. We are also in a position to emphatically invest into our future, from a position of strength.

"Aareal 2020 – Adjust.Advance.Achieve.", the programme for the future which we presented at the beginning of 2016, defines the thrust for these investments. Aareal 2020 is designed to safeguard the Group's strong foundation, given the business environment which will remain very challenging in the future, whilst unlocking new income potential by further developing the business model. In this context, and across all Group entities, we want to consistently exploit opportunities arising from investments in new markets and products, and from digitalisation. Of course, Aareal Bank will continue to concentrate on optimising processes and structures.

During the financial year under review, we concluded many preparations for a rapid implementation of the programme on schedule. Key initial milestones were already achieved: for instance, the Bank launched a comprehensive realignment of its IT infrastructure, significantly grew its business in the US, pursued the expansion of digital platform offers in the Consulting / Services segment, and initiated cooperations with start-ups in order to swiftly implement its digital agenda. Moreover, we expedited our syndication activities, designed to facilitate more flexible portfolio management, and grew our business along the entire value chain in commercial property financing, in a targeted manner and in line with our strategy.

Our objective now is to consistently pursue our chosen path during the current year. Specifically, we will expedite investment for the future – for example, by investing in further strengthening our USPs and enhancing digital solutions. Likewise, the Bank will focus on the further optimisation of its processes and structures, having concentrated its internal measures on the integration of two major acquisitions during previous years. The objective here is to make Aareal Bank even more efficient and flexible. At the same time, we want to continue reducing non-strategic credit portfolios, in line with our strategy.

As the past year has impressively demonstrated, our strategy is working – we are on the right track. In 2017, the Company's transformation will clearly pick up speed, along the lines of our strategic priorities defined through Aareal 2020. There is no doubt that we have the financial resources at our disposal to embark upon the appropriate and necessary measures now – more so, since we anticipate a continuation of our positive operational performance during the current financial year, with another good consolidated operating profit figure of between € 260 million to € 300 million. We are convinced that our strategy will increasingly pay off in the following years. Hence, we affirm our medium-term target return on equity of at least 12 per cent before taxes.

Our claim in this context is clear: we will be the leading provider of smart financing, software products and digital solutions for the property sector and related industries. Once Aareal 2020 has been fully implemented we will be more flexible and more efficient than ever, and the Bank will be sustainably profitable and successful, even in a fundamentally changed market and competitive environment. Aareal Bank Group's clients and employees will benefit from this – but so will you, our esteemed shareholders. We look forward to your continued support for our work, and thank you for the trust you have placed in Aareal Bank Group.

Yours sincerely,

Hermann J. Merkens
Chairman of the Management Board

The Aareal Bank Share

Investor Relations activities

As a listed public limited company included in the MDAX® index, Aareal Bank is subject to numerous disclosure obligations. Aareal Bank sees these as an opportunity, not an obligation – an opportunity to enter into open dialogue with analysts, investors and clients, as well as with the media.

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

To this end, two conferences are held, among other things, in Frankfurt each year for analysts and the media, at which the Management Board presents the results of the financial year under review in great detail, and also provides a strategic outlook for the future, comprising the current financial year as well as the medium-term horizon ("Aareal 2020"). Aareal Bank also uses the quarterly results conference calls as an opportunity to inform analysts, investors and the media about current Group developments.

Overall, market communications thus remained at a high level throughout 2016. In the course of the financial year under review, the Investor Relations team took part in ten international capital markets conferences and conducted more than 200 one-on-one meetings with more than 300 investors and analysts during 12 roadshows in Europe and the US. Investors greatly appreciate the fact that Management Board members also regularly attend conferences and roadshows in order to be available for personal meetings.

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

In the 2017 financial year, we will maintain our proactive communication with capital markets in order to strengthen shareholders' confidence in the sustainable success of Aareal Bank Group's business model.

Key data and indicators of the Aareal Bank share

	2016	2015
Share price (€)[1]		
Year-end price	35.765	29.140
High	36.955	40.905
Low	21.660	28.380
Book value per share (€)	43.22	41.80
Dividends per share (€)[3]	2.00	1.65
Earnings per ordinary share (€)	3.33	5.66
Price/earnings ratio[2]	10.94	5.15
Dividend yield (%)[2]	5.6	5.7
Market capitalisation (€ mn)[2]	2,141	1,744

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

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

Shareholder structure

since 3 February 2015

Analysts' opinions

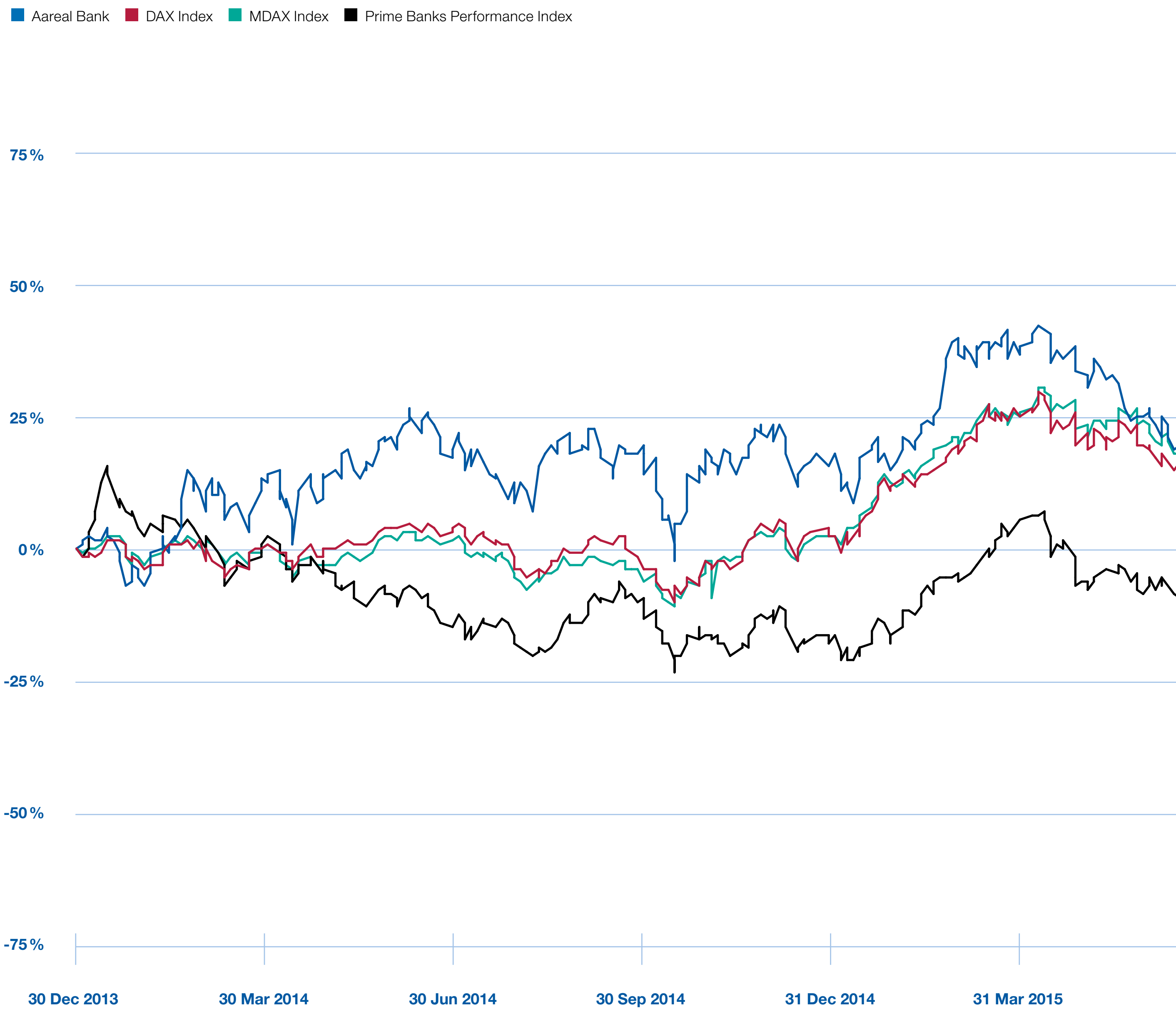
Of the 13 brokerages and analyst firms that regularly covered Aareal Bank at the start of the financial year, one stopped coverage during the course of the year whilst another started coverage, so that at the end of 2016 the number of brokerages and analyst firms publishing independent studies and comments about developments at Aareal Bank Group was unchanged at 13.

Having finished the 2015 financial year on a positive note, Aareal Bank also needed to meet expectations by market participants and analysts in 2016. Aareal Bank fulfilled these high expectations, with currently seven "buy" recommendations and four "neutral" recommendations, contrasting with two "sell" recommendations.

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

Relative performance of the Aareal Bank share price

2014 - 2016



(1) 25 February 2016
Aareal Bank Group posts another set of record results for the financial year 2015 – proposes dividend increase from € 1.20 to € 1.65 per share

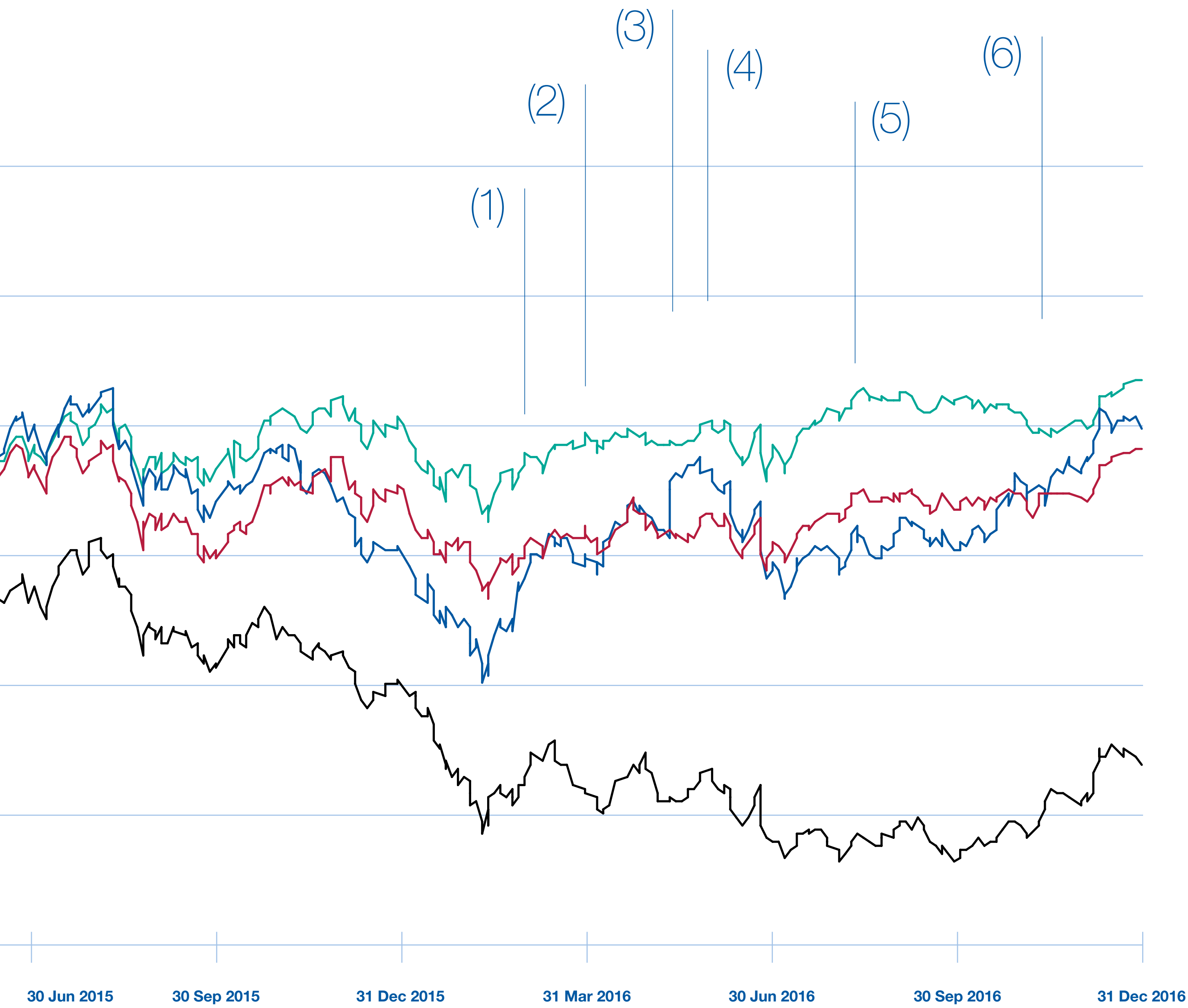
(2) 30 March 2016
Aareal Bank Group publishes its Annual Report 2015

(3) 10 May 2016
Aareal Bank Group posts a successful start to the 2016 financial year

(4) 25 May 2016
Annual General Meeting of Aareal Bank resolves to pay a dividend of € 1.65 per share for the 2015 financial year

(5) 11 August 2016
Aareal Bank Group remains on course during the second quarter of 2016 too

(6) 10 November 2016
Aareal Bank raises forecast for full-year consolidated operating profit, based on a good performance during the third quarter of 2016



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

Group Management Report

Group Management Report

Aareal Bank Group is a leading international property specialist. It is active in more than 20 countries across three continents – in Europe, North America and Asia.

Fundamental Information about the Group

The Group's business model

Aareal Bank AG, headquartered in Wiesbaden, Germany, is the parent company of the Group. Its shares are admitted to trading on the regulated market (Geregelter Markt) of the Frankfurt Stock Exchange, and are included in the mid-cap MDAX® index. Aareal Bank Group provides financing solutions and services to clients in the national and international property industry.

Aareal Bank is a member of the Association of German Banks (BdB) and the Association of German Pfandbrief Banks (vdp).

Aareal Bank Group's business model comprises two segments:

Structured Property Financing

The Structured Property Financing segment comprises all of the property financing and refinancing activities.

In this segment, Aareal Bank facilitates property projects for its domestic and international clients, and is active in this respect in Europe, North America and Asia. It stands out here especially for the direct and long-standing relationships it has established with its clients. Aareal Bank offers commercial property financing solutions, especially for office buildings, hotels, retail, logistics and residential properties. The Bank's particular strength lies in it successfully combining local market expertise and sector-specific know-how. This allows Aareal Bank to offer tailor-made financing concepts that meet the special requirements of its national and international clients.

Aareal Bank manages its sales activities in the individual regions worldwide via a network of sales centres (hubs), of which five are located in Europe. In addition to the locally-based experts, the distribution centres for sector specialists covering hotels, shopping centres and logistics properties are located in Wiesbaden.

The regional hubs or branch offices in Europe are located at the following offices, and are specifically responsible for the following regions:

- Wiesbaden: Germany and Austria;
- London: United Kingdom, the Netherlands and the Northern European countries;
- Paris: Belgium, France, Luxembourg, Switzerland and Spain;
- Rome: Italy;
- Warsaw: Central and Eastern European countries.

In addition to these five regional hubs in Europe, there are locations in another five countries (in Brussels, Istanbul, Madrid, Moscow, Stockholm) that are each assigned to the corresponding regional distribution centre. The business in Turkey is an exception; it is managed from the Wiesbaden head office, reflecting the importance of shopping centres and hotels for the Bank's activities in the Turkish market. Aareal Bank Group also has a presence in Germany through its WestImmo subsidiary, which has twin registered offices in both Mainz and Münster.

Aareal Bank Group maintains an active presence in North America through its subsidiary Aareal Capital Corporation, which has an office in New York and also manages new business activities in the US.

The Singapore subsidiary Aareal Bank Asia Limited conducts the sales activities in the Asia/Pacific region. The Group also has a representative office in Shanghai.

Aareal Bank has a broad and solid refinancing base. It has established itself as an active issuer of Pfandbriefe, which account for a major share of its long-term funding. The AAA rating of the Pfandbriefe – affirmed by rating agency Moody's in January 2017 – additionally confirms the quality of the cover assets pool. To cater to a broad investor base, Aareal Bank covers a wide range of other refinancing tools, including promissory notes and debt securities. Private placements are the focal point of the Bank's capital market activities. These are complemented by larger, public placements that are issued depending on market conditions. In the Consulting/Services segment the Bank also generates deposits from the housing industry, which represent a strategically important additional source of funding. Furthermore, it has recourse to institutional money market investor deposits. The success of our capital and money market activities, and the business with housing industry clients, are the results of a combination of a sustainable business model with a sound understanding of the capital markets, and the quality of the cover assets pool.

Consulting/Services

The Consulting/Services segment offers the property industry services and products for managing property portfolios and processing payments. Within this segment, our subsidiary Aareon AG and the Bank's Housing Industry division work together closely.

We provide IT systems consultancy and related advisory services to the property industry through our Aareon AG subsidiary, which looks back at almost 60 years of experience. Aareon offers its customers secure, standard-setting solutions in the areas of consultancy, software and services to optimise IT-based business processes in the digital age. Its Enterprise Resource Planning (ERP) systems, which are tailored to meet the requirements of the respective target market may be supplemented by other digital solutions for process optimisation. Together, the large variety of these integrated systems constitute Aareon's digital ecosystem – the "Aareon Smart World", which links property companies with their customers, staff, and business partners, and also connects technical devices in apartments and buildings to one another. Aareon Smart World can be used to restructure and optimise processes. The applications help to reduce costs, enable the creation of new business models by providing links between all participants and offer more ease-of-use in the dialogue between tenants and employees of the housing industry.

Aareon offers software solutions both in Germany and abroad that may be used in various types of operating environments: in-house services, hosting and Software as a Service (SaaS) from the exclusive Aareon Cloud. Data from Aareon's Cloud Computing is held in Aareon's certified data-processing centre in Mainz, which guarantees data security and protection at the highest level. Following successful advice, implementation and training, customers usually opt for a maintenance model covering regular support services.

In its Housing Industry division, Aareal Bank offers its customers process optimisation, electronic banking and asset management and markets its BK 01 software which is the leading procedure in the German housing property industry for the automated settlement of mass payments. The procedure is integrated in licensed bookkeeping systems. Therefore, customers in Germany may process their payment transactions and account management from the administration software employed. In addition to the German property industry, the German energy and waste disposal industries form a second major client group of the Bank's Housing Industry division. This enables the offer of further products, facilitating the cross-sector cooperation of target groups and realising synergies via end-to-end digital processes. The use of the payment transaction products of Aareal Bank generates deposits that contribute significantly to Aareal Bank Group's refinancing base.

Management system

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

The indicators set out below are key financial performance indicators for Aareal Bank Group; they are used for the purposes of managing the business and the Group's profitability.

- **Group / consolidated:**
  - » Net interest income (in accordance with IFRSs)
  - » Allowance for credit losses (in accordance with IFRSs)
  - » Net commission income (in accordance with IFRSs)
  - » Administrative expenses (in accordance with IFRSs)
  - » Operating profit (in accordance with IFRSs)
  - » Return on equity (RoE) before taxes[1)]
  - » Earnings per ordinary share (EpS)[2)]
  - » Common Equity Tier I ratio (CET I ratio)
  - » Liquidity Coverage Ratio (LCR)
- **Structured Property Financing segment**
  - » New business[3)]
  - » Credit portfolio of Aareal Bank Group
- **Consulting / Services segment**
  - » Aareon's contribution to consolidated operating profit (in accordance with IFRSs)

The Group's existing risk management system is used to manage and monitor the various risk exposures of Aareal Bank Group entities, in a centralised manner. All management-relevant information is systematically collected and analysed, to develop suitable strategies for risk management and monitoring. We also employ forecasting models for balance sheet structure, liquidity and portfolio development for strategic business and revenue planning.

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

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

3) New business = newly-originated loans plus renewals

In addition to business-related management tools, we also use various other instruments to optimise our organisation and workflows. These include comprehensive cost management, centralised management of project activities and Human Resources controlling, for example.

Structured Property Financing also deploys supplementary management tools and indicators. For example, we manage our new business in this segment using lending policies which are specific to the relevant property type and country, and which are monitored within the scope of the lending process.

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

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

Report on the Economic Position

Macro-economic environment

The economy was characterised by low interest rates and moderate growth in 2016, but above all the year was defined by several political events that created uncertainty and volatility in the markets.

Economy

At 2.2 %, global economic output expanded in 2016 at a significantly lesser pace than in the previous year (2.7 %). Besides stagnating global trade, the structural transformation in China and political uncertainties worldwide, investment activities in particular were moderate in many economies over the entire course of the year. The industrial nations reported moderate but stable growth. The emerging markets, on the other hand, enjoyed slightly higher growth levels but were burdened by structural problems and lower raw material prices. Several political events increased uncertainty about further economic trends in the course of the year. In a referendum held on 23 June 2016, Britons voted in favour of the UK leaving the European Union ("Brexit"). While the outcome of the referendum caused political uncertainty, the real economy appeared to be unaffected for the remainder of the year. Italy rejected legislation to reform the senate in December. The global economy proved stable in face of all these events and continued to maintain positive growth.

Growth in the euro zone was stable in 2016 – without being particularly dynamic. The growth rate eased slightly compared with the previous year. Economic output was disappointing at the start of the year, on the back of weak demand from the emerging markets, but was supported by strong private consumption and by investments. Despite all the uncertainty factors, the economic situation proved robust in the second half of the year.

German economy was more dynamic in early 2016 than in the second half of the year. All in all, the economy remained quite strong, however.

Private consumption and strong construction activity boosted growth from mid-year onwards, while industrial production and exports weakened on the other hand over the course of the year. Consumer sentiment as well as expectations of the manufacturing industry were at a high level at the end of the year.

French economic growth, which got off to a solid start in 2016, was halted by strikes, among other things. Weak exports in particular inhibited stronger growth in the second half-year. The overall economic growth rate in 2016 was comparable to the previous year.

Economic growth in Italy was weak up to the middle of the year. Activity was overshadowed in the second half-year by the referendum held in December on reforming the senate. Economic output rose only slightly for the year 2016 as a whole compared with the previous year and therefore continued to grow at a slow pace. The referendum on reforming the senate caused volatility for a short period only, with Italian government bonds yields reacting relatively indifferent to events. The high share of NPLs held by the big Italian banks impacted on the economy, despite the increase of the bank rescue fund set up by the government.

Growth in Spain was robust in 2016, supported by private consumption, investments, and strong exports. The growth rate was in line with the previous year's level, and well above the euro zone average – with the political uncertainty in the country having no real effect on the economy.

Economic growth in various non-euro countries within the EU was slightly higher than in the euro zone, but lower year-on-year. Growth in the Czech Republic fell by almost half compared with the previous year and Poland painted a similar picture. While growth in Sweden was not as strong as in the previous year, the weakening was not as pronounced. Economic growth in Denmark on the other hand was markedly weaker than the year before.

Britons voted in favour of the UK leaving the European Union in a referendum held on 23 June 2016, triggering volatility on the financial and capital markets, as well as economic and political uncertainty. The uncertainty fed through to the property market, which led to the temporary suspension of trading in British property funds. Nonetheless, the vote hardly had any real effect on economic output in the course of 2016 but had a short-term negative impact on the relevant trend barometers instead. Economic expansion was more or less in line with the previous year. Growth in the second half of the year was supported by the services sector, while industrial production and the construction industry significantly declined. Investment eased slightly and private consumption was strong despite the sharp devaluation of the pound sterling.

The failed coup attempt in Turkey by parts of the military in July determined events in the country. The consequences impacted more on the economy so that growth rates were weaker compared with previous years, especially owing to a lack of investment and exports.

The rate of economic decline slowed in Russia, leading to a slightly negative growth rate compared with the very weak previous year, not least because of weak private consumption.

Economic growth in the US was significantly weaker for the year as a whole over the previous year. The slightly weaker growth in the first half-year due to lower investments in the oil industry recovered slightly in the second half of the year. Growth was sustained by private consumption, as was the case in the previous year too. The presidential election in November attracted great attention but had no material consequences for the economy in 2016.

Economic output in China reached the growth rate targeted by the government but fell short of the previous year's level. Government-backed measures and programmes supported borrowing at the start of the year but low global demand had a dampening effect on growth in the second half. Corporate debt grew continuously and significantly in the course of the year. China experienced another boom in residential property and in the construction industry, which – together with the high level of private debt – was a growing cause for concern. The government restricted capital export at the end of the year in response to the high outflow of capital. Weak consumption in Japan resulted in muted economic growth.

The unemployment rate in the euro zone fell slightly during the course of the year but remained at a high level nevertheless. The rate of unemployment fell below 20 % in Spain for the first time in five years; in the EU the rate fell slightly in 2016. The unemployment rate in the US fell to a very low level up to mid-year, before stagnating in autumn. The good increase in the workforce towards the end of the year led to a further reduction in unemployment, thus reaching a level last seen before the financial crisis.

Financial and capital markets, monetary policy and inflation

A persistent low interest rate environment, with temporarily negative interest rates, continued to characterise the financial and capital markets of the developed economies in 2016. Interest rates rose in some regions by the end of the year but there was no sign yet of a general end to the environment of low interest rates. Markets remained receptive at all times. A series of political events and occasional doubts about the solidity of some big European banks (whereby one Italian bank was bailed out by the state) led to pronounced volatility at times.

Following a good first half-year 2016 with euro-denominated covered bond issues in the amount of around €93 billion, the volume eased considerably in the second half of the year: total issuance for 2016 reached € 127.8 billion (2015: € 154 billion). Investors are demonstrating a generally cautious buying behaviour, are selective with regard to their choice of issuer and sensitive to spreads. Covered bond repayments totalled € 148.6 billion during 2016, leading to a decline in outstanding covered bond volumes.

As expected, Germany was once again the strongest country in terms of issuance in the euro benchmark segment (€ 26.9 billion), followed by Scandinavia (€ 22.3 billion), France (€ 20.3 billion), Spain (€ 13.3 billion), and Canada (€ 12.5 billion).

Spread development on the covered bond market was defined by low volatility during the year under review, with spreads widening initially at the start of the year before moving towards a sideways trend.

Annual rate of change in real gross domestic product

in %	2016[1]	2015[2]
Europe		
Euro zone	1.7	1.9
Austria	1.5	0.8
Belgium	1.2	1.5
Finland	1.4	0.2
France	1.1	1.2
Germany	1.8	1.5
Italy	0.9	0.6
Luxembourg	3.5	3.5
Netherlands	2.1	2.0
Portugal	1.2	1.6
Spain	3.3	3.2
Other European countries		
Czech Republic	2.4	4.6
Denmark	1.1	1.6
Poland	2.4	3.9
Russia	-0.5	-3.7
Sweden	3.1	3.8
Switzerland	1.4	0.8
Turkey	2.0	6.1
United Kingdom	2.0	2.2
North America		
Canada	1.3	0.9
USA	1.6	2.6
Asia		
China	6.7	6.9
Japan	1.0	1.2
Singapore	1.8	2.0

[1] Provisional figures; [2] Adjusted to final figures

A high volume of new issues prevented spreads from tightening in the first quarter of the year. Spreads tightened significantly in the second and third quarter of 2016 as the number of new issues declined and the European Central Bank (ECB) continued to buy covered bonds within the scope of its third covered bond purchase programme. Even the British vote to leave the European Union failed to end this trend, and the outcome of the US election had no impact on the covered bond market. Spreads started to widen in mid-November, prompted by portfolio adjustments and profit-taking by covered bond investors.

Pfandbrief yields are often no longer sufficient for insurance companies in particular to reach their earnings targets. This is traditionally one of the most important buyer groups of registered mortgage bonds. In fact, according to the German Insurance Association (GDV), the volume of direct covered bond holdings of the German direct insurers has been decreasing steadily in recent years (2015 vs. 2012: -10 %), despite the increase in investments overall (+13 %).

The long-term trend of falling yields on ten-year government bonds continued essentially in all currency areas up to autumn 2016. The Brexit vote in the UK in June, the speculation about the end of the ECB's bond purchase programme in October and the presidential election in the US in November represented special events that impacted on government bond yields at the long end. Heightened inflation expectations in autumn were another reason for the trend. Yields on ten-year government bonds in the UK fell sharply as a consequence of the Brexit vote, but rose again strongly in the further course of the year. Ten-year German government bond yields continued to fall in the first three quarters and even reached negative territory at times. Yields were no longer negative from October onwards and even rose again marginally up to the end of the year. Yields on ten-year US government bonds rose in autumn – and after the presidential election in November – to slightly above the level seen in 2015.

Long-term interest rates[1] in the most important currencies for Aareal Bank portrayed a similar pattern to that of government bond yields during the year under review. They fell significantly in the euro zone up to the third quarter, after which they rose again and remained slightly below the previous year's figure. They fell up to the third quarter in the US dollar area too, but then rose again more strongly towards the end of the year so that they closed above the previous year's level. The development for the Canadian dollar was comparable. The performance of long-term GBP interest rates was similar to that of the euro zone, with marked declines until the third quarter followed by a moderate increase. The impact of the Brexit referendum here was equally strong as it was on UK government bonds. Long-term interest rates in the Swedish krona and Danish krone fell until the third quarter. They also rose up to the end of the year but were down significantly compared with the end of the previous year. Long-term interest rates in Japan were slightly negative up to mid-year but climbed again slightly into positive territory again by the end of the year.

The changes in the short-term interest rates[2] in the various currencies areas that are relevant for Aareal Bank were less than for their long-term counterparts. They fell consistently year-on-year in the euro zone and stabilised slightly just below zero per cent at the end of the year. They were stable in the UK until the Brexit vote but then fell quite sharply and stabilised towards the end of the year at a marginally lower but still positive level at year-end. Short-term Swedish krona interest rates fell sharply in the first quarter of the year under review. They then fell gradually but slightly throughout the year, and thus remained in negative territory. Short-term Danish krone interest rates fell considerably year-on-year up to mid-year and remained negative until the end of the year. On the other hand, short-term interest rates in the US dollar area rose significantly to around one per cent,

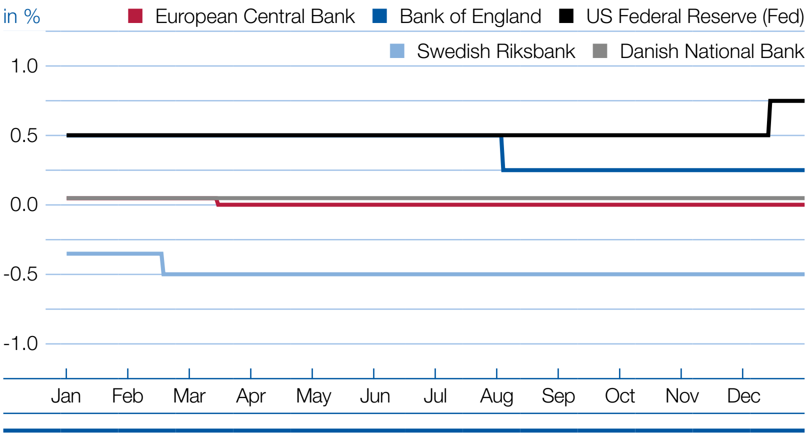
[1] Based on the 10-year swap rate

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

with a more pronounced increase in the second half of the year under review. Short-term interest rates in Canada rose slightly last year over the previous year.

The central banks in the currency areas that are relevant for Aareal Bank continued to pursue their expansionary monetary policy during the year. The big central banks made only a few slight adjustments to key interest rates. The ECB cut its main refinancing rate by five basis points in March to 0.0 % and the deposit rate by 10 basis points, to -0.4 %. The quantitative easing measures were extended, with the objective of bringing inflation to or close to the ECB's self-imposed target value of just under 2 %. The ECB therefore expanded its purchase programme of government and private euro-denominated bonds by € 20 billion to € 80 billion per month in June. It thus implemented the Corporate Sector Purchasing Programme (CSPP) in June, through which it buys investment-grade corporate bonds issued by non-financial enterprises. In December, it announced the extension of the programme up to at least the end of 2017, with a reduced amount of € 60 billion per month as from March 2017. Added to this was the continuation of the long-term refinancing measures (TLTRO II), which are another of the ECB's expansionary tools. The Bank of Japan (BoJ) lowered its deposit rate to -0.1 % at the start of 2016 and extended the equity purchase programme during the year in order to further stimulate the economy. The Swedish National Bank lowered its key interest rate by 15 basis points in March 2016, to -0.5 %, whilst extending its existing purchase programme for Swedish government bonds by SEK 45 billion in April and by another SEK 30 billion in December. The US Federal Reserve (Fed) raised its benchmark interest rate by 25 basis points in December 2016, to a corridor between 0.50 % and 0.75 %, on the basis of good economic and labour market data. The previous decision to move interest rates was made in December 2015, when the Fed had also raised the corridor by 25 basis points. In response to the Brexit vote, the Bank of England (BoE) lowered the key interest rate by 25bp to 0.25 % in August and also expanded its quantitative easing measures.

Key rate developments in 2016 [1)]



[1)] The upper level of the Fed Funds corridor of 0.50 % to 0.75 % is shown.

The currencies that are important for Aareal Bank and the global economy faced increased volatility with regard to the exchange rates to the euro during the year under review, not least owing to a number of political events and measures taken by central banks. The US dollar fell marginally against the euro in the first half of the year but then appreciated continuously from October onwards – almost reaching parity against the euro in December. During the final days of 2016 the US dollar slightly lost ground again. Pound sterling lost a little ground to the euro in the first half of 2016 until just before the Brexit vote. It then depreciated significantly, and was at times even weaker than during the financial crisis, when the Pound sterling was very weak compared to the euro. The pound sterling recovered slightly against the euro at year-end but still remained considerably weaker than at the start of the year. The Swedish krona depreciated considerably against the euro during the year under review, as a consequence of the very expansionary monetary policy pursued in Sweden. An uptrend of the Danish krone was suppressed during the year under review by central bank measures – in accordance with Denmark's membership of the European Exchange Rate Mechanism II (ERM II)[2)],

[2)] Under ERM II, the exchange rate of the domestic currency vis-a-vis the euro must remain within a predefined range in order to meet one of the euro zone accession criteria.

so that the currency remained stable. The Japanese yen appreciated strongly against the euro in the first half of the year – a trend that was reversed during the second half of the year: the yen eased slightly towards the year-end, but was still higher year-on-year.

Inflation picked up noticeably in many economies towards the end of the year, this being one of the results of the slight increase in the oil price during the second half of the year, as well as due to basis effects. At 0.2 %, average euro zone inflation for the full year 2016 was slightly higher than the previous year, but still well below the ECB's target of just under 2 %. The general inflationary pressure from the real economy remained low. Inflation rose noticeably to a two-year high in the UK due to the sharp fall in the value of the pound sterling in the second half of the year but remained under one per cent nonetheless at the end of the year. At just below one per cent, US inflation was above that of the euro zone. The annual rate of inflation in China rose slightly year-on-year but remained below the target of three per cent.

Regulatory environment

The environment in which banks are operating continues to be defined by highly dynamic regulatory requirements, as well as by changes in banking supervision. Especially when considering the extensive work the Basel Committee is undertaking to complete the already-implemented Basel III regime, it is currently not possible to fully assess the impact. In addition, the amendment to the Minimum Requirements for Risk Management (MaRisk), especially with regard to the aggregation of risk data and risk reporting, the EU Commission's proposals to revise supervisory regimes (CRR, CRD IV, BRRD and SRMR) as well as the EBA consultation paper on "Guidelines on PD estimation, LGD estimation and the treatment of defaulted exposures" will all lead to further regulatory changes.

Following the introduction of the Single Supervisory Mechanism (SSM), Aareal Bank Group has been directly supervised by the ECB since 4 November 2014.

The ECB's Supervisory Review and Evaluation Process (SREP) ensures a common approach on the supervisory review of banks, within the framework of Pillar 2. The SREP is built around a business model analysis, an assessment of governance and controls, as well as of the capital and liquidity risks. The results of the individual areas are aggregated in a score value, from which the ECB derives supervisory measures on holding additional capital and / or additional liquidity requirements. The ECB converted the SREP requirements from a pure CET 1 ratio to a total SREP ratio (total SREP capital requirements, TSCR) with effect from 1 January 2017. This will be 9.75 % as of 1 January 2017, and includes the 8 % total capital ratio for Pillar 1 and a (Pillar 2) capital requirement of 1.75 % from the ECB's SREP. In addition, the Bank is required to hold a capital conservation buffer of 1.25 % (phase-in), plus a countercyclical capital buffer of 0.03 % as of 2017. Aareal Bank's pure SREP-driven CET 1 requirement has been at 7.53 % since 1 January 2017, comprising 4.5 % for Pillar 1, the Pillar 2 requirement of 1.75 % (as mentioned above) as well as the capital conservation buffer (1.25 %) and countercyclical buffer (0.03 %). Additional liquidity requirements were not demanded of Aareal Bank.

Sector-specific and business developments

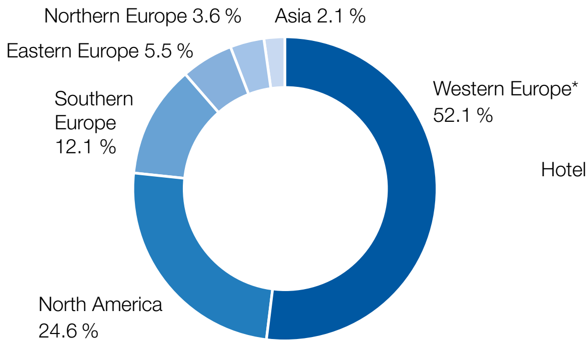
Structured Property Financing segment

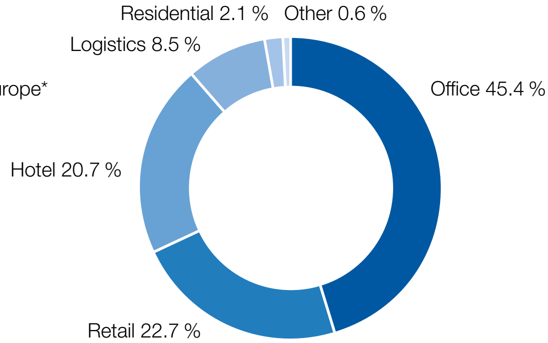
Transaction volumes in commercial property worldwide – measured in US dollar terms – fell significantly compared to the particularly high levels seen in the previous year. Transaction activity fell most in Europe compared with a less pronounced decline in Asia and North America.

However, commercial property was in demand as an asset class in the financial year under review, not least owing to the persistent low interest rate environment. The volatility – and temporary closure – of British property funds in conjunction with the EU referendum barely impacted property markets in Europe.

New business 2016

by region | by type of property





* Incl. Germany

The rental markets reported stable to slightly higher rents – compared with the previous year – in most of the big markets. Rents declined marginally in some markets; this applies to office, retail as well as logistics properties. Hotel markets presented a mixed picture overall. Although the average revenues per available room rose in many markets, this was offset on the other hand by significant losses incurred on markets affected by terrorism.

When assessing the description of fundamental market trends, it should be noted that commercial property markets do not represent homogeneous markets. Individual properties differ – even within a regional market or for a given property type – with regard to the factors that determine their value and rents, such as construction quality, modernity, floor space and energy efficiency, flexibility and property management. The location – within regional or local markets – is of course an important factor as well. Hence, rents, income, vacancies, yields and values of individual properties from the same regional market or property type may develop differently.

Commercial property financing was defined by considerable competitive pressure in the year under review. Even though the margins for structured commercial property loans came under pressure in some markets during the course of the year, they strengthened in most European markets and in the US. Margins in the UK rose slightly as a result of the Brexit vote. The loan-to-value ratios remained moderate. The readiness to provide for large-volume investments was unchanged in an environment of strong competition.

In a highly competitive environment defined by uncertainties, Aareal Bank Group[1] originated new business totalling € 9.2 billion (previous year: € 9.6 billion) during the year under review, markedly exceeding its original target of between € 7 billion and € 8 billion. The higher amount was largely due to early renewals.

The share of newly-originated loans relative to new business amounted to 63.3 % (2015: 52.4 %) or € 5.8 billion (2015: € 5.0 billion). Renewals amounted to € 3.4 billion (2015: € 4.6 billion).

At 73.3 % (2015: 78.0 %), Europe accounted for the highest share of Aareal Bank Group's new business, followed by North America with 24.6 %

[1] Excluding new business for private clients and local authority lending by WestImmo

(2015: 20.6 %) and Asia with 2.1 % (2015: 1.4 %).[1)] The slightly higher share of financings in North America reflects our growth strategy as part of the "Aareal 2020" programme for the future.

With a share of 45.4 %, office properties accounted for the largest share in new business in terms of property type (2015: 43.1 %). This was followed by retail property with 22.7 % (2015: 19.9 %), ahead of hotel property with 20.7 % (2015: 19.0 %) and logistics property with 8.5 % (2015: 9.8 %). The share of residential property was 2.1 % (2015: 6.0 %) while other property and financing amounted to 0.6 % (2015: 2.2 %).

Europe

In Europe, the transaction volume in commercial property was down significantly on the previous year, with volumes clearly falling in Germany, France and the UK while rising – against the general trend – in Spain and Poland. Private investors were net sellers, while institutional investors and listed companies tended to be more on the side of the net buyers.

Rents for first-class office properties increased for new rentals in many of Europe's economic centres during the year. Top rents in some markets, such as Barcelona, Berlin, Birmingham and Stockholm, were considerably higher than in 2015 due to the strong rental demand. Slight increases were observed in Edinburgh and the centre of Paris, for example. Top rents fell compared with 2015 in a few markets such as London and Moscow, but were largely stable in many other markets such as Amsterdam or Rome. The picture varied more in the sub-markets or in smaller locations. While rents increased for example in sub-markets of Madrid and Barcelona, they fell slightly in many sub-markets in the Netherlands. Rents in Paris were stable in most of the sub-markets. Average rents in Germany rose in three out of the six largest markets.

Rents in the market for retail property was largely stable. However, some markets, for example London and Warsaw, benefited from rising top rents on the back of robust consumer spending. Declines were observed in Istanbul, for example.

Demand for logistics space was strong at the start of 2016, but the momentum eased somewhat during the year. All in all, the take-up of space was in line with the very high level of the previous year. Top rents rose only sporadically, for example in Berlin and Edinburgh. However, they remained stable in many markets – while markets such as Hamburg and Warsaw also saw a slight decline.

Investment yields for almost all types of newly-acquired premium properties fell slightly in Europe compared with 2015. Relatively strong declines were observed for retail properties in Eastern Europe and throughout Europe in the best locations of the large logistics markets. The spread between prime and peripheral locations did not widen any further during the year. Yields for secondary office property in Germany fell consistently throughout the year. Investment yields remained stable in Italy's secondary locations, but rose slightly in contrast in the UK after initial declines in response to the uncertainty triggered by the Brexit vote. They rose slightly more for secondary than for top-quality properties. Investment yields in the UK remained stable over the remainder of the year.

The situation varied on the European hotel markets. Occupancy ratios declined moderately year-on-year in some markets, such as Milan or Munich. The decline in Milan was due to the particularly high figure for the previous year, which can be explained by the fact that the Expo was held here in 2015. The occupancy ratio in London remained at a very high level; it declined significantly year-on-year in Paris and Brussels, a result of the terrorist attacks. On the other hand, occupancy ratios rose in Barcelona and Madrid. The first half of the year was better on the whole than the second.

The important indicator of average revenues per available room (RevPar) recorded a slight increase in 2016 compared with the previous year in most European markets. Average revenues increased for

[1)] New business is allocated to the individual regions on the basis of the location of the property used as collateral. For exposures not collateralised by property, the allocation is based on the borrower's country of domicile.

example in Amsterdam, Barcelona, Berlin, Copenhagen, Hamburg and Madrid, and higher room rates could thus be achieved overall. As expected, average revenues fell significantly in Brussels, Istanbul and Paris as a consequence of the terrorist attacks. Marginal declines were observed in London and Munich, albeit remaining at a high level in both cases.

Aareal Bank Group originated new business of € 6.7 billion (2015: € 8.1 billion) in Europe during the year under review. At € 4.8 billion (2015: € 4.3 billion), Western Europe accounted for the largest share of new business in 2016, as it had in previous years. The remaining new business was originated in Southern Europe (€ 1.1 billion; 2015: € 1.7 billion), followed by Eastern Europe with € 0.5 billion (2015: € 1.0 billion) and Northern Europe with € 0.3 billion (2015: € 0.5 billion).

North America

The volume transacted in the North American property markets was down slightly from the previous year's high level. Contrary to the continuous decline in Europe, the transaction volume in the third quarter rose sharply at times but then lost momentum in the fourth quarter. Listed companies were predominantly on the seller side, while institutional investors were net buyers again for the first time in three years. Investors from the Asian region were cautious in the first three quarters but stepped up their activity again on the market in the fourth quarter.

Rents increased across the board throughout 2016 as a whole in the large American office markets, with particularly strong growth reported in Boston, Los Angeles and San Francisco. In contrast, office rents rose only slightly in Washington D.C. All in all, growth momentum was slightly stronger in the first half-year and eased a bit in the second. Rents for retail property rose overall in line with office rents, although these varied considerably in the big cities. The rent increase was particularly strong in Boston, Los Angeles and San Francisco. Rents in Chicago, on the other hand, fell slightly during the first half of the year – at the end of 2016, they were unchanged from the previous year. In New York and Washington D.C., rents for retail space remained stable at year-end compared with the previous year.

Yields on office properties in the large centres declined only slightly overall throughout 2016, but nonetheless reached an all-time low. In comparison, yields in the two Californian office markets of Los Angeles and San Francisco rose slightly from mid-year onwards. On the other hand, falling yields on retail property were observed over the entire year in all large locations. Generally, the declines were however only marginal and eased during the course of the year. Yields here were at an all-time low, too.

The scenario was largely positive on the hotel markets in North America. On a national average, utilisation figures were slightly weaker than at the start of the year, but finished 2016 overall at the previous year's levels. On the other hand, average revenues per available room had climbed quite substantially on a national average in spring compared to the same period of the previous year; the level was confirmed for the year as a whole towards the end of the year. Utilisation in Canada was at the previous year's high level. The average revenues per available room once again exceeded the previous year's good figure.

Aareal Bank Group originated new business of € 2.3 billion (2015: € 2.0 billion) in North America during the year under review, exclusively in the US. The higher volume compared with the previous year underlines our growth strategy in the region.

Asia

The volume transacted in commercial property fell slightly – in US dollar terms – in the Asia-Pacific region, too. Institutional investors were net buyers while private investors sold more. The transaction volume in China was a bit lower than in the previous year, despite a stronger fourth quarter.

Top rents for office properties in Asia showed a mixed picture; they decreased significantly in Singapore yet slightly increased in Beijing, Shanghai and Tokyo compared to the end of 2015. Rents for retail properties remained stable in Beijing and Shanghai, while easing slightly in Singapore.

Yields of premium office property in Asia were stable compared with the fourth quarter of 2015. They fell slightly in Beijing and Shanghai and remained stable in Singapore and Tokyo. The yields on premium retail property fell marginally in Shanghai and remained stable in Beijing, Singapore and Tokyo.

Developments in the market for hotel property varied during 2016. In Beijing and Shanghai the utilisation figures as well as the average revenues per available room rose quite strongly and consistently throughout the year. The figures for utilisation and the average revenues per available room improved in Singapore in the first half-year but declined slightly towards the end of the year compared with the previous year. The utilisation figures in Tokyo eased slightly from a very high level at the start of the year. Nonetheless, average revenues per available room were up slightly. New business in Asia amounted to € 0.2 billion in the year under review (2015: € 0.1 billion) and was generated exclusively in China.

Consulting / Services segment

Bank division Housing Industry

Clients of the Bank's Housing Industry division are drawn largely from the housing and property housing industries, as well as the utilities and waste disposal industries.

The German housing industry continued to show solid overall development in 2016, too. This was supported mainly by stable rental income thanks to the highly-diversified tenant group and long-term financing structures. The housing industry companies continue to focus on a sustainable development of portfolios and on improving energy efficiency. The housing and property companies organised in the German Federation of German Housing and Real Estate Enterprises (Bundesverband deutscher Wohnungs- und Immobilienunternehmen – "GdW") and its regional federations, invested more than € 14 billion in the future of their portfolios.

The German housing market demonstrated that it was largely unaffected by short-term economic fluctuations, since long-term factors such as income and population development tend to impact on the price level. In October 2016, rents throughout Germany were approx. 2.8 % higher than in the previous year.

The housing market continued to be subject to significant regional differences. Whilst demand for housing rose in growth regions, driven by job creation, weak economic locations experienced population declines. Vacancy ratios fell moderately to 8 % in the Eastern Federal German states, compared with vacancies of around 2 % in the West German states.

The Bank's Housing Industry division further strengthened its market position in the 2016 financial year and significantly increased the revenue from payment services through acquiring new customers as well as intensifying business relationships with existing customers. This brought in more clients from the housing industry – managing more than 180,000 residential units between them – for the payments and deposit-taking businesses. Roughly half of these newly-acquired companies manage housing assets on behalf of third parties, in line with our strategic orientation. Moreover, new clients were acquired in commercial property management, and the existing clients there connected more managed units to our payment transaction processes year-on-year. More companies from the utilities and waste disposal industries opted for Aareal Bank's payment transaction systems and / or investment products. We also have an established customer base in this sector and therefore a solid base for further growth.

We also invested in products in 2016 that simplify and automate processes. Special attention was paid to the improvement in the collaboration of our target industries – housing industry and energy industry – for example through BK 01 eConnect, which facilitates the total automation of invoicing and settlement.

At present, more than 3,200 clients throughout Germany are using our process-optimising products and banking services. In line with the Aareal 2020 strategic agenda, the volume of deposits from the housing industry rose to an average of almost € 9.6 billion in the 2016 financial year (2015: € 9.0 billion). Deposits averaged more than € 10.0 billion in the fourth quarter of 2016. Besides the increase in sight deposits, the share of rent deposits was also raised. All in all, this reflects the strong trust our clients place in Aareal Bank.

Aareon

Aareon Group is pursuing a profitable growth strategy and continued to grow organically in the 2016 financial year. The key growth areas are the digital solutions, the ERP systems and exploration of new markets associated with the property sector. A strategic programme was developed in 2016 in order to realise this growth in a systematic and sustainable manner. The programme will position Aareon Group as the leading partner for digitalisation in the property industry. The programme will also break down the digital transformation process at Aareon across all business units, and will translate it into the corporate culture. Aareon also continues with the process of internal optimisation to enhance efficiency and profitability. Aareon's strategic programme is integrated in the "Aareal 2020" programme for the future.

The research and development activities form the basis for the new digital solutions. By developing digital solutions, Aareon is supporting the property industry and related markets so that they can exploit the opportunities presented by digitalisation. The focus here is on creating added value for customers. The research and development activities benefit from the country-specific focus on digitalisation in order to expand the entire Aareon Smart World. Aareon adopts an agile approach to development so as to carry out intensive tests at an early stage and move as quickly as possible from concept to prototype. The Aareon data centre plays a central role for the range of solutions, as a growing number of customers use the Aareon solutions provided as a service from the exclusive Aareon Cloud. Data protection and data security are therefore of great importance to Aareon, and are ascertained through regular certifications, among other things.

Aareon recorded a positive business development in 2016 in its Germany and International Business divisions, as planned. Overall, sales revenues were boosted significantly, from € 187 million to € 211 million, and the contribution to consolidated operating profit from € 27 million to € 34 million.

Germany

The ERP business developed successfully for Aareon in Germany. A large number of solutions were rolled out at the start of the year, 36 companies managing around 100,000 units started in parallel with Wodis Sigma. In addition, many GES customers opted to change to Wodis Sigma in 2016 within the framework of our migration campaign. The migration projects have been progressing on schedule. As expected, the favoured version is the one that uses Wodis Sigma as a service from the exclusive Aareon Cloud. With a total of around 840 clients that have already opted for Wodis Sigma, this ERP solution is the leader in the German housing industry. Because of the ongoing migration, Aareon continues to see a – planned – decline in the business with the ERP product GES. The licensing business for SAP® solutions and Blue Eagle has been developing positively, especially through the acquisition of new customers and additional licenses sold to existing clients. The increase in the maintenance business is largely due to product roll-outs in the previous year.

Business with digital solutions has also been developing positively, with the Mareon service portal, Aareon Archiv kompakt, Aareon CRM, Aareon Immoblue Plus, and Mobile Services being particularly in demand. The digital solutions also benefit from the migration business with the ERP products, as a change in software results in the analysis of further potential for process optimisation. Customer interest was particularly pronounced regarding Mobile Services: Aareon has been successful in winning around 150 companies for this offer.

Aareon also recorded positive business development with add-on products, such as insurance management with BauSecura and IT outsourcing. The IT outsourcing business was extended considerably thanks to a higher number of approvals. Aareon concluded its first full year in the energy business with phi-Consulting, which was acquired the year before, in line with expectations. The energy utilities industry is an important partner to property companies. Based on Aareon's portfolio of products and services, phi-Consulting complements the service range by offering an advisory and development service on the basis of SAP for Utilities. The portfolio is complemented by solutions provided by Aareal Bank. The volume of insurance management business with BauSecura was increased as expected.

International Business

In the Netherlands, additional customers opted for and rolled out the Tobias AX ERP solution. Many new clients and an extended product portfolio resulted in significantly higher revenues. Demand was also evident for digital solutions, especially Mareon, Aareon Archiv kompakt, Aareon CRM, tenant app, the call centre function and the Trace & Treasury solution. The integration of the Dutch Square DMS B.V. (previously Square DMS Groep B.V.), acquired effective 1 October 2015 in order to include a case management solution with the associated process advisory service into Aareon Smart World, was concluded successfully and strengthened the market position. Aareon Nederland B.V. acquired the remaining (50 %) stake in its Dutch subsidiary SG2ALL B.V. from de Alliantie, Hilversum, with effect from 27 December 2016, enabling Aareon to further extend its outsourcing competence on an international level.

In France, Aareon reported successful business this year too with platinum maintenance contracts for the PortalImmo Habitat and Prem'Habitat ERP products. Similarly, Aareon France is supporting several customers with the realisation of Aareon Smart World digital solutions. Tenant portals, invoicing services and mobile property inspection, as well as Mareon, were particularly in demand.

In the UK, Aareon UK took part in several calls for tender with the QL.net ERP solution, winning most of them and thus gaining further market share. The new ERP product generation QL.net was presented to the market, where it met with a very good response. Looking at digitalisation, the UK market has already reached a high degree of maturity, especially regarding mobile solutions. Subsidiary 1st Touch with 360° Tenant Portal and 360° Field Worker is providing new impetus by offering new functional features and design.

Swedish Incit Group has won further new customers for its Incit Xpand ERP solution, including a major hotel group in Scandinavia. A campaign for acquiring new clients was successful, particularly with regard to small and medium-sized companies, and implementation has started. The advisory business also picked up well, and the digital signature for rental agreements was introduced successfully.

Financial Position and Financial Performance

Financial performance

Group

Consolidated operating profit in the 2016 financial year amounted to € 366 million, exceeding both the previous year's figure of € 320 million (adjusted for € 150 million in negative goodwill from the initial consolidation of WestImmo) as well as the range of € 300 million to € 330 million forecast at the beginning of the 2016 financial year.

Net interest income declined to € 701 million (2015: € 781 million) and was thus in line with our expectations (€ 700 million to € 740 million). The decline was largely attributable to the reduction of exposures no longer in line with our strategy, and to lower non-recurring income from early loan repayments.

Allowance for credit losses fell to € 97 million in the 2016 financial year (2015: € 128 million) and therefore remained within the forecast range of € 80 million to € 120 million for the full year. It

Consolidated net income of Aareal Bank Group

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Net interest income	701	781
Allowance for credit losses	97	128
Net interest income after allowance for credit losses	**604**	**653**
Net commission income	193	175
Net result on hedge accounting	0	8
Net trading income/expenses	19	13
Results from non-trading assets	67	-17
Results from investments accounted for using the equity method	0	0
Administrative expenses	547	553
Net other operating income/expenses	30	41
Negative goodwill from the acquisition of WestImmo	–	150
Operating profit	**366**	**470**
Income taxes	132	96
Consolidated net income	**234**	**374**
Consolidated net income attributable to non-controlling interests	19	19
Consolidated net income attributable to shareholders of Aareal Bank AG	215	355

mainly comprises net additions to specific allowance for credit losses of € 109 million.

Net commission income increased to € 193 million (2015: € 175 million), which was mainly due to higher sales revenue at Aareon. The net figure was within the forecast range of € 190 million to € 200 million for the year.

The aggregate of net trading income / expenses and the net result on hedge accounting of € 19 million (2015: € 21 million) resulted largely from the measurement and close-out of derivatives used to hedge interest rate and currency risks.

The net result from non-trading assets amounted to € 67 million (2015: € -17 million) of which an amount of € 61 million was due to the disposal of all shares in Aareal Bank's wholly-owned subsidiary Aqvatrium, which is the owner of a commercial property located in Stockholm. Moreover, the sale of the remaining asset-backed securities (ABS) yielded realised profits of € 5 million.

Administrative expenses amounted to € 547 million and were thus slightly lower year-on-year (2015: € 553 million), and within the € 520 million to € 550 million range projected for the financial year. The figure includes expenses for integration and running costs of WestImmo, as well as expenses for projects and investments. Net other operating income / expenses of € 30 million (2015: € 41 million) includes net income from the successful conclusion of legal disputes with holders of profit-participation certificates issued by the former Corealcredit. This positive effect is offset by a corresponding tax expense of virtually the same amount.

All in all, consolidated operating profit for the 2016 financial year totalled € 366 million, after € 470 million in 2015. Taking into consideration income tax expenses of € 132 million and non-controlling interest income of € 19 million, consolidated net income attributable to shareholders of Aareal Bank AG amounted to € 215 million (2015: € 355 million). Assuming the pro rata temporis accrual of net interest payments on the AT1 bond, consolidated net income allocated to ordinary shareholders stood at € 199 million

(2015: € 339 million). Earnings per ordinary share amounted to € 3.33 (2015: € 5.66), and RoE before taxes was 13.2 % (2015: 18.6 %).

Structured Property Financing segment

Segment operating profit for Structured Property Financing of € 395 million was above last year's figure (€ 343 million), which was adjusted for € 150 million in negative goodwill from the initial consolidation of WestImmo.

Net interest income declined to € 716 million (2015: € 783 million). The decline was largely attributable to the reduction of exposures no longer in line with our strategy, and to lower non-recurring income from early loan repayments.

Allowance for credit losses fell to € 97 million in the 2016 financial year (2015: € 128 million). It mainly comprises net additions to specific allowance for credit losses of € 109 million.

The aggregate of net trading income / expenses and the net result on hedge accounting of € 19 million (2015: € 21 million) resulted largely from the measurement and close-out of derivatives used to hedge interest rate and currency risks.

The net result from non-trading assets amounted to € 66 million (2015: € -17 million) of which an amount of € 61 million was due to the disposal of all shares in Aareal Bank's wholly-owned subsidiary Aqvatrium, which is the owner of a commercial property located in Stockholm. Moreover, the sale of the remaining asset-backed securities (ABS) yielded realised profits of € 5 million.

Administrative expenses amounted to € 346 million in the 2016 financial year (2015: € 359 million). The figure includes expenses for integration and running costs of WestImmo, as well as expenses for projects and investments.

Net other operating income / expenses of € 27 million (2015: € 37 million) includes net income from the successful conclusion of legal disputes with holders of profit-participation certificates issued by the former Corealcredit. This positive effect is offset by a corresponding tax expense of virtually the same amount.

Operating profit in the Structured Property Financing segment totalled € 395 million. After inclusion of € 143 million in income taxes, the segment result amounted to € 252 million (2015: € 387 million).

Structured Property Financing segment result

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Net interest income	716	783
Allowance for credit losses	97	128
Net interest income after allowance for credit losses	**619**	**655**
Net commission income	10	6
Net result on hedge accounting	0	8
Net trading income/expenses	19	13
Results from non-trading assets	66	-17
Results from investments accounted for using the equity method	–	0
Administrative expenses	346	359
Net other operating income/expenses	27	37
Negative goodwill from the acquisition of WestImmo	–	150
Operating profit	**395**	**493**
Income taxes	143	106
Segment result	**252**	**387**

Consulting / Services segment

Operating profit in the Consulting / Services segment remained negative, at € -29 million (2015: € -23 million). Compared with the previous year, Aareon made a significantly higher contribution – of € 34 million – to Aareal Bank Group's consolidated operating profit. However, low margins from the deposit-taking business with the housing industry, due to the persistent low interest rate levels, clearly influenced the segment result.

Sales revenues amounted to € 206 million in the 2016 financial year (2015: € 193 million), driven by sales revenues at Aareon increasing to € 211 million (2015: € 187 million). In line with higher sales revenues, the cost of materials purchased rose to € 35 million (€ 24 million).

Staff expenses of € 144 million were higher than the previous year's level, reflecting higher staffing levels and Aareon's acquisitions during 2015, amongst other factors.

On balance, the Consulting/Services segment generated operating profit of € -29 million (2015: € -23 million). After inclusion of tax reclaims in the amount of € 11 million, the segment result amounted to € - 18 million (2015: € - 13 million).

Consulting / Services segment result

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Sales revenue	206	193
Own work capitalised	6	4
Changes in inventory	0	0
Other operating income	7	9
Cost of materials purchased	35	24
Staff expenses	144	139
Depreciation, amortisation and impairment losses	11	12
Results from investments accounted for using the equity method	0	0
Other operating expenses	58	54
Interest and similar income/expenses	0	0
Operating profit	**-29**	**-23**
Income taxes	-11	-10
Segment result	**-18**	**-13**

Financial position

Consolidated total assets of Aareal Bank Group as at 31 December 2016 amounted to € 47.7 billion, after € 51.9 billion as at 31 December 2015.

Interbank deposits, repos, and cash funds

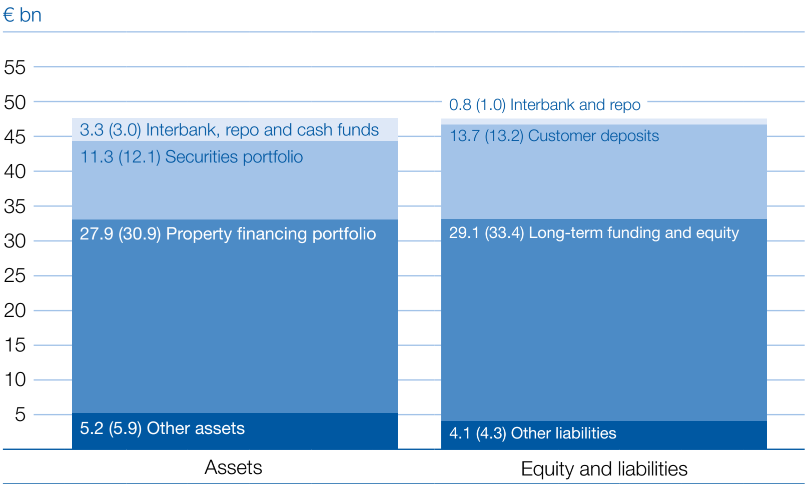
Interbank deposits, repos, and cash funds comprise short-term investments of surplus liquidity. As at 31 December 2016, this comprised predominantly cash funds and deposits with central banks, term deposits and current account balances with other banks.

Property financing portfolio

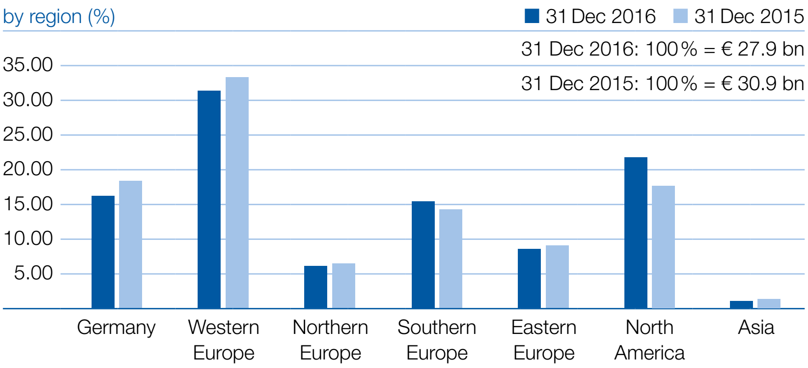
Portfolio structure

The volume of Aareal Bank Group's property financing portfolio stood at € 27.9 billion as at 31 December 2016, a decline of approximately 9.6 % compared to the 2015 year-end figure of € 30.9 billion. This development was largely attributable to the planned reduction of non-strategic portfolios. The international share of the portfolio increased slightly, to 83.9 % (31 December 2015: 81.7 %).

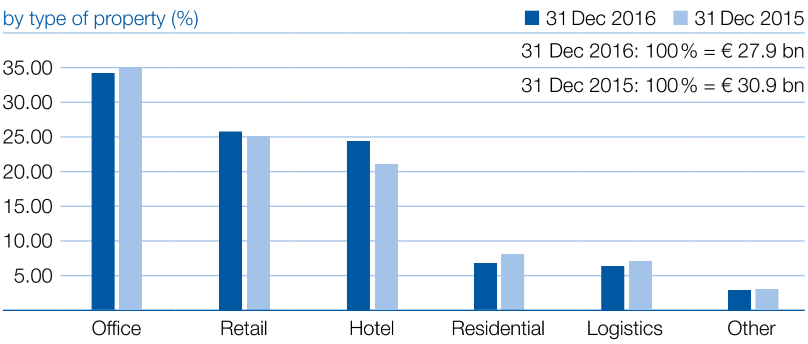
Asset/liability structure as at 31 Dec 2016 (31 Dec 2015)



Property financing volume[1] (amounts drawn)



Property financing volume[1] (amounts drawn)



At the reporting date (31 December 2016), Aareal Bank Group's property financing portfolio was composed as follows, compared with year-end 2015.

Portfolio allocation by region and continent changed only marginally compared with the end of the previous year. Whilst the portfolio share of exposures in North America rose slightly (about 4 percentage points), in accordance with the "Aareal 2020" strategy, it declined in Germany and Western Europe (by about 2 percentage points). It remained almost stable for all other regions.

The breakdown of the portfolio by property type did not change significantly during the reporting period. The share of hotel properties rose by 3.5 percentage points, whilst the share of financings for office, residential, logistics, and retail property as well as other financings included in the overall portfolio remained almost unchanged compared to the year-end 2015.

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

Securities portfolio

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

As at 31 December 2016, the nominal volume of the consolidated securities portfolio[2] was € 9.3 billion (31 December 2015: € 10.2 billion).

Key aspects taken into account for portfolio management are good credit quality and the related value stability, as well as a high degree of liquidity, particularly with regard to Basel III criteria. Following the sale of the remaining asset-backed securities (ABS), the securities portfolio comprises three asset

[1] Excluding € 1.1 billion in private client business (31 December 2015: € 1.5 billion) and € 0.6 billion in local authority lending business by WestImmo (31 December 2015: € 0.6 billion)

[2] As at 31 December 2016, the securities portfolio was carried at € 11.3 billion (31 December 2015: € 12.1 billion).

classes: public-sector borrowers, covered bonds and Pfandbriefe, as well as bank bonds.

99 % of the overall portfolio is denominated in euro. 98 % of the portfolio has an investment grade rating.[1] More than 75 % of the portfolio fulfils the requirements of "High Quality Liquid Assets" in the Liquidity Coverage Ratio (LCR).

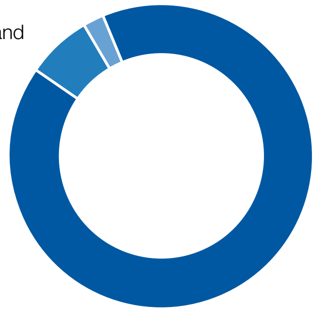
Public-sector borrowers are the largest asset class held, accounting for a share of approx. 91 %. These include securities and promissory note loans that qualify as ordinary cover for Public Sector Pfandbriefe. 99 % of these issuers are headquartered in the EU. Approx. 79 % are rated AAA or AA, and a further 3 % are rated single-A. Overall, 98 % have an investment grade rating.

The share of Pfandbriefe and covered bonds at year-end was 7 %. 92 % consist of European covered bonds, with the remainder invested in Canadian covered bonds. All Pfandbriefe and covered bonds were rated AAA or AA.

Given the emerging regulatory changes, bank bonds may be used for liquidity management purposes only to a very limited extent going forward. Against this background, the share of bank bonds in the total portfolio was only 2 % as at year-end.

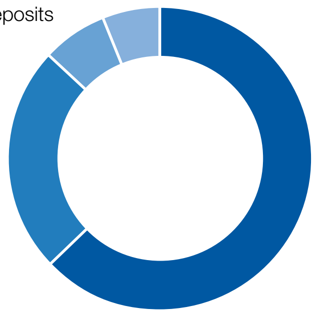
Securities portfolio as at 31 December 2016

% Total volume (nominal): € 9.3 bn



Money market funding mix as at 31 December 2016

% Total volume: € 14.5 bn



Financial position

Interbank and repo business

Generally, in addition to customer deposits, Aareal Bank Group also uses interbank and repurchase transactions for short-term refinancing, the latter being used primarily to manage liquidity and cash positions.

There were no repos and no liabilities vis-à-vis Deutsche Bundesbank or the ECB as at 31 December 2016.

Customer deposits

As part of our business activities, we generate deposits from housing industry customers, and from institutional investors. The volume of deposits from the housing industry could be increased during the reporting period. As at 31 December 2016, they amounted to € 9.2 billion (31 December 2015: € 8.4 billion). Deposits from institutional investors amounted to € 4.5 billion as at 31 December 2016 (31 December 2015: € 4.8 billion).

Long-term funding and equity

Funding structure

Aareal Bank Group's funding remains very solid indeed, as evidenced by the high proportion of long-term refinancing. This encompasses registered and bearer Pfandbriefe, promissory note loans, medium-

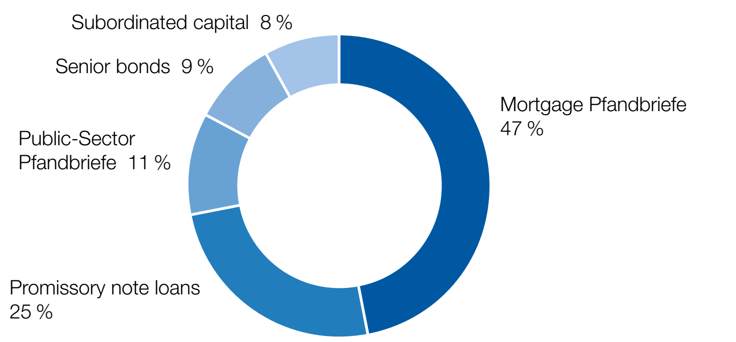
[1] The rating details are based on the composite ratings.

term notes, other bonds and subordinated issues. The latter include subordinated liabilities, profit-participation certificates, silent participations, Additional Tier 1 (AT 1) issues, and trust preferred securities.

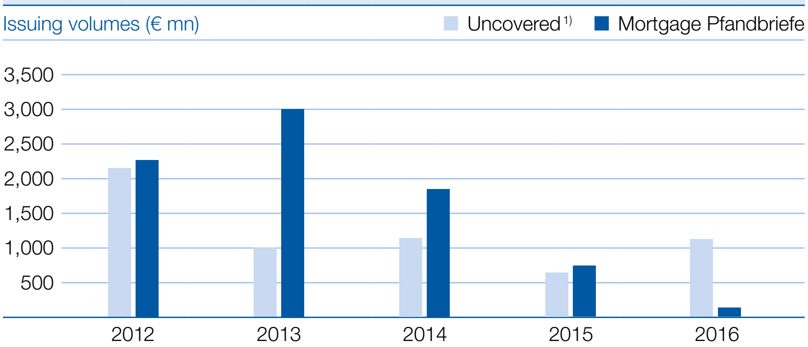
As at 31 December 2016, the long-term refinancing portfolio amounted to € 26.5 billion. Of this amount, Mortgage Pfandbriefe accounted for € 12.5 billion, public-sector Pfandbriefe for € 3.0 billion, uncovered long-term refinancing for € 9.1 billion and subordinated long-term refinancing for € 1.9 billion.

Capital market funding mix as at 31 December 2016

% Total volume: € 26.5 bn



Issuing activities – 2012 to 2016



Thus, Mortgage Pfandbriefe accounted for a total share of 47 % of long-term refinancing. The Liquidity Coverage Ratio (LCR) exceeded 150 % on the reporting days of the periods under review.

Refinancing activities

Aareal Bank Group raised € 1.2 billion on the capital market during 2016, comprising € 1.1 billion in senior unsecured, and € 0.1 billion in secured issues. One of the highlights was the increase of an existing senior unsecured bond by € 150 million in March 2016, to reach a benchmark volume of € 500 million.

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

Equity

Aareal Bank Group's total equity as disclosed in the statement of financial position amounted to € 3,129 million as at the reporting date (31 December 2015: € 3,044 million), comprising € 300 million in the Additional Tier 1 (AT 1) bond and € 242 million in non-controlling interests.

Regulatory capital [2]

	30 Dec 2016 [3]	31 Dec 2015
€ mn		
Common Equity Tier 1 (CET 1)	2,351	2,298
Tier 1 (T1)	2,896	2,882
Total capital (TC)	3,994	3,977
%		
Common Equity Tier 1 ratio (CET 1 ratio)	16.2	13.8
Tier 1 ratio (T1 ratio)	19.9	17.2
Total capital ratio (TC ratio)	27.5	23.8

1) excluding SoFFin-guaranteed issues and subordinated capital

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

3) After confirmation of Aareal Bank AG's financial statements for 2016. The calculation of regulatory capital takes into account the Management Board's proposal for the appropriation of profits for the financial year 2016. The appropriation of profits is subject to approval by the Annual General Meeting.

Our Employees

Age structure and fluctuation

Aareal Bank's fluctuation ratio for 2016 was 1.1 %. The average number of years in service for the Company is 13.9. These two figures are a reflection of the strong relationship between Aareal Bank and its employees. The average age of employees is 45.8 years.

Qualification and training programmes

Qualified and motivated employees make a decisive contribution to a company's economic performance and are thus a key factor to its success as well as a competitive advantage. A company's success largely depends on its employees.

For this purpose, Aareal Bank Group operates a human resources approach aimed at the further qualification of its managers, experts and employees. In line with the corporate strategy, the Bank's human resources approach was adjusted during the period under review to incorporate training innovations and new qualification methods. Aareal Bank Group supports employees' change processes and promotes lifelong professional training.

The Bank further developed its continuous training programme during the year under review, and implemented innovative educational solutions such as learning journeys and digital knowledge pools. For instance, foreign language courses were offered via online platforms, accessible anywhere and at any time, thus featuring the utmost flexibility to course participants.

Furthermore, Aareal Bank Group offered vocational qualifications and study courses, complemented by the opportunity for individual development planning.

The "Structured Appraisal and Target Setting Dialogue" is the starting point for individual development plans at Aareal Bank. Every year, each employee discusses his or her personal development with the responsible manager, agreeing upon concrete measures. In addition, employees may participate in an internal potential method that Aareal Bank has conducted since 2010. This tool is used to systematically select employees and introduce them as managers or experts to new fields of activity, by way of seminars and coaching measures that are tailored to the individuals and their development requirements.

Aareal Bank Group supports all employees willing to develop themselves throughout the different phases of their professional paths, thus establishing

Employee data as at 31 December 2016

	31 Dec 2016	31 Dec 2015	Change
Number of employees of Aareal Bank Group	2,728	2,861	-4.7 %
Number of employees of Aareal Bank AG	933	1,009	-7.5 %
of which: outside Germany	75	84	
of which: proportion of women	45.1 %	45.5 %	
Proportion of women in executive positions	22.9 %	21.7 %	
No. of years service	13.9 years	14.0 years	-0.1 years
Average age	45.8 years	46.1 years	-0.3 years
Staff turnover rate	1.1 %	1.6%	
Part-time ratio	19.7 %	20.5%	
Retired employees and surviving dependants	745	728	2.3 %

a culture of lifelong learning within the Company. Against this background, Aareal Bank established, in 2016, a new concept aimed at the further qualification of its managers, and another system for the qualification of experts, each covering different stages of professional development.

In addition to the ”manager” career path, Aareal Bank AG has been offering the ”expert” career path since 2006. One feature of this career path is that the entire programme – covering subjects such as assumption of responsibility, business writing, complexity, stakeholder management or lateral leadership – is centred around concrete tasks and goals to be achieved by the participating experts. New formats, such as the Group conference of second-level experts, introduced in 2016, fosters the exchange of expertise and professional networking across all divisions.

2016 also saw the introduction of a fundamentally renewed Leadership Development initiative. Aareal Bank executives may drive their professional education on a modular, individual and subject-specific basis by participating in basic modules (”Essentials”), and in-depth advanced courses (”Elements”). The programme focuses on the transfer of theoretical approaches into the real working environment, and emphasises a common learning experience among colleagues across all hierarchy levels. The hands-on, workshop-like short modules cover a large variety of topics and were also introduced in 2016 with the new Learning Day concept, which is offered every month. Moreover, so-called leadership workshops take place on a quarterly basis, with a variety of different formats: a coaching conference among colleagues, teamwork with smaller/larger group of co-workers, discussion with a moderator.

Our subsidiary Aareon promotes young talent and the sciences with a chair for business informatics at EBZ Business School in Bochum, as agreed by both parties.

In addition, the University of Applied Sciences Mainz and Aareon agreed in 2015 on a practice-oriented partnership in the area of facilities management.

Aareon also continued to focus on the CPD of its managers during the 2016 financial year. Within the scope of the Professional individual executive development (“ProFI”) initiative, the managers were offered training (including labour law for managers and leadership at Aareon), diagnostics (including a development centre for new executives) and advisory measures (including individual coaching and managerial circles). Another focus was to continue supporting the international profile of Aareon, particularly by means of language courses. The training programme to become a certified property manager at the Hochschule für Wirtschaft und Umwelt in Nürtingen-Geislingen was also continued in 2016.

Furthermore, Aareal Bank Group successfully completed the first cross-mentoring programme in 2016. This programme promotes the targeted exchange of employees from different companies, and is used as a means of human resources development and transfer of know-how.

Promoting the next generation

Promoting the next generation through training is a central element of the Human Resources work of Aareal Bank Group. The specialist knowledge required in our business segments requires us to invest continuously – and in a targeted manner – in training the next generation. Nine younger employees were supported during the year under review, as part of the junior training programme. The following employees participated in the programme: trainees for office management (IHK), students in the fields of business administration, banking, and business information systems at the Duale Hochschule Baden-Württemberg Mannheim, one master student/trainee as well as business administration students from the University of Applied Sciences Mainz.

Alongside the trainee programmes, Aareon also offers a training programme for new entrants to the profession. Aareon AG offers vocational training in various careers: office management, IT applications developer, IT system integrator. It also offers the dual course of study: ”Business Administration – Property Manager”, in cooperation with the College of Advanced Vocational Studies in Leipzig. Aareon cooperated with DHBW Mannheim to set up the ”Business Administration – Exhibition, Congress and Event Management”, the ”Business Informatics – Software Engineering” and the ”Business Informatics – Application Management” dual courses of study. During their training, participants benefit from additional education and take over responsibilities early on. As at year-end 2016, Aareon employed 16 trainees and three students from the College of Advanced Vocational Studies.

Aareal Bank and Aareon held the Girls’ Day and the Boys’ Day in 2016 again as part of its measures for promoting the next generation. A total of 64 boys and girls aged between 8 and 12 years visited the Aareon Science Camps ”Batteries and solar cells – energetic experiments”, which aim at stimulating and promoting interest in technology at an early age. This was the fourth anniversary for Aareon Science Camps, which have now been attended by a total of more than 250 participants. Aareon awarded the Aareon IT Award ”WohnIT” for the first time in 2016. The price was awarded to the Internatsschule Schloss Hansenberg for the development of ”IntLight” (Indoor Location for Smart Homes). With this competition, Aareon addressed pupils of all ages and types of school, aiming to spark enthusiasm for the topics of ”IT” and ”future housing”.

Furthermore, Aareon supported the initiative JOBLINGE aimed at socially deprived young citizens. In March 2016, Aareon organised a joint project week centred around the digitalisation of housing as part of this initiative. A total of 16 participants in the JOBLINGE initiative and seven Aareon trainees took part in a series of workshops throughout the week aimed at an extensive exchange of views and an intensification of IT and digitalisation skills. The focal point of the workshops was the creative and constructive approach towards the future of housing.

Within the scope of promoting the next generation, Aareal Bank Group also offers students the opportunity to gain their first impressions of the professional world and Group divisions by actively participating in internships. The internship programme was continued successfully during the year under review.

Remuneration system

The remuneration systems are based on remuneration principles that apply throughout Aareal Bank Group. The Supervisory Board and the Management Board carried out the annual review of the remuneration systems, involving the Human Resources division, the Remuneration Officer, and internal control units in line with their respective functions, supported by external legal and remuneration advisors. External advisors were retained, amongst other things, for examining the appropriateness of remuneration systems, and remuneration for members of the Management Board and employees, as well as regarding the design of the Group-wide remuneration strategy.

In addition to the fixed remuneration that is paid in twelve monthly instalments, all employees receive a performance-related variable remuneration. The variable remuneration of a limited number of employees (senior executives and so-called risk takers) comprises a short-term and a long-term component. The limitation of variable remuneration components is designed to avoid negative incentives for taking disproportionately high risks.

Salaries are reviewed annually, to ensure that individual remuneration packages are appropriate. The objective is to offer a remuneration level that is both appropriate and attractive to all Group employees.

Work-life balance

Aareal Bank Group places great importance on supporting its employees to achieve compatibility of career and family. Employees are supported in many ways.

Since July 2012, the Bank has cooperated with a non-profit organisation, which operates childcare facilities in Wiesbaden. This cooperation agreement offers employees childcare places for children aged between ten months and six years. Aareal Bank also cooperates with the City of Wiesbaden to offer childcare facilities to its employees during the school holidays. Since summer 2013 it has cooperated with the Biberbau children and youth farm in the city, where employees' children can take advantage of educational and leisure opportunities. These offers are supplemented by flexible working hours, part-time work or the possibility to incorporate mobile working and home working into their working hours – provided the respective position allows it. To provide particular support to those employees based outside Wiesbaden in balancing the demands of family and career, we are offering help in finding private childcare solutions.

Another component for improving the work-life balance of Aareal Bank's staff consists of services that make it easier to combine working life with the care of close relatives. This includes the opportunity to use statutory family caregiver leave, and in particular advisory and support services where close relatives are ill or in need of care, all over Germany. Furthermore, employees have access to the Bank-internal nursing care network offering substantial information about nursing and support services as well as the opportunity to get in touch with co-workers in similar situations to share insights and get valuable advice. Our employees may also participate in trainings to develop and hone the skills needed to successfully combine care and career, offered by Bündnis für Familie, Wiesbaden. Given the importance of this topic for Aareal Bank Group, we signed the Charter for the Reconciliation of Working Life and Nursing Care in Hesse (Charta zur Vereinbarkeit von Beruf und Pflege in Hessen) during the year under review.

For the last nine years, Aareon has been certified as a family-friendly company by berufundfamilie gemeinnützige GmbH, a non-profit organisation. Aareon's staff policy services include the promotion of workplace flexibility through part-time work and home working. Aareon also works together with a family service company that supports its employees by providing an advisory service on the topics of childcare, care situation and psychosocial concerns. Together with another company, Aareon offers places at a day nursery and nursery school at a daycare centre in Mainz, where the nursery school places are free of charge for Aareon employees. The "Success Factor Family" competition was held for the first time since 2012, the year in which Aareon won the medium-sized company category. Aareon was once again among the finalists in 2016.

In response to the changing requirements in a digital working world, Aareon is one of the first 100 pilot companies to conduct the INQA (Initiative Neue Qualität der Arbeit – New Quality of Work Initiative) audit, which is supported by the Federal Ministry of Labour and Social Affairs. The German Federal Minister of Labour and Social Affairs, Andrea Nahles, awarded Aareon with the programme certificate in September, acknowledging its sustainable company culture. This certification confirms that Aareon developed and put into practice various measures to implement the INQA topics of human resources management, equal opportunity & diversity, health, knowledge & competence. This also implied the development of human resources policy being aligned towards the various life phases – something that started already the year before.

Besides the various measures for promoting the compatibility of career and family, parent/child offices have been set up at Aareal Bank in Wiesbaden and at various locations of Aareon. The objective is to support employees that are faced with short-term bottlenecks in the provision of care for their children.

Health

Aareal Bank practices Company Health Management to promote employee health. This includes information and trainings on preventative healthcare, physical activity & ergonomics, nutrition as well as mental health & relaxation.

For instance, our employees took advantage of extensive preventative healthcare offers, such as health advice and examinations through the company doctor, as well as expert advice regarding nutrition, physical activity, and lifestyle. Furthermore, we organised an annual influenza vaccination, eye inspections and intra-ocular pressure testing, a blood donation day as well as skin screenings as part of cancer prevention, and early detection of colorectal cancer. The offer was complemented by a new seminar on brain tuning aimed at the improvement of participants' mental performance. Besides substantial information on a sustainable way of living, our employees have access to healthy basic nutrition through our Bank-internal restaurant – the Casino –, featuring regular special campaigns and offering healthy snacks.

Particular emphasis was placed on mental health & relaxation during the year under review. Furthermore, we have provided our employees with the opportunity to utilise the Employee Assistance Program (EAP), a phone service for employees designed to assist in overcoming crises in the professional and private sphere. This facility is available 24 hours a day and 365 days a year. In addition, Aareal Bank in Wiesbaden continued to offer massages to help employees relax, together with seminars on mindfulness and stress management. For its dedication to health and individual performance of its employees, as well as for its forward-looking and sustainable personnel strategy, Aareal Bank was once again distinguished with the Certificate of Excellence at the Corporate Health Awards 2016.

Aareon operated its corporate health management in 2016 under the motto "fit for the working environment 4.0", since the employee survey and the INQA audit had shown that this topic is of particular interest. A mixture of a large variety of seminars – covering subjects such as "recharge your batteries", "Healthy leadership", "deceleration", "time management", a presentation on "how to better deal with the flood of information", an E-Learning-Tool on mental health, massages, influenza vaccinations, and last but not least the Aareon Health Day – support a healthy work environment at Aareon.

Diversity

The Management Board has made an express commitment to diversity in Aareal Bank Group, and published it on the Internet and Intranet. This defines diversity as follows:

- An appreciation for the uniqueness of every individual and respect for their differences,
- equal opportunities at all levels,
- the prevention of discrimination of any kind, along with
- actively representing and living the belief that diversity enriches corporate culture and also represents a success factor in reaching strategic goals.

The goals are to promote Aareal Bank's image as a modern employer, to strengthen employee commitment and increase employee motivation, to ensure skills and competencies are fostered individually in a way that promotes employee performance, to react to demographic change and an ageing workforce, and to take into account individual circumstances and stages of life.

In order to highlight the significance of diversity and document the fact that the concept of diversity is very important to Aareal Bank Group, the Bank signed the Charter of Diversity (an initiative launched by German industry in 2006) in 2013.

Aareal Bank Group currently employs people from 28 different countries. It makes sure that its international operations are filled by mainly local nationalities.

The share of female employees in Aareal Bank AG was 45.1 % in the 2016 financial year, with women accounting for 22.9 % of executive positions. Within Aareon Group, the figures were 32.7 % and 21.8 % respectively.

Severely disabled persons made up 3.9 % of Aareal Bank's staff base in 2016. This employee group is represented in the Group's German entities by a disability representative.

Equal treatment

It is very important for Aareal Bank Group that men and women are treated equally, in relation to recruitment decisions and further development through qualification measures, as well as with regard to remuneration in the Company. As a rule, all vacant positions below executive staff level are filled within the scope of an internal recruitment procedure. All employees may apply for the advertised positions. The employees' remuneration is, so to speak, not differentiated by gender, but – aside from the individual performance – solely on the basis of aspects such as qualification, experience and education.

The employee representative bodies regularly check within the scope of their co-determination rights that qualification is the decisive criteria for filling positions. In addition, recruitment decisions at Management Board and executive staff levels must take into account primarily the qualifications and experience when selecting a suitable candidate.

In Germany, Aareal Bank and Aareon apply the German General Equal Treatment Act (Allgemeines Gleichbehandlungsgesetz – "AGG"), with specially-appointed AGG Officers overseeing compliance.

At the same time, AGG training is held for all employees. In the US, the employee manual contains anti-harassment rules to avoid harassment and discrimination in the workplace.

Risk Report

Aareal Bank Group Risk Management

The ability to correctly assess risks, and to manage them in a targeted manner, is a core skill in banking. Accordingly, being able to control risks in all their relevant variations is a key factor for a bank's sustainable, commercial success. Besides this purely economic motivation for a highly-developed risk management system, extensive regulatory requirements apply to the risk management as well. We therefore continued to drive the development of our processes for identifying, measuring, limiting and managing risks in the financial year under review too.

Risk management – scope of application and areas of responsibility

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

Uniform methods and procedures are deployed to monitor the risks generally associated with banking business across all entities of Aareal Bank Group. Risks in the Consulting/Services segment are taken into account as part of investment risk. Specific risk monitoring methods have been developed and deployed to suit the relevant risk exposure at the respective subsidiaries. In addition, risk monitoring for these subsidiaries at Group level is carried out via the relevant control bodies of the respective entity, and equity investment controlling.

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

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	Business & Syndication Management, Credit Management	Risk Contolling, Credit Management
Credit risks	Property Finance Portfolio risks	Credit Management, Portfolio Management & Controlling	Risk Controlling
Credit risks	Treasury business	Treasury	Risk Controlling
Credit risks	Country risks	Treasury, Credit Management	Risk Controlling
Operational risks		Process owners	Risk Controlling
Investment risks		Acquisitions & Subsidiaries	Risk Controlling, Acquisitions & Subsidiaries, Controlling bodies

Process-independent monitoring: Audit

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

The Bank resolved to establish a Risk Executive Committee ("RiskExCo") during the year under review. The RiskExCo supports the entire Management Board in maintaining a holistic risk management system, develops proposals for resolutions in line with delegated tasks, and promotes risk communications and a risk culture within the Bank.

Strategies

The business policy set by the Management Board, and duly acknowledged 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. These strategies are designed to ensure a professional and conscious management of risks. Accordingly, these strategies include general policies, to ensure a uniform understanding of risks across all parts of the Group. They also provide a cross-sectional, binding framework applicable to all divisions. The Bank has implemented adequate risk management and risk control processes to implement these strategies, and to safeguard the Bank's risk-bearing capacity. During the financial year under review, risk strategies as well as the Bank's business strategy were adapted to the changed environment, and the new strategies were adopted by the Management Board and duly acknowledged by the Supervisory Board.

Risk-bearing capacity and risk limits

The Bank's ability to carry and sustain risk is a core determining factor governing the structure of its risk management system. To ascertain its uninterrupted risk-bearing capacity, Aareal Bank Group has adopted a dual management approach whereby its risk management is primarily based on the assumption of a going concern. This approach ensures that risk positions are only established to an extent that the institution's continued existence will not be threatened should the risks materialise.

A secondary management process ensures that risk positions are only established to an extent that even in the event of liquidation there will still be sufficient potential risk cover in order to service all liabilities (the "gone concern" approach). The statements below relate to the going-concern approach which the Bank has implemented as a primary management process.

In accordance with this approach, potential risk cover is determined using data derived from the income statement and from the statement of financial position; this derivation also forms the basis for determining regulatory capital. This involves setting aside the maximum amount of own funds required as potential risk cover to offset risks without causing a breach of minimum requirements pursuant to the Capital Requirements Regulation (CRR). Aareal Bank has decided to considerably exceed this minimum requirement, and to prudently apply a Tier I ratio (calculated in accordance with the CRR) equivalent to 8 % of forecast risk-weighted assets (RWA), plus buffer. The Bank switched to full Basel III implementation during the year under review. Only free own funds exceeding this level are applied as potential risk cover, of which a further minimum of 10 % (currently 11 %) is retained as a risk cushion. This cushion is not applied to risk limits, and is thus available for risk types that cannot be quantified (for example, reputational or strategic risks).

We adopt an equally conservative stance with respect to setting risk limits. The aggregation of individual limits is based on the assumption that no risk-mitigating correlation effects exist amongst different types of risk. Taking into account the prior deduction of a minimum Tier I ratio of 8 % of RWA, the value-at-risk models used to quantify risks are based on a confidence interval of 95 % and a one-year holding period (250 trading days). A monthly report submitted to the Management Board provides information regarding the utilisation of individual limits for the material types of risk, as well as on the overall limit utilisation. The following table (p. 76) summarises the Group's overall risk-bearing capacity as at 31 December 2016.

Risk-bearing capacity of Aareal Bank Group as at 31 December 2016
– Going concern approach –

€ mn	31 Dec 2016	31 Dec 2015
Own funds for risk cover potential	2,598	2,937
less 8 % of RWA (Tier 1 capital (T1))	1,477	1,606
Freely available funds	**1,121**	**1,331**
Utilisation of freely available funds		
Credit risks	317	313
Market risks	207	244
Operational risks	106	100
Investment risks	24	65
Total utilisation	**654**	**721**
Utilisation as a percentage of freely available funds	**58 %**	**54 %**

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

Stress testing

Stress testing, and the analysis of stress test results, form an additional focal aspect of our risk management system. This involves conducting stress tests for all material risks, using both historical parameters as well as hypothetical stress testing scenarios. To also be able to assess cross-relationships between the various types of risk, we have defined multi-factor stress scenarios, so-called "global" stress tests. For instance, the impact of a crisis affecting financial markets and the economy on individual types of risk and aggregate risk is analysed within the scope of a historical scenario. An escalation of the financial markets and economic crisis is modelled as a hypothetical scenario. The stress testing methodology implemented also takes into account the impact of any risk concentrations. We compare the aggregate risk cover available in a stress situation with the result of stress tests, thus assessing Aareal Bank's ability to bear risk in a stressed environment. The Management Board and the Supervisory Board are informed of the results of such stress analyses on a quarterly basis.

Organisational structure and workflows

Lending business

Division of functions and voting

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

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

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

The RiskExCo, which has delegated authority to the heads of Risk Controlling, Operations, and Portfolio Management & Controlling (which are independent of Sales units), is responsible for the approval of counterparty, issuer, or country limits.

We have implemented and documented the clear separation of Sales and Credit Management processes across all relevant divisions.

Process requirements

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

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

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

Early risk detection procedures

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

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

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

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

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

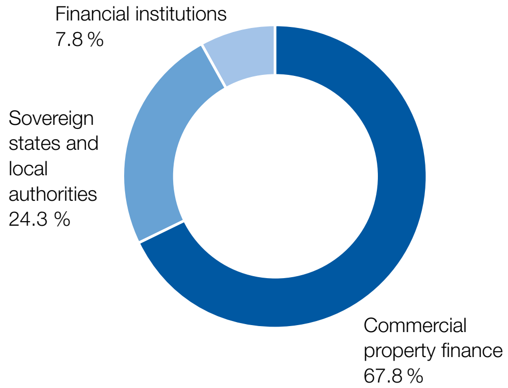
Risk classification procedures

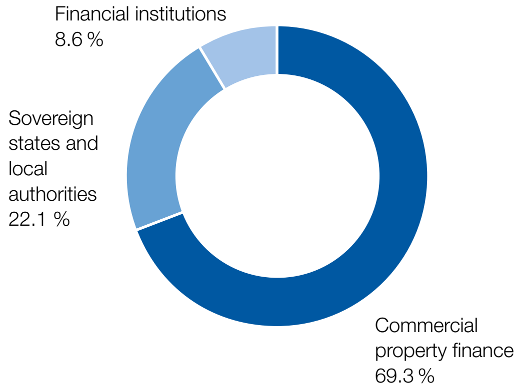
Aareal Bank employs risk classification procedures tailored to the requirements of the respective asset class for the initial, regular, or event-driven assessment of counterparty credit risk. The rating scales and exposure definitions have been customised to match the respective methods. Responsibility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

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

Breakdown of exposure by rating procedure

31 Dec 2016 | 31 Dec 2015 100 % = € 43.2 bn | 100 % = € 46.4 bn





Note: The rating procedures for financial institutions also apply to development and promotional banks. Such institutions accounted for 51 % of all rated financial institutions as at 31 December 2016.

Property financing business

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

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

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

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

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

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

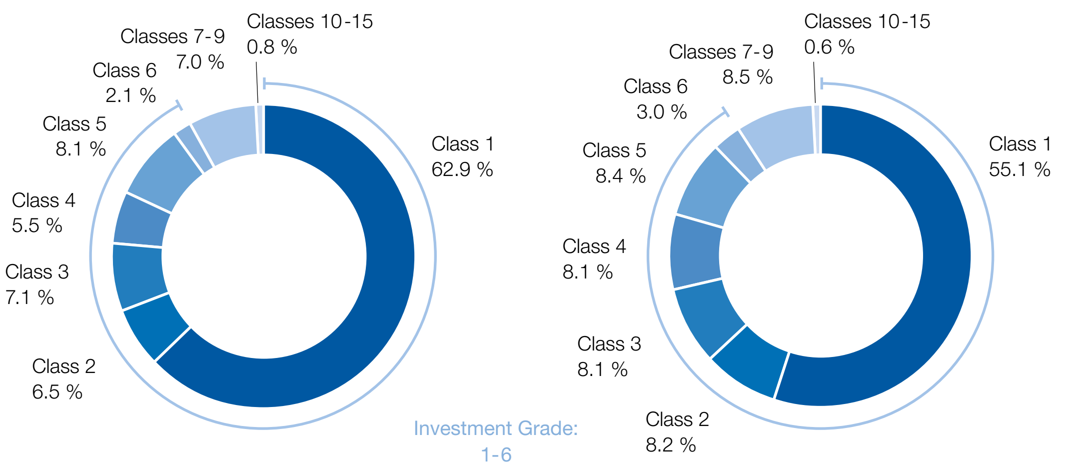
The following diagrams depict the distribution of lending volume by EL classes as at 31 December 2015 and 31 December 2016, based on the maximum current or future drawdown. The distribution excludes exposures for which no rating has been concluded, or which are in default (as defined under the CRR).

Financial institutions

Aareal Bank employs an internal rating procedure for financial institutions, which incorporates qualitative and quantitative factors as well as our client's

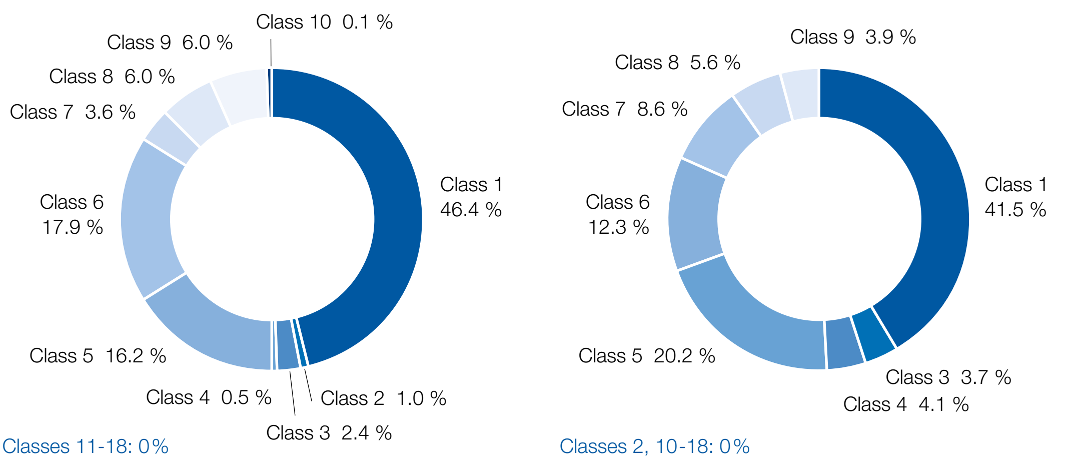
Large-sized commercial property finance

by internal expected loss classes — as at 31 Dec 2016 | as at 31 Dec 2015



Financial institutions

by rating class — as at 31 Dec 2016 | as at 31 Dec 2015



group affiliation, to classify the risk exposure to banks, financial services providers, securities firms, public-sector development banks, and insurance companies. Financial institutions are assigned to a specific rating grade by way of assessing relevant financial indicators and taking into account expert knowledge.

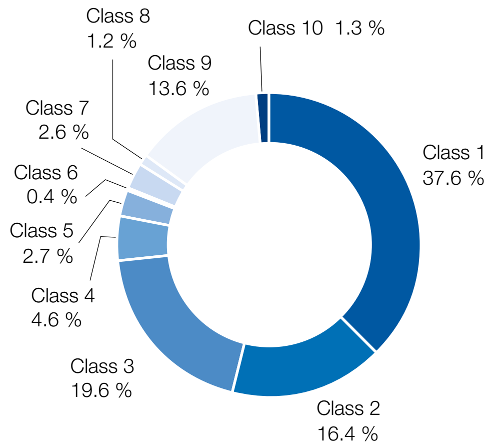
Sovereign states and local authorities

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

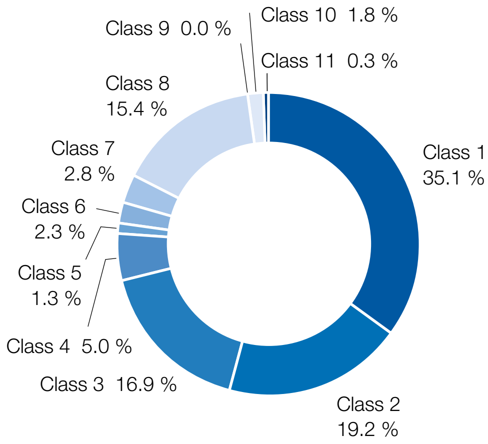
In general, the risk classification procedures employed by the Bank are dynamic methods which are permanently adapted to changing risk structures and market conditions.

Sovereign states and local authorities

by rating class — as at 31 Dec 2016 | as at 31 Dec 2015



Classes 11-20: 0%



Classes 12-20: 0%

Trading activities

Functional separation

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

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

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

The detailed assignment of responsibilities is outlined below.

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

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

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

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

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

Process requirements

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

Moreover, processes and systems are designed in a way that allows to incorporate new products into the risk monitoring system swiftly and adequately, in order to ensure the flexibility of the Sales units in their business activities.

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

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

Risk exposure by type of risk

Credit risks

Definition

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

Credit risk strategy

Based on the Bank's overall business strategy, Aareal Bank's credit risk strategy sets out all material aspects of the Group's credit risk management and policies. Proposals for the credit risk strategy are prepared jointly by Sales units and Credit Management, adopted by the entire Management Board, and duly acknowledged by the Supervisory 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 Sales units and Credit Management, who submit a proposal (on which they 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 (as a general guideline) plus individual sub-strategies called Lending Policies. Given the hierarchical structure of the credit risk strategy, the Group credit risk strategy overrides individual sub-strategies. These rules serve as a guideline for generating new business.

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 anticipated loss, at portfolio level, for a given confidence interval.

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.

The Bank focuses in particular on the identification, monitoring and management of risk concentrations, where both quantitative and qualitative methods are being used. With regard to counterparty credit risk, these include for example, the regular analysis of our largest borrower units and the analysis of the portfolios by countries, risk classes and categories of collateral. Thresholds are set within this system for individual sub-markets and product groups. Risk Controlling uses a "red-amber-green" indicator system to assess the utilisation of the limits on a monthly basis, which it submits to the Management Board. The thresholds are reviewed annually within the scope of the target portfolio and Group planning.

The model-based review and monitoring of risk concentrations is carried out on the basis of the credit risk models used in the Bank. The models in question allow the Bank to include in particular, rating changes and diversification effects in the model-based assessment of the risk concentrations.

Within the process-oriented monitoring of individual exposures, the Bank uses specific tools to monitor exposures on an ongoing basis: 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.

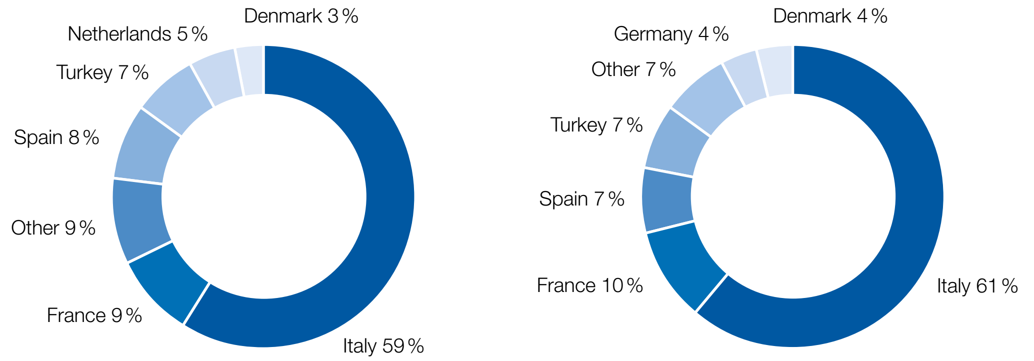
A risk report that complies with the Minimum Requirements for Risk Management (MaRisk) is prepared and submitted to the Bank's senior management and Supervisory Board on a regular basis, at least quarterly. This report contains extensive information on the development of the credit portfolio (covering countries, types of property and product types, risk classes and types of collateral), with a particular focus on risk concentrations.

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

Individually impaired property financing[1] (amounts drawn)

by country (%) 31 Dec 2016: 100 % = € 1.4 bn | 31 Dec 2015: 100 % = € 1.4 bn



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

risk considerations, these are escalated to the responsible members of senior management, using a standardised escalation process.

Credit risk mitigation

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

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

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 a valuer; any discrepancies must be substantiated in writing. In any case, the market and mortgage lending values determined by the Bank must not exceed the values assessed by independent internal or external valuers.

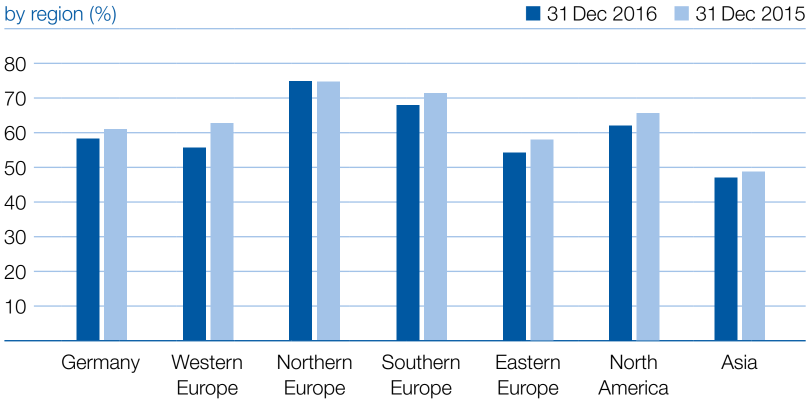
To mitigate credit risk, the Bank also accepts collateralisation through a pledge of shareholdings in property companies or special-purpose entities not listed on a stock exchange. The Bank has set out detailed provisions governing the valuation of such collateral.

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

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

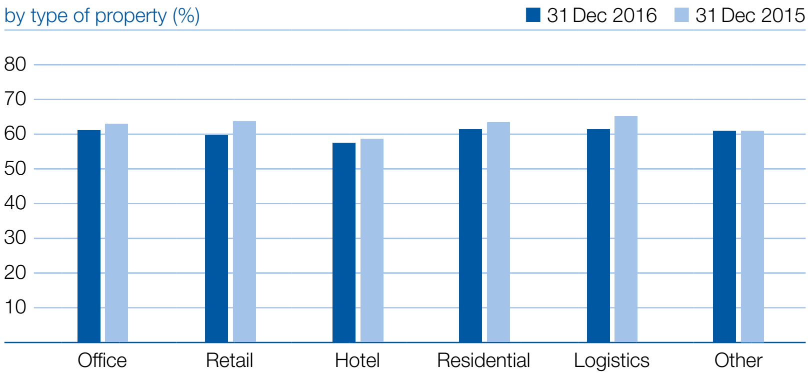
Average LTV of property financing[1)]

by region (%)



Average LTV of property financing[1)]

by type of property (%)



1) Excluding WestImmo's private client business and local authority lending business.
Note that the loan-to-value ratios are calculated on the basis of market values, including supplementary collateral with sustainable value.

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

To reduce counterparty credit 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.

The derivatives master agreements used by the Bank contain mutual 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.

To further reduce default risks, the provision of collateral is agreed upon.

Prior to entering into agreements, and on a regular basis following conclusion of an agreement, the responsible legal services unit within the Operations division 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 CRR, a clause providing for a review of eligibility is added to the netting agreements. This review is carried out in accordance with the CRR, 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 higher amount of collateral to be provided in the event of a downgrade of the Bank's external rating.

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

Country risk

Definition

When defining country risk, in addition to the risk of sovereign default or default of state entities, Aareal Bank also considers the risk that a counterparty could become unable to meet its payment obligations as a result of government action, despite being willing and able to pay, due to restrictions being imposed on making payments to creditors (transfer risk). These types of risks arise only if the borrower is located in a different country from the lender, or if the financed property is located in another country.

Country risk measurement and monitoring

Country risk exposure is managed using a cross-divisional process. Countries are assigned to risk classes on the basis of internal ratings and the annual review of country limits. The limits are set by the Management Board. The Risk Controlling division is responsible for the continuous monitoring of country limits and limit utilisation, and for monthly reporting. Country limits defined for the purposes of risk management were always observed during the financial year under review.

The diagram below illustrates the risk exposure by country in the Bank's international business, as at year-end. In the property financing business, country exposures are allocated by location of the property used as collateral. For exposures not collateralised by property, the allocation is based on the borrower's country of domicile. This reflects the exposure of the property finance business, as well as the activities of Treasury.

Market price risks

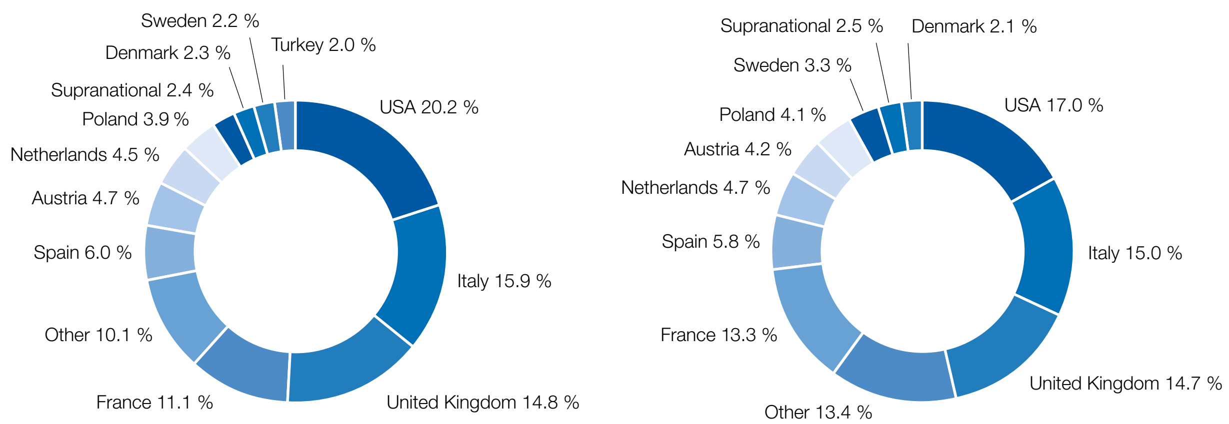
Definition

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

Derivative financial instruments are primarily used as hedging instruments. Credit spread and basis spread risks between the various yield curves (e.g. government, Pfandbrief and swap curves) are taken into account. The risk exposure from bonds that is not related to market price or interest rate risks is

Breakdown of country exposure in the international business

in % 31 Dec 2016 | 31 Dec 2015



managed as part of "specific risk", in particular, credit and liquidity risk exposure of the bond portfolio.

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 indicates the potential loss incurred before countermeasures 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, the VaR figure takes into account the correlation between individual risk types within market price risk. Statistical parameters used in the VaR model are calculated directly from a 250-day historical data pool maintained within the Bank. The loss potential is determined applying a 95 % confidence interval and a 250-day holding period.

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

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.

€ mn	MAX	MIN	Mean	Limit
Year-to-date (full previous year), 95 %, 250-day holding period				
Aareal Bank Group – general market price risk	305.0 (422.3)	161.1 (187.5)	224.5 (263.3)	– (–)
Group VaR (interest rates)	211.6 (404.4)	103.0 (119.5)	149.5 (216.5)	– (–)
Group VaR (FX)	185.9 (170.5)	102.2 (61.0)	135.5 (114.7)	– (–)
VaR (funds)	5.8 (4.7)	3.5 (2.8)	4.6 (3.7)	20.0 (20.0)
Aggregate VaR in the trading book (incl. specific VaR)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	5.0 (5.0)
Trading book VaR (interest rates)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	– (–)
Trading book VaR (FX)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	– (–)
VaR (equities)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	– (–)
Group VaR (specific risks)	85.9 (92.0)	62.8 (72.3)	73.3 (83.8)	– (–)
Aggregate VaR – Aareal Bank Group	311.5 (428.7)	174.0 (207.5)	237.5 (277.4)	390.0 (435.0)

When interpreting the VaR figures stated before, it should be taken into account that these refer to the overall portfolio. Hence, the analysis provided represents a very extensive disclosure of market price risks by industry standards.

To ensure that Aareal Bank's figures are comparable to those published by other institutions, the risk parameters shown below were determined for a one-day holding period:

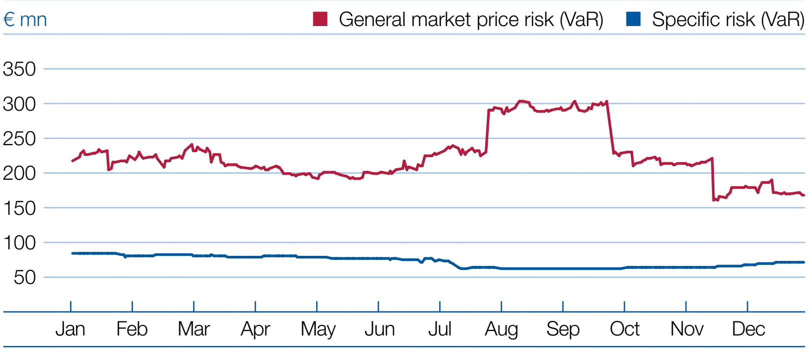
€ mn	MAX	MIN	Mean	Limit
Year-to-date (full previous year), 95 %, 1-day holding period				
Aareal Bank Group – general market price risk	19.3 (26.7)	10.2 (11.9)	14.2 (16.7)	– (–)
Group VaR (interest rates)	13.4 (25.6)	6.5 (7.6)	9.5 (13.7)	– (–)
Group VaR (FX)	11.8 (10.8)	6.5 (3.9)	8.6 (7.3)	– (–)
VaR (funds)	0.4 (0.3)	0.2 (0.2)	0.3 (0.2)	1.3 (1.3)
Aggregate VaR in the trading book (incl. specific VaR)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.3 (0.3)
Trading book VaR (interest rates)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	– (–)
Trading book VaR (FX)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	– (–)
VaR (equities)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	– (–)
Group VaR (specific risks)	5.4 (5.8)	4.0 (4.6)	4.6 (5.3)	– (–)
Aggregate VaR – Aareal Bank Group	19.7 (27.1)	11.0 (13.1)	15.0 (17.5)	24.7 (27.5)

Aggregate VaR – Aareal Bank Group

Group-wide limits are being continuously monitored as part of the analysis of the Bank's risk-bearing capacity. These limits were adjusted in line with the updated risk-bearing capacity during the second quarter of the financial year. No limit breaches were detected even after this re-calibration.

VaR movments in July, September and November resulted from market fluctuations (due to the "Brexit", for example) and related adjustments to statistical model parameters.

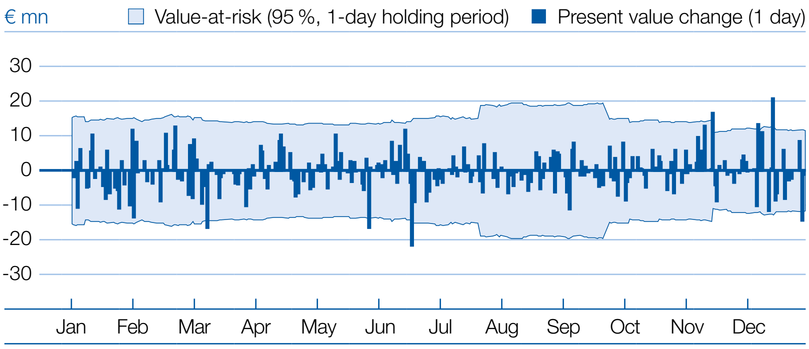
General market price risk and specific risk during 2016



Backtesting

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 (≤ 17 for a 250-day period). Four negative outliers at Group level occurred during the last 250 trading days, affirming the high forecasting quality of the VaR model we use. During the year under review, the statistical model was expanded, in order to better reflect the development of market data – specifically, the low-interest rate environment.

Present values and 1-day VaR during the course of 2016



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 end-2008 phase of the financial markets crisis. For this reason, the VaR projection is supplemented by simulating stress scenarios on a monthly basis.

Aareal Bank Group calculates present value fluctuations both on the basis of real extreme market movements over recent years, 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 monthly stress test reporting.

The worst-case scenario used in the financial year under review was a hypothetical scenario, where a deteriorating financial markets crisis caused bond and CDS spreads to widen due to rating downgrades, combined with an appreciation of the euro and unchanged interest rate markets. This scenario implied a present value loss of 26 % of the stressed aggregate risk cover limit as at year-end 2016. No breach of set limits occurred during the year under review.

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

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 that no such trades were concluded during the financial year under review, trading book risks played a negligible role in the overall risk scenario during the period.

Liquidity risks

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

Risk measurement and monitoring
Treasury is responsible for managing liquidity risks, whilst Risk Controlling ensures the continuous monitoring, including a daily liquidity report submitted to Treasury, and a contribution to the monthly

risk report to the entire Management Board. The following tools are used for this purpose:

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 expected 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. This liquidity stock comprises all assets that can be liquidated at very short notice. The difference of both figures (in absolute terms) indicates excess liquidity, once all claims assumed in the run-off profile have been fulfilled through the liquidity stock. There were no liquidity shortages throughout the period under review.

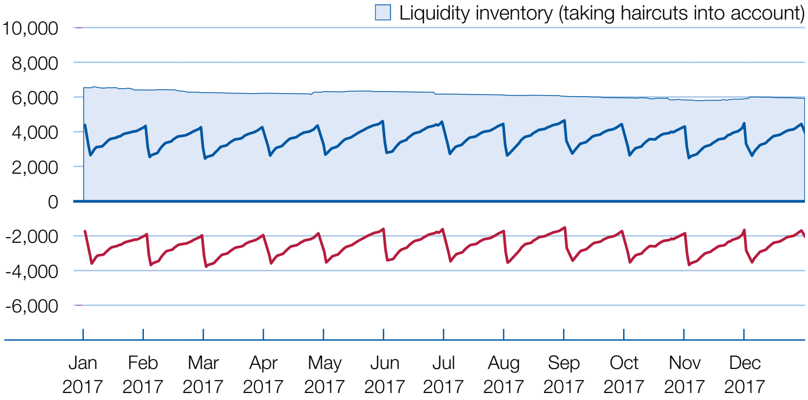
The chart above shows the planned development of the liquidity stock, expected aggregate cash inflows and outflows, and the total liquidity requirements (based on stressed assumptions) until the end of 2017. This presentation demonstrates that the liquidity stock will always exceed liquidity requirements, even under unfavourable conditions.

Further details are provided in the comments on the Bank's liquidity in the section on "Refinancing and Equity".

c) Funding profile

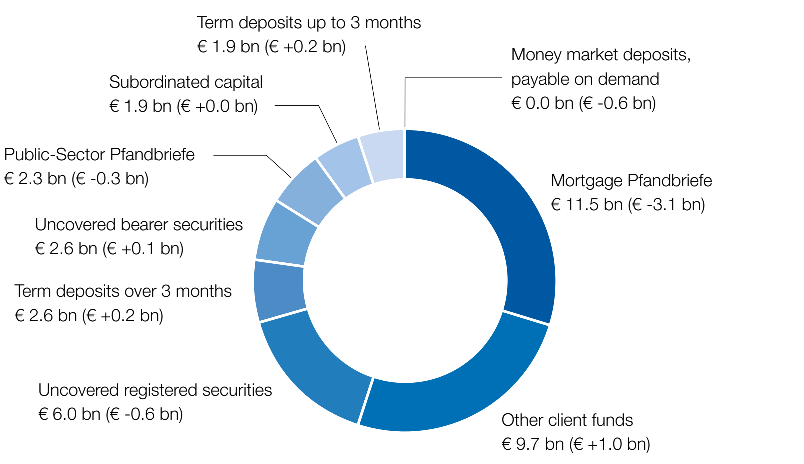
Diversifying the Bank's refinancing profile by type of investor, and by product, represents a further key aspect of our approach to liquidity risk management. Core sources of funding such as customer deposits and funds invested by institutional clients – alongside covered and uncovered bond issues – constitute the foundation of our liability profile.

Liquidity



Refinancing portfolio diversification by product

as at 31 Dec 2016 versus 31 Dec 2015 Total: € 38.6 bn



Stress testing

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

From our point of view, the most significant scenario is the institution-specific "idiosyncratic stress" scenario, which simulates a withdrawal of funds deposited by public-sector entities and banks, as well as a 30 % reduction in current account balances. Even in this stress scenario, liquidity is sufficient to cover the expected liquidity needs under stress conditions.

Operational risks

Definition

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

Risk measurement and monitoring

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

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

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

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

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

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

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

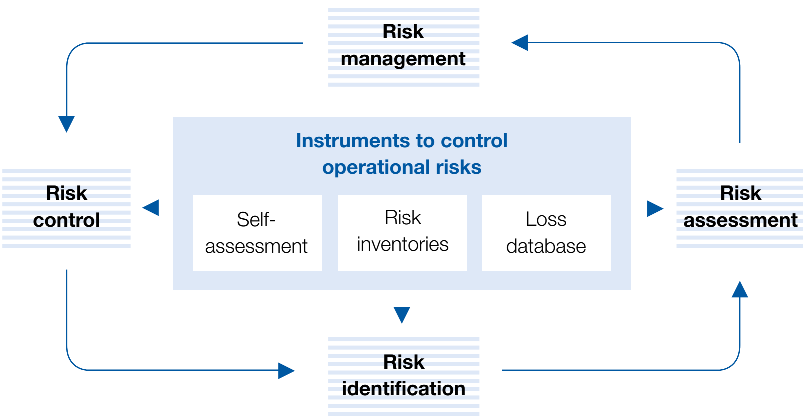
Legal also compiles all information concerning any legal disputes involving Aareal Bank Group, whether in or out of court. To this extent, the involvement of the legal department is based on corresponding Group-wide guidelines. The Bank's decentralised operating legal entities, as well as the legal departments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

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

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

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

Management of operational risks



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

Investment risks

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.

Aareal Bank Group acquires equity investments strictly for the purpose of positioning the Group as an international property financing specialist and provider of property-related services.

Definition

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

Risk measurement and monitoring

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

The existing procedures used to measure and monitor risk exposure are supplemented by subjecting the equity portfolio to regular stress testing.

The Acquisitions & Subsidiaries and Risk Controlling divisions are jointly responsible for measuring and monitoring investment risk exposure.

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

Aareon AG

Aareon AG has introduced a Group risk management system (which includes early-warning features on the basis of the R2C_risk to chance standard software) in order to monitor and control company risk. This risk management system requires the regular recording and assessment of risks (but not opportunities) by those individuals holding responsibility for divisions, shareholdings and projects, and provides for the conception of active risk management measures. In this context, risks are assessed separately in terms of their impact and their probability. Specifically, risk is viewed on a net basis, using the residual risk after taking into account adequate measures taken. The risk reports prepared in this manner are consolidated by the Group Legal and Risk Management divisions and by the Compliance Office; they form the basis for quarterly risk reporting which is regularly discussed during meetings of the Bank's corporate bodies and committees. The reports are also incorporated into the quarterly reporting package submitted to Aareon AG's Supervisory Board. Aareon's risk reporting system creates transparency regarding the company's risk situation, providing a basis for decisions regarding any measures to be taken by senior management.

The measures, proposed by those individuals responsible for risk, regarding the top ten risks perceived during the current quarter are documented within the scope of risk reporting, provided that the expected value of such risks (calculated as a function of impact and probability of occurrence) exceeds a defined threshold of currently € 100,000. In the fourth-quarter reporting, which is relevant for the reporting date, six risks fulfilled this criterion on a single-exposure level. In addition to measures taken during the current quarter, risk-related measures are also documented if they related to the risks involving the ten highest expected values during one of the preceding three quarters. This juxtaposition of risks and related measures serves both to enhance transparency of risk assessments as well as to verify the effectiveness of the measures taken. Furthermore, Aareon AG's International Board as well as the senior management of Aareon Deutschland GmbH take action with respect to any risks the expected value of which exceeds a further defined threshold.

Aareon's Internal Audit carries out checks of the risk management system. This includes an oversight of compliance with legal requirements and Group-wide guidelines, and of the effectiveness of internal controls established.

Aareon's risk categories include financial and market risks, management and organisational risks, environmental/business risks, and production risks. The financial risk category includes liquidity, cost and revenue risks. Market risks comprise client risks, competition risks, as well as the risks emanating from the views of opinion leaders in industry associations and advisory boards, as well as supplier risks. Management and organisational risks include risks related to human resources as well as risks from internal processes. The environmental/business risk category covers legal risks, political and regulatory risks as well as compliance risks. Production risks comprise product-specific risks, project risks, and IT security risks. Cross-relationships exist between individual risks. On a risk category level, Aareon does not determine an aggregate risk value. The time horizon on this level is one year.

In a first step, categories and sub-categories are introduced to create a uniform risk atlas – and hence, a uniform risk view. The risk atlas provides an overview of the risks and indicators monitored by the individual divisions or entities.

Central risk management will adapt the risk atlas in the event of any material changes to the organisation, strategy or business policy resolved during meetings of corporate bodies and committees.

Based on the average of quarterly risk assessments, risk exposure during 2016 was assessed at a slightly higher overall level compared to the previous year. Overall, there were no risks which would have jeopardised the continued existence, or which would have had a material impact on the financial position and performance of Aareon.

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 AG, which 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 process for licensing BK 01 products, 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.

The stand-alone "Aareal Account Rent Deposits" solution, which is independent of specific systems environments, has been in production and fully migrated since 2015. At present, rent deposits of approximately € 25 million (and rising) are being managed using this software.

Development partnerships with providers of institutional housing or utility software are being continuously monitored; such partnerships will not be extended, or will be terminated, if the partners fail to comply with the stringent quality requirements placed upon them.

Aareal First Financial Solutions AG has offered Aareal Bank's clients a browser-based online access since 2015, via the Aareal EBICS platform. Aareal First Financial Solutions AG complies with regulatory requirements for this new risk class (in accordance with BaFin's Minimum Requirements for the Security of Internet Payments – "MaSI"): strong client authentication and multi-level security procedures are strictly adhered to; external risk analyses were commissioned and application-related access tests carried out.

The further development of the BK@1 accounting system is based on Release 21.01 – the version which is currently in productive use – and therefore does not represent any material risk.The currently valid SEPA procedures have been fully implemented. Risk exposure resulting from the operation of the BK@1 and PTS software solutions is sufficiently covered through the regular operational processes.

Within the framework of a project scheduled to run until April 2017, Aareal First Financial Solutions AG is currently working on the technical infrastructure required to adequately meet the strategic, functional and technical requirements for a future banking portal: all current access rights for customers and account managers have been reviewed, island applications and systems are being gradually replaced, migrated or integrated; in addition, value-added functionality such as an electronic mailbox is being implemented.

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 AG's project management system. This allows for continuous monitoring, facilitating swift counteraction if necessary.

Company management receives comprehensive monthly reports covering the level of rendered and responsible production, which includes the provision and maintenance of applications and products, the hotline, and the provision of support services for operations.

A standardised procedure for the management of operational risks is being consistently applied. 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 AG acts on behalf of Aareal Bank, within the scope of agency agreements in place. Aareal First Financial Solutions AG has outsourced its print server system, as well as host and server platform operations, to Aareon AG. Regular discussions are held with both contracting parties on the topics of request management, change management, and active control of outsourced activities.

Aareal First Financial Solutions AG 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 interfaces to relevant third-party systems on the market, such as SAP or platforms developed by other software providers to the commercial housing sector, alongside connectivity to Aareon' AG's systems. These interfaces are refined on an ongoing basis.

Deutsche Bau- und Grundstücks-Aktiengesellschaft

Deutsche Bau- und Grundstücks Aktiengesellschaft ("BauGrund") looks back on a track record – either directly or through its subsidiaries – covering more than eight decades in the property management sector. The business focus is on commercial and technical property management, primarily for residential property, but also for commercial and special property. BauGrund also manages properties on behalf of third parties according to the Residential Property Act (Wohnungseigentumsgesetz – "WEG").

BauGrund manages properties on behalf of the German federal government, institutional investors and companies, and for private investors including home owners' associations. The company's key risk factors are developments in the German property market, particularly regarding residential property investments, which in turn influence the behaviour of BauGrund's private, institutional and public-sector clients. In light of the low interest rate environment and the greater interest shown in tangible assets as a result of the sovereign debt crisis, it is fair to expect stronger construction activity on the German residential property market for the foreseeable future. Accordingly, the demand for property management services is likely to be stable or to slightly rise. Given the increasingly systematic workflows employed by the majority of market participants and the ongoing efficiency enhancements of all process steps (in an industrial business environment), service quality demands are set to rise further. However, clients are not expected to accept corresponding price increases.

To counter the risk of shrinkage in the managed portfolio, the activities were focused on stabilising and securing these portfolios. In addition, the company has revised its sales concept in order to originate further attractive follow-up orders from existing clients, targeting both institutional investors as well as private customers. BauGrund plans further investments, especially to enhance efficiency, in order to sharpen the company's profile as a quality provider with nationwide coverage.

Going forward however, there is a distinct expectation that property managers who fail to deliver the service standards demanded by clients stand to be replaced in the near future. This offers BauGrund potential for acquisitions, which has been reflected in the steady acquisition of new orders: the company was able to acquire new business of approximately € 1.6 million during 2015, which impacted income in 2016. The majority of BauGrund's existing contracts were largely secured. As a result, revenues for 2016 continued to rise year-on-year.

Other risks

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.

Risk measurement and monitoring

The Bank has defined a suitable early-warning system – focusing on media observation/social media, client/staff and investors/analysts – that is designed to assess reputational risks. By analysing the early-warning indicators and deploying experiences already gained by the Bank, the Management Board can take a proactive stance in relation to potential reputational risks.

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 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. 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 the various divisions, for instance, via the continuous monitoring of trends which may be relevant to business policy.

Accounting-related Internal Control and Risk Management System

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

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

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

Organisation of the accounting-related ICS and RMS

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

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

Aareal Bank Group entities prepare an IFRS package as at the relevant balance sheet date. This includes financial statements prepared under IFRSs and in accordance with the IFRS Group Accounting Manual, as well as the Notes and consolidation information (intercompany balances). All packages are recorded by the Finance division in a consolidation software and aggregated for the purpose of preparing the consolidated financial statements. The number of employees within Aareal Bank's Finance division is adequate, as are their qualifications. Furthermore, they possess the necessary knowledge and experience relevant for their functions.

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

Internal Audit also has a process-independent monitoring function. It reports directly to the Management Board, and provides auditing and consulting services which are designed to optimise Aareal Bank's business processes with regard to accuracy, safety and efficiency. The Internal Audit division supports the Management Board by evaluating the effectiveness and appropriateness of the process-dependent Internal Control System and of the Risk Management System in general. Any detected weaknesses regarding the identification, evaluation and reduction of risks are reported and addressed within the context of specific action plans.

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

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

Components of the accounting-related ICS and RMS

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

A prerequisite for the monitoring system to work efficiently is a written set of procedural rules governing the distribution of tasks between the individual divisions and the scope of the respective activities. The organisational structure of the Finance division is set out in the Bank's organisational guidelines. Aareal Bank's accounting system is structured observing the principle of separation of functions. The functional separation makes for a split between operative and administrative roles, and is designed to ensure a sufficient level of control. In addition, the preparation of the consolidated and the single-entity financial statements is carried out in distinct units.

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

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

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

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

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

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

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

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

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

Report on Expected Developments

In the Report on Expected Developments, we present the macro-economic environment as well as sector-specific and business developments, including Group targets, considering the resulting opportunities.

Macro-economic environment

The macro-economic environment continues to be exposed to high risks and uncertainties. These also impact on the commercial property markets and can influence their development in the future. Besides economic components such as weak investment and stagnating global trade, we also see the threat of geopolitical danger – especially due to terrorism. Overall, there is a risk of global political stances shifting towards protectionism and demarcation.

The focal point continues to be the low interest rate environment, which harbours risks for financial stability of a systemic dimension. Low interest rates can lead to a misallocation of investment capital, possibly resulting in asset-price bubbles. Moreover, market participants might be encouraged to take on higher levels of risk. Sudden changes in interest rates may trigger a revaluation and changes in investor behaviour, potentially leading to a collapse in asset prices. A longer-lasting period of low interest rates may delay an exit from such an environment, heightening the risks for the financial and capital markets. Low interest rates may also entice a scaling back of reform and consolidation efforts in various sectors.

A sharp increase in interest rates entails considerable risk: an excessively quick rise can hamper investments, have negative implications for asset prices, and impact other regions. The latter concerns in particular the emerging economies that need to face capital outflows, and which may have to raise their own interest rates. Although financial market players have been expecting interest rates to rise further in the US for some time now, the extent – and possible resulting financial market volatility – is still an unknown factor. Turmoil in the financial and capital markets may still hurt the global economy.

A major risk factor in Europe is the UK's exit from the EU (Brexit). Despite the minimal economic impact this had in 2016, we continue to see a high level of economic risk for the UK, as well as for the EU. Besides the possibility of a split of the UK itself, another risk factor is the breakup of the EU. The referendum on reforming the Italian senate that was rejected in December 2016, and the forthcoming presidential or parliamentary elections in some European countries are both fuelling uncertainty.

The sovereign debt crisis might potentially raise its head again in Europe: the problem of high levels of indebtedness is still there, and has not been resolved once and for all. The diverging monetary policy between the US and the euro zone could heighten the risk.

There is a danger that the residential property boom in China and the sharp increase in levels of private debt could lead to a pronounced market correction. Overall, there is a threat of substantial capital withdrawal from the emerging markets, with far-reaching negative consequences for the global economy.

Economy

Global economic development shows a mixed picture. We predict that economic development will be weaker in Europe compared with North America and the Asia-Pacific region. Taking into account the aforementioned threats and risks, economic development might turn out to be weaker across all regions, or even lead to a recession. The threat of protectionist measures in some regions might – through the trade channels - influence the entire global economy.

We forecast stable growth for the euro zone in 2017, that will be down slightly on 2016. Despite weak global trade and uncertainty factors as well as risks, we anticipate robust growth. Political risk will be a key issue for the euro zone in 2017, with elections to be held in several of the big euro zone countries. Stable fundamental data is expected to lead to a further slight decline in unemployment. In this environment, we expect economic growth in France to pick up slightly compared with 2016, while growth in Italy should remain weak, and slightly below 2016's levels. We forecast growth in Germany, the Netherlands and Spain to be slightly weaker than in 2016.

We envisage slightly higher growth for the EU overall than in the euro zone. The uncertainty about the specifications and negotiations surrounding the planned Brexit is determining the economic outlook in the UK. The sharp depreciation of pound sterling vis-à-vis the euro and the US dollar as a consequence of the Brexit vote will support exports this year. Higher inflation and ongoing uncertainty make it likely that the support provided by private consumption to date will ease. The economy will therefore grow at a slower pace than in 2016, and the labour market could slow down due to the uncertainty factors. We expect a distinct strengthening of the Danish economy in 2017. With domestic demand remaining the sole driver of growth in Poland, the growth rate will remain in line with the previous years' levels. After several particularly strong years in Sweden, growth momentum is expected to slow down, on robust fundamental data.

In light of the political uncertainty, we expect weak growth for Turkey at the level seen in 2016. A fragile recovery, with slightly positive growth, can be expected for Russia – following two years of recession.

We anticipate the newly-elected US administration to pursue a more expansionary fiscal policy, embarking upon a series of structural reforms in 2017, including tax cuts. Economic growth will rise moderately compared with 2016. As in 2016, growth will be supported mainly by private consumption, so that additional investment will be expected from the private sector this year. Owing to the uncertainty about protectionist plans, and the new administration's further political measures, the outlook is clouded by a high degree of uncertainty.

The economy will remain weak in Japan, and will grow at the same low level that was seen in 2016. It will be supported by a current economic programme.

We anticipate a slight fall in the growth rate in China in the course of reducing excess capacity this year. The outlook is slightly uncertain in light of future trade relations with the US.

Financial and capital markets, monetary policy and inflation

We anticipate moderate volatility on the financial and capital markets this year, as well as a steeper euro zone yield curve compared with the previous year. However, the markets will remain liquid and receptive.

As far as monetary policy is concerned, we predict further divergence in polical trends in the relevant currency areas. We expect a moderate rise in the key interest rate in the US, and therefore a continuation of the moderate shift away from the expansionary monetary policy. In the euro zone, quantitative measures will remain in place, given the extension of the securities purchasing programme at least until the end of December 2017. An increase in the key interest rate for the euro zone is not expected this year, so that monetary policy will remain extremely expansionary. However, developments in the US and a reduction in the volume of securities purchased by the ECB might nonetheless drive up government bond yields. The Bank of England (BoE) will take its cue from the consequences of the Brexit vote. We do not anticipate any further expansionary measures, as the BoE will be faced with higher inflation and a weaker currency – as expected. The positive economic development in the UK supports the cautious attitude of the BoE.

The US dollar is expected to make further moderate gains over the euro in the medium term, owing to the expansionary fiscal policy and expectation of rising key interest rates in the US. On the other hand, any appreciation should be stemmed by the higher expected US budget deficit.

The pound sterling will remain weaker against the euro than in the past years as a result of the UK's Brexit vote. Besides political uncertainty, the very negative current account balance will also be felt here. On the other hand, the currency is being supported by the surprisingly good economic situation.

The Danish krone remained in a fixed exchange rate regime relative to the euro with very little change in the exchange rate. We do not anticipate any appreciable volatility for the current year.

The Swedish krona has depreciated considerably against the euro in the past year. We expect the currency to stabilise in the current year, and to appreciate slightly versus the euro. The krona is supported by stable and strong economic growth, which is countered by the expansionary monetary policy.

Yields could rise moderately due to the developments described above; in this context, we see the long end of the euro zone yield curve being especially affected. The ECB's purchase programmes for various securities will continue to influence interest rates in the current year. Rising inflation expectations and the robust economy on the other hand might strengthen the upside pressure on interest rates, countered by the ECB's securities purchases. However, any upside pressure is expected to remain moderate. The covered bond market will be influenced significantly. Overall, the combination of low yields, growing ECB purchases and stricter regulatory requirements have increasingly curbed trading activity on the covered bond market over the last two years. This is unlikely to change much in the near future.

Basis effects and the dwindling effect of lower energy prices will drive up inflation significantly in the euro zone, to levels that significantly exceed the previous year. However, weak wage increases are likely to prevent the central bank's target of inflation at just under two per cent from being reached. Core inflation will remain low.

Thanks to healthy labour market data and a positive wage development, we anticipate significantly higher inflation in the US during the current year, compared with previous years. The announcement of a more expansionary fiscal policy also drove up inflation expectations sharply in the US.[1)]

[1)] Measured in terms of the US 5Y5Y forward swap (inflation expectation)

Inflation in Japan remains close to zero and is therefore well below the target of two per cent stated by the central bank in January 2013.

Regulatory environment

The trend towards a tighter regulatory framework in the banking business is set to persist during the coming years. Numerous initiatives, such as the revision of the Credit Risk Standard Approach (CRSA), the Internal Ratings-based Approaches (IRBA) and the basic approaches for operational risk and the capital floor rules are currently being discussed, for example. EBA has also finalised its Guidelines on the collection of information related to the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP).

The ECB will also review the internal model of Pillar I (Targeted Review of Internal Models) in 2017, whose exact impacts on banks – and the consequences – cannot be fully assessed at present.

Regulators have yet to come up with final details for some of these additional regulatory requirements; hence, various technical standards, guidelines and regulations still have to be finalised. In addition, EBA published a consultation paper in November 2016 on "Guidelines on PD estimation, LGD estimation and the treatment of defaulted exposures". The EU Commission made proposals to revise supervisory regimes (CRR, CRD IV, BRRD and SRMR) that implement in particular international banking supervision rules of the Basel Committee and the FSB (Financial Stability Board) in Europe.

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

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

Sector-specific and business developments

Structured Property Financing segment

Commercial property continued to be a sought-after asset class in 2016, despite the different appetites for risk amongst investors. We expect this trend to continue, and to be reflected in transaction volumes.

Transaction activity worldwide will, in our view, decline further in the current year. The quest for yield will not ease much, despite the growing attraction of alternative investments, as commercial property will largely continue to offer a strong yield pick-up over comparable investments.

Several factors will impact on the value of commercial property in the current year. Whilst the low interest rate environment will continue to prevail, alongside a stable economy with gradually improving labour market figures, the market faces greater uncertainty factors, both political and otherwise.

We therefore anticipate a largely stable development in the market values of commercial property in many markets this year. However, the combination of the existing low interest rate environment and adjustments to the (often very low) returns on investment, given potential interest rate hikes, pose the risk of a correction to the market values of commercial property.

We expect a stable performance in most European countries in 2017. Deviating from this, we expect a slightly positive development owing to the good economic situation in Denmark and Spain. The situation in the UK is subject to uncertainty because of the Brexit vote. Values could fall in some sub-markets although we anticipate a stable development overall. Property values in some sub-markets in Turkey might be negatively influenced by political uncertainty and the tense security situation.

We forecast a stable performance for example in Germany, France, Italy, the Netherlands and Poland.

Following the sharp decline in property values in Russia in recent years, we believe these will stabilise in the current year due to the slight economic recovery. Ongoing difficult international relationships and uncertainties arising from the Syrian and Ukrainian conflicts could continue to burden the situation.

Property values in the US are expected to develop slightly positively, thanks to the relatively favourable economic outlook. Rising interest rates pose a certain risk for this development, while the property markets should benefit from the expansionary fiscal policy the new administration is expected to pursue. We expect a stable performance in Canada.

Developments in commercial property values are likely to vary in Asia. Stable values are expected in China and Singapore, while prime commercial property values could continue to rise further in Japan as interest rates remain low.

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

We expect varied developments in 2017 on the hotel markets of Europe's most significant economic centres. Brussels and Paris should see a slight increase in the occupancy ratios and average revenues per available room. As we see it, occupancy ratios should be stable in the other big European cities with slightly higher average revenues per available room. The difficult political situation in Turkey will continue to have negative implications for the hotel markets: hence, we do not anticipate any substantial recovery in the current year.

We believe a slight improvement on average in revenues per available room is likely in North America, with stable or slightly lower occupancy ratios.

We see the hotel markets in the large Asian cities as being stable. Seasonal volatility is highly likely in all markets in 2017.

The intense competition of previous years is also likely to persist in many markets during the current year, with less of an incentive to lower the margins. We do not anticipate any notable increases in loan-to-value ratios.

Interest amongst financiers to provide finance for first-class properties in top locations will remain high. However, the limited supply of these kinds of property in some markets will restrict the financing options.

Aareal Bank takes property market developments into account for its ongoing risk monitoring. Within the framework of orienting its lending policies, Aareal Bank monitors expected diverging developments in different countries. It also performs regional analyses within these countries.

We are planning our new business for the coming financial year on the basis of various market aspects. In the Structured Property Financing segment, we aim to generate aggregate new business of between € 7 billion and € 8 billion. Aareal Bank Group's property financing portfolio is expected to be in the region of € 25 billion to € 28 billion, subject to currency fluctuations. The Bank plans to expand its US portfolio, within the scope of the "Aareal 2020" programme for the future, increasingly managing this portfolio (and the associated risks) by way of syndication. Syndication is a suitable tool, which also offers scope for providing larger-scale financing solutions.

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

Consulting / Services segment

Bank division Housing Industry

We expect the stable development of the German housing and commercial property industries to prevail throughout 2017. This stability is largely due to the mainly constant rental income and the high stability of property values.

In addition to implementing the energy turnaround in buildings, the impact of demographic change and immigration requires the industry to make additional investment. Additionally, new construction projects, above all in the conurbations, will come under scrutiny.

The industry's future investment activities will be closely connected with the political environment and its impact on the profitability of any projects undertaken. Increased requirements of energy measures or changes to the modernisation levy could have a dampening effect on investment.

Given the stable German economic framework, we assume that developments on the German housing market are likely to remain stable. Rental growth will continue to be highest in cities with growing populations and high economic output. This trend will be beneficial to property investors and potential sellers within the housing and commercial property industries.

We see good opportunities during 2017 to acquire new clients and to intensify the business relationships with our existing client base. We will also benefit from the product innovations in 2016, such as BK 01 eConnect, which facilitates the total automation of invoicing and settlement, as well as internet applications that can further streamline and speed up our client's processes.

Looking at the volume of deposits taken, we expect the positive trend to continue, particularly in relation to current account balances and rent deposits, in line with the Aareal 2020 strategic agenda. The persistent low interest rate environment, which is relevant for the results from our deposit-taking business, will continue to place a significant burden on segment results. However, the importance of this business goes way beyond the interest margin generated from the deposits, which is under pressure in the current market environment. This is because the deposits from the housing industry represent a strategically important additional source of funding for Aareal Bank.

Aareon

Aareon will continue in 2017 to pursue the growth strategy based on its strategy programme integrated in the "Aareal 2020" programme for the future. Consolidated sales revenues are expected to rise slightly, accompanied by an almost steady contribution to Group results. The expansion of the digital solutions of the Aareon Smart World portfolio of products, strengthening the ERP business and tapping new areas of business will be the key growth factors. We will continue to invest in the expansion of Aareon Smart World as well as in measures to enhance performance and efficiency.

Aareon anticipates its advisory business to expand in Germany as the migration of GES clients to the Wodis Sigma ERP solution proceeds as planned. We also believe that sales revenues with digital solutions will continue to grow in 2017 as the topic has considerably gained in importance in the housing industry alongside customer interest.

Aareon expects to increase its advisory business in the Netherlands by further penetrating the market for digital solutions, in particular. For Aareon France, we expect the positive trend in maintenance will continue together with a decline in the licensing business due to the cyclical release planning. Very strong growth in sales revenue is also expected of the digital solutions on the back of further market penetration. A sharp increase in the advisory and licensing business for the ERP solution QL is expected in the UK for 2017, while the new ERP product generation QL.net should also be established further in the market. The demand for digital solutions – including the 1st Touch mobile solution, 360° Tenant Portal and the tenant portal – is expected to increase further here too. The Swedish Incit Group is expected to increase sales revenues stemming from Incit Xpand, in particular through a rise in business with new clients in the Scandinavian markets and, as a consequence, a more dynamic advisory business.

In view of the aforesaid, Aareon expects a slight increase in sales revenues for 2017, together with a contribution to consolidated operating profit of between € 34 million and € 35 million.

Group targets

We expect the competitive environment to remain challenging during the current financial year 2017, with a continuation of diverging developments in the key economic regions. The low interest rate environment is likely to persist during 2017. Whilst financial markets participants expect further interest rate increases in the US, as well as a steepening of the yield curve in the euro area, the scope of such changes – and the resulting volatility on the financial markets – remain difficult to predict. In a highly competitive environment, commercial property is likely to remain a sought-after asset class during the current financial year.

We will adhere to our selective strategy in originating new business, with active portfolio management, in 2017. As in the previous year, the Bank will expand in growing markets with attractive margins, in a targeted manner.

Consolidated net interest income is expected to decline to between € 620 million and € 660 million, largely due to the continued, scheduled reduction of non-strategic portfolios in the entities acquired over the past two years. Allowance for credit losses is expected to be in a range between € 75 million and € 100 million during 2017, once again reaping the benefits of a prudent risk policy over recent years. Net commission income is projected to be in a range between € 195 million and € 210 million, slightly above the previous year's level. Administrative expenses are expected to fall, to a range between € 470 million and € 510 million, in spite of expected project costs and substantial forward-looking investments, such as for realigning the Bank's IT infrastructure.

We therefore expect to generate a good consolidated operating profit during the current year, in a range between € 260 million and € 300 million – in a demanding environment. We anticipate Return on Equity (RoE) before taxes of between 9.0 % and 10.5 % for the current financial year, with earnings per share (EpS) between € 2.45 and € 2.90. We affirm our medium-term target RoE of at around 12 % before taxes.

In the Structured Property Financing segment, the credit portfolio is projected at between € 25 billion and € 28 billion by the end of 2017, subject to currency fluctuations. We are targeting new business between € 7 billion and € 8 billion in the current year. In the Consulting / Services segment, we expect our IT subsidiary Aareon to contribute between € 34 million and € 35 million to consolidated operating profit.

Given prevailing uncertainty with regard to future regulatory requirements as well as any potential deterioration to economic developments, and considering our dividend policy, we project the fully-phased in Common Equity Tier 1 ratio (CET 1 – assuming full implementation of Basel III) by the end of 2017 to be moderately higher than the current level of 15.7 %. Further, we expect the Liquidity Coverage Ratio (LCR), which should be at least 100 %, to largely remain at a very high level.

Corporate Governance Statement pursuant to Section 315 (5) in conjunction with Section 289a of the HGB

Given the implementation of the EU Accounting Directive (2013/34/EU), a Corporate Governance Statement is required to be included in the Group Management Report for the 2016 financial year for the first time. The existing obligation to issue a Corporate Governance Statement, as part of Aareal Bank AG's Management Report, pursuant to section 289a of the German Commercial Code (HGB) remains in place. Pursuant to section 315 (5) sentence 2 of the HGB, the requirements of section 289a of the HGB must be applied, mutatis mutandis, to the Corporate Governance Statement at

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

The Corporate Governance Statement is available to the public on the Company's website on http://www.aareal-bank.com/en/about-us/corporate-governance/. Please refer also to the "Transparency" section.

Principles of Remuneration of Members of the Management Board and the Supervisory Board

The Supervisory Board determines the structure and amount of remuneration for members of the Management Board.

The Remuneration Control Committee (Vergütungskontrollausschuss) fulfils the requirements according to section 25d (12) of the German Banking Act (Kreditwesengesetz – KWG) and section 15 of the InstitutsVergV, and held six meetings throughout the 2016 financial year.

The Supervisory Board defines before the beginning, but no later than immediately after the beginning of every financial year, the Management Board members' targets regarding the performance-based remuneration components. The Supervisory Board assesses Management Board members' success and performance after the end of every financial year.

Aareal Bank AG has entered into fixed-term service contracts with the members of its Management Board. Besides their fixed annual salary, Management Board members receive a performance-related remuneration that is determined using an assessment basis extending over several years.

The level of this performance-related remuneration is determined by reference to the personal performance of each Management Board member, which is measured by the degree to which targets set in advance by the Supervisory Board are achieved, based on contractually agreed initial values for a 100 % target achievement. The targets which are relevant for performance-related remuneration include annual targets and multiple-year targets. The measurement of the multiple-year target is now undertaken retrospectively over a time period of three years. The weighting of annual to multiple-year targets is fixed for each financial year, with a weighting of 45 % (annual target) to 55 % (multiple-year target) taken as a guideline. Until now, the target system envisaged a weighting of 60 % for the annual target and 40 % for the preceding three-year target period.

For each financial year, the Supervisory Board sets a target level for the Common Equity Tier 1 ratio (CET 1 ratio) as the measurement threshold in order to secure adherence of the regulatory capital adequacy and a suitable liquidity measure (Liquidity Coverage Ratio – LCR). No variable remuneration will be determined for any financial year where these two targets have not been achieved. The Supervisory Board also defines the sectional and individual targets for every member of the Management Board, for each financial year.

Annual targets and multiple-year targets are integrated into the Bank's overall strategy and are geared towards achieving the objectives set out in the Bank's business and risk strategies. The targets comprise quantitative components and qualitative components, which are also related to non-financial parameters. In this context, the Group's overall performance, the performance of the section the Management Board member is responsible for, and the individual performance contributions of the Management Board member concerned, are all taken into consideration, with a weighting of one-third for every component towards the annual target. Aareal Bank Group's overall performance is determined using the categories of consolidated operating profit/loss before taxes and risk-weighted assets.

The initial value of the performance-related remuneration may increase – depending on the Management Board member's degree of target achievement – up to a maximum of 150 % of the target value. If the overall target achievement level exceeds 150 %, the initial value of the performance-related remuneration will not increase any further (cap). If the overall target achievement level is 0 %, no performance-related remuneration will be awarded for the financial year concerned. Unconscionable behaviour or behaviour in breach of duties cannot be balanced out by positive performance contributions in other areas and will automatically lead to an appropriate reduction in the variable remuneration. The variable remuneration generally depends on the Supervisory Board's decision to provide for the applicable financial year an amount (mathematically) sufficient for all variable remuneration components to be paid out accordance with section 45 (2) sentence 1 no. 5a of the KWG and section 7 of the InstitutsVergV.

To ensure that the remuneration system provides long-term incentives, variable remuneration is awarded at the end of the financial year, according to the following principles:

20 % of the variable remuneration is paid out in cash (cash bonus) after the Supervisory Board has determined the overall target achievement level. A further 20 % of the variable remuneration is awarded as a share bonus subject to a holding period (and forms part of the share-based bonus plan), in the form of virtual shares, also after the Supervisory Board has determined the overall target achievement level. 30 % of the variable remuneration is retained (cash deferral) and disbursed in equal proportions over a three-year period. The remaining 30 % of variable remuneration is credited, as a cash amount, to a virtual account maintained on behalf of each Management Board member, and forms part of the share deferral plan.

With regard to the portion of the variable remuneration that is deferred initially as a cash deferral or a share deferral, the Supervisory Board makes a decision regarding the granting of one third of the amount, as well as the associated interest, in the three years following the determination of the performance-related remuneration (retention period). Until the end of the retention period, there is no right to the relevant remuneration components. Once the deferred remuneration components for Management Board members are vested, the cash deferral is paid out in cash and the share deferral is converted into phantom shares, subject to a two-year holding period.

In making its determination about the amount to be awarded, the Supervisory Board particularly takes into account any negative aspects of the Management Board member's performance, that of his section, as well as any weakness in the performance of Aareal Bank Group (backtesting). The existence of a negative aspect in the performance of a Management Board member is to be assumed, in particular, if serious breaches of duty and/or performance deficiencies are discovered, which lead to the performance contributions – which were initially assumed to be positive – being later shown to have not been sustained. A negative performance contribution on the part of the section within the respective Management Board member's responsibility, or of Aareal Bank Group, is to be assumed if significant assumptions which formed the basis of the calculation of the variable remuneration are later proven to be incorrect or unsustainable. The Supervisory Board may award the deferred variable remuneration components in full, partially, or not at all. If the full amount of the bonus is not awarded, the remaining sum is forfeited, i.e. it is not carried forward into subsequent years. An award of the deferred variable remuneration components will not be made insofar and for so long as the German Federal Financial Supervisory Authority ("BaFin") forbids this according to section 45 (2) sentence 1 nos. 5a and 6 of the KWG. The entitlement no longer exists if BaFin so orders by way of a final and conclusive decision pursuant to section 45 (5) sentences 5 to 8 of the KWG.

A variable remuneration component may not be vested (share deferral) or disbursed (cash deferral) if the Supervisory Board believes that the Management Board member's performance on the whole was so poor that it would make awarding performance-related remuneration inappropriate. In particular, this is to be assumed if significant breaches of the duty of care have been determined, which would give rise to an extraordinary termination of the appointment to the Management Board contract. Further, this is to be assumed if the member of the Management Board was causally and negligently actively involved in behaviour which has led to considerable losses, or for which losses the Management Board member was causally and negligently responsible.

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

Remuneration for the services of the Supervisory Board members is specified in Article 9 of the Memorandum and Articles of Association of Aareal Bank AG.

The remuneration system for the Supervisory Board only comprises a fixed remuneration, supplemented by a compensation for attending meetings. In addition, the Supervisory Board members will be reimbursed for their expenses. Where membership in the Supervisory Board falls short of an entire financial year, said remuneration shall be paid on a pro rata temporis basis. Any value-added tax invoiced will also be deemed to be a refundable expense.

The fixed remuneration is € 50,000.00 p.a. for each Supervisory Board member. The Chairman of the Supervisory Board shall receive three times this amount, while the deputy shall receive one and a half times as much as a normal member. The fixed remuneration is increased for each membership in a committee (with the exception of the Committee for Urgent Decisions, which is part of the Risk Committee). This additional fixed remuneration amounts to € 20,000 p.a. for membership of the Risk Committee and the Audit Committee; fixed remuneration is increased by € 40,000 p.a. for the chairmanship of one of these committees.

Additional fixed remuneration for membership of the other committees amounts to € 15,000 p.a.; or € 30,000 p.a. for the chairmanship of such other committee. The meeting attendance compensation amounts to € 1,000.00 for each meeting attended (except for the Committee for Urgent Decisions).

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

Please refer to the Notes to the financial statements (Remuneration Report) 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.

Explanatory Report of the Management Board on Takeover Disclosures in Accordance with Section 315 (4) of the German Commercial Code (Handelsgesetzbuch – HGB)

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

The composition of Aareal Bank AG's subscribed capital is shown in Note 60 ("Equity") to the consolidated financial statements. Each share casts one vote at a General Meeting. There are no shares with special rights granting supervisory powers to any shareholder or shareholder group. The Company currently does not hold any treasury shares, which would not be entitled to vote.

Restrictions affecting voting rights or the transfer of shares

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

Shareholdings exceeding 10 % of voting rights

Details regarding any shareholdings exceeding 10 % of voting rights are provided in Note 94 to the consolidated financial statements.

Shares with special rights granting the holder supervisory powers

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

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

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

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

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

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

Authorisation of the Management Board to issue or repurchase shares

Authorised capital

The Annual General Meeting held on 23 May 2012 resolved to authorise the Management Board to increase, on one or more occasions, the Company's share capital, subject to the approval of the Supervisory Board, by up to a maximum total amount of € 89,785,830 by issuance of new shares for contribution in cash or in kind; the Management Board is also authorised, within defined limits, to disapply pre-emptive rights, given the fulfilment of certain conditions. This authorisation will expire on 22 May 2017. When exercising this authorisation, the Management Board will restrict any exclusion of shareholders' pre-emptive rights to a total of 20 % of the Company's share capital. The authorised capital has not been utilised to date.

Conditional capital

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

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

Authorisation to purchase treasury shares

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

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

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

In addition, the Management Board was authorised to purchase treasury shares using put or call options. However, any and all share purchases involving the use of derivatives shall be limited to a maximum threshold value of 5 % of the Company's share capital. Moreover, such share purchases shall be taken into account with the 10% threshold value for the purchase of treasury shares as specified in the Annual General Meeting's resolution. Where treasury shares are acquired using equity derivatives, the shareholders' right to enter into any option transactions with the Company is excluded in analogous application of section 186 (3) sentence 4 of the AktG.

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

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

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

For details regarding compensation agreements entered into with members of the Management Board or employees in the event of a takeover bid, please refer to the Remuneration Report, which forms part of the Notes to the consolidated financial statements.

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

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Consolidated Financial Statements
Statement of Comprehensive Income

Income Statement

	Note	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015 [1]
€ mn			
Interest income		847	1.017
Positive interest from financial liabilities		3	0
Interest expenses		137	232
Negative interest from financial assets		12	4
Net interest income	27	**701**	**781**
Allowance for credit losses	28	97	128
Net interest income after allowance for credit losses		**604**	**653**
Commission income		234	204
Commission expenses		41	29
Net commission income	29	**193**	**175**
Net result on hedge accounting	30	0	8
Net trading income/expenses	31	19	13
Results from non-trading assets	32	67	-17
Results from investments accounted for using the equity method	33	0	0
Administrative expenses	34	547	553
Net other operating income/expenses	35	30	41
Negative goodwill from the acquisition of WestImmo		–	150
Operating profit		**366**	**470**
Income taxes	36	132	96
Consolidated net income		**234**	**374**
Consolidated net income attributable to non-controlling interests		19	19
Consolidated net income attributable to shareholders of Aareal Bank AG		215	355
Earnings per share (EpS)			
Consolidated net income attributable to shareholders of Aareal Bank AG [2]		215	355
of which: allocated to ordinary shareholders		199	339
of which: allocated to AT1 investors		16	16
Earnings per ordinary share (in €) [3]		3.33	5.66
Earnings per AT1 unit (in €) [4]		0.16	0.16

[1] Previous year's figures were adjusted due to separate disclosure of negative interest

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

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

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

Statement of Comprehensive Income

Reconciliation from Consolidated Net Income to Total Comprehensive Income

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Consolidated net income	**234**	**374**
Items that will not be reclassified subsequently to profit or loss		
Changes in the reserve from remeasurements of defined benefit plans	**-20**	**15**
Remeasurements	-29	22
Taxes	9	-7
Items that are reclassified subsequently to profit or loss		
Changes in revaluation surplus	**1**	**13**
Gains and losses on remeasuring AfS financial instruments	3	25
Reclassifications to the income statement	0	-6
Taxes	-2	-6
Changes in hedging reserves	**4**	**14**
Profit/loss from derivatives used to hedge future cash flows	2	21
Reclassifications to the income statement	4	–
Taxes	-2	-7
Changes in currency translation reserves	**-1**	**3**
Profit/loss from translating foreign operations‘ financial statements	-2	3
Reclassifications to the income statement	1	–
Taxes	–	–
Other comprehensive income	**-16**	**45**
Total comprehensive income	**218**	**419**
Allocation of total comprehensive income		
Total comprehensive income attributable to non-controlling interests	19	19
Total comprehensive income attributable to shareholders of Aareal Bank AG	199	400

Statement of Financial Position

€ mn	Note	31 Dec 2016	31 Dec 2015
Assets			
Cash funds	7, 37	1,786	1,282
Loans and advances to banks	8, 38	1,583	1,893
Loans and advances to customers	9, 39	31,203	34,566
Allowance for credit losses	10, 40	-554	-528
Positive market value of derivative hedging instruments	11, 41	2,481	2,498
Trading assets	12, 42	502	638
Non-trading assets	13, 43	9,730	10,507
Investments accounted for using the equity method	14, 44	0	1
Intangible assets	15, 45	126	126
Property and equipment	16, 46	252	267
Income tax assets	47	68	20
Deferred tax assets	17, 48	134	239
Other assets	18, 49	397	439
Total		**47,708**	**51,948**
Equity and liabilities			
Liabilities to banks	19, 50	1,703	1,898
Liabilities to customers	20, 51	29,077	30,360
Certificated liabilities	21, 52	8,346	10,819
Negative market value of derivative hedging instruments	11, 53	2,529	2,720
Trading liabilities	12, 54	652	663
Provisions	22, 55	680	783
Income tax liabilities	56	71	102
Deferred tax liabilities	17, 57	28	34
Other liabilities	23, 58	127	114
Subordinated liabilities	24, 59	1,366	1,411
Equity	25, 60		
Subscribed capital		180	180
Capital reserves		721	721
Retained earnings		1,734	1,633
AT1 bond		300	300
Other reserves		-48	-32
Non-controlling interests		242	242
Total equity		3,129	3,044
Total		**47,708**	**51,948**

Statement of Changes in Equity

€ mn	Subscribed capital	Capital reserves	Retained earnings	AT1 bond	Other reserves: Reserve from remeasurements of defined benefit plans	Other reserves: Revaluation surplus	Other reserves: Hedging reserves	Other reserves: Currency translation reserves	Total	Non-controlling interests	Equity
Equity as at 1 Jan 2016	**180**	**721**	**1,633**	**300**	**-80**	**28**	**13**	**7**	**2,802**	**242**	**3,044**
Total comprehensive income for the period			215		-20	1	4	-1	**199**	19	**218**
Payments to non-controlling interests										-19	**-19**
Dividends			-99						**-99**		**-99**
AT1 coupon			-16						**-16**		**-16**
Other changes			1						**1**		**1**
Equity as at 31 Dec 2016	**180**	**721**	**1,734**	**300**	**-100**	**29**	**17**	**6**	**2,887**	**242**	**3,129**

€ mn	Subscribed capital	Capital reserves	Retained earnings	AT1 bonds	Other reserves: Reserve from remeasurements of defined benefit plans	Other reserves: Revaluation surplus	Other reserves: Hedging reserves	Other reserves: Currency translation reserves	Total	Non-controlling interests	Equity
Equity as at 1 Jan 2015	**180**	**721**	**1,357**	**300**	**-95**	**15**	**-1**	**4**	**2,481**	**242**	**2,723**
Total comprehensive income for the period			355		15	13	14	3	**400**	19	**419**
Payments to non-controlling interests										-19	**-19**
Dividends			-72						**-72**		**-72**
AT1 coupon			-7						**-7**		**-7**
Other changes											
Equity as at 31 Dec 2015	**180**	**721**	**1,633**	**300**	**-80**	**28**	**13**	**7**	**2,802**	**242**	**3,044**

Statement of Cash Flows

€ mn	Cashflow 1 Jan-31 Dec 2016	Cashflow 1 Jan-31 Dec 2015
Consolidated net income	**234**	**374**
Write-downs, valuation allowances and write-ups on loans and advances	136	138
Additions to and reversals of loan loss provisions, net	-8	-2
Amortisation, depreciation, impairment and write-ups of non-current assets	38	27
Other non-cash changes	-584	131
Gains/losses on the disposal of non-current assets	-69	10
Other adjustments	-163	-376
Subtotal	**-479**	**302**
Changes in loans and advances to banks	319	1,657
Changes in loans and advances to customers	3,513	2,975
Changes in trading assets	94	112
Changes in other assets from operating activities	-154	118
Changes in liabilities to banks	-116	-1,255
Changes in liabilities to customers	-1,061	-3,085
Changes in certificated liabilities	-2,436	-1,259
Changes in trading liabilities	-55	-165
Changes in provisions	-179	-105
Changes in other liabilities from operating activities	-110	-267
Income taxes paid	-115	-66
Interest received	840	616
Interest paid	-334	-115
Dividends received	–	–
Cash flow from operating activities	**-210**	**-537**
Proceeds from the disposal of non-trading assets and investments accounted for using the equity method	971	2,602
Payments for the acquisition of non-trading assets and investments accounted for using the equity method	-168	-372
Proceeds from the disposal of property and equipment, intangible assets and investment properties	8	0
Payments for the acquisition of property and equipment, intangible assets and investment properties	-34	-35
Effect of changes in reporting entity structure	116	-337
Changes due to other investing activities	–	–
Cash flow from investing activities	**893**	**1,858**
Dividends and AT1 coupon paid	-114	-79
Changes in subordinated capital	-46	-94
Changes due to other funding activities	-19	-50
Cash flow from financing activities	**-179**	**-223**
Cash and cash equivalents as at 1 January	**1,282**	**184**
Cash flow from operating activities	-210	-537
Cash flow from investing activities	893	1,858
Cash flow from financing activities	-179	-223
Cash and cash equivalents as at 31 December	**1,786**	**1,282**

Notes
Basis of Accounting

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

As a listed public limited company, Aareal Bank AG has prepared its consolidated financial statements for the financial year ended on 31 December 2016 in accordance with International Financial Reporting Standards (IFRSs) applicable within the European Union (EU) as at the reporting date, in connection with the provisions pursuant to section 315a (1) of the German Commercial Code (Handelsgesetzbuch – "HGB"). The reporting currency is the euro (€).

The consolidated financial statements were released for publication by the Management Board on 1 March 2017, and have been deposited with the Register of Companies at the Wiesbaden District Court (Amtsgericht, HRB 13 184) and are also available from Aareal Bank AG in Wiesbaden, Germany.

Accounting Policies

(1) Accounting standards

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

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

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

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

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

Interest income and expenses are recognised using the effective interest method. It is no longer recorded if the cash inflow from interest payments is no longer deemed likely. Interest from derivatives designated for hedge accounting and economic hedging relationships is included in net interest income. Negative interest from financial assets and positive interest from financial liabilities are reported separately in the income statement. These assets and liabilities are deposits as well as money market and securities repurchase transactions.

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

Commission income and expenses are recognised either on the basis of the accounting method used for the related financial instruments, or the purpose. Commissions for services provided over a specific time period are deferred over the period in which services are performed.

Revenue received in connection with consulting projects, training, license and maintenance agreements and hosting or outsourcing services, is recorded when services have been performed or when goods or products have been delivered. The recognition of revenue from implementation services within the framework of projects is based on the percentage-of-completion method. License revenue is deemed to be realised when there is an agreement signed by both parties without a right of rescission, the product has been delivered in its entirety, the license fee is fixed, and payment is probable. Maintenance services are realised proportionately over the contractual performance period.

In the preparation of the financial statements, assets and liabilities were primarily measured using amortised cost or fair value. Which measurement method will actually be used for a particular item is defined by the applicable accounting standard. Financial instruments are accounted for in accordance with the classification and measurement principles as defined in IAS 39. Derivative hedging instruments are accounted for on the basis of the provisions for hedge accounting.

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

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

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

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

(2) Changes in accounting policies

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

- **IAS 19 Defined Benefit Plans: Employee Contribution**
  The amendments to IAS 19 include a clarification regarding the recognition of employee contributions made to defined benefit plans paid by the employees themselves for service elements. Contributions by employees or third parties reduce the ultimate costs of benefit commitments and are therefore accounted for on the basis of accounting policies for benefit commitments.

- **Annual Improvements Cycle 2010-2012**
  The Annual Improvements Cycle 2010-2012 resulted in a collection of clarifications and minor amendments to different standards. The amendment to IFRS 2 mainly consists of a clarification of the definition for ”vesting condition” by adding definitions for ”service condition” and ”performance condition” to Appendix A of the standard. The amendments to IFRS 3 related to the classification of contingent consideration as debt or equity pursuant to IFRS 3.40. According to the latest amendments, only contingent considerations transferred as part of a business combination and fulfilling the definition of a financial instrument shall be considered for classification, while the reference to ”other applicable IFRSs” was deleted. If a contingent consideration is classified as a financial liability, it shall be recognised at fair value and all resulting effects shall be recognised through profit or loss. The amendments to IFRS 8 clarified the aggregation of operating segments and the reconciliation of segments’ assets to the entity’s assets as disclosed in the statement of financial position. The amendment to IFRS 13 clarified that short-term receivables and liabilities may not be subject to discounting if the effect of not discounting

is immaterial. The amendments to IAS 16 and 38 provide clarification on the restatement of accumulated depreciation in case of a revaluation of assets. The amendment to IAS 24 broadens the definition of "related parties" to include entities (and group companies of such entities) providing key management personnel services to the reporting entity, without any other form of close relationship being in place between the two companies within the meaning of IAS 24 (so-called "management entities").

- **IFRS 11 Accounting for Acquisitions of Interests in Joint Operations**
  The amendments to IFRS 11 govern the recognition of acquisitions of interests in joint operations in which the activity constitutes a business within the meaning of IFRS 3 Business Combinations. In such cases, the acquirer has to apply the principles on business combinations accounting set out in IFRS 3. Moreover, disclosure requirements of IFRS 3 apply in these cases. In addition, the amendment clarifies that, in the context of the acquisition of additional interests, previously held interests in a joint operation are not remeasured if joint control is retained.

- **IAS 16 and IAS 38 Clarification of Acceptable Methods of Depreciation and Amortisation**
  The amendment includes guidance for determining an acceptable method of depreciation and amortisation. The amendment clarifies that depreciation of property, plant and equipment on the basis of revenue from the goods produced by such property, plant and equipment is not appropriate. In addition, rules are introduced pursuant to which future reductions in the selling price of goods and services are an indication of their economic obsolescence and, therefore, an indication for the decline of potential future economic benefits of the assets required for the production of such goods or services.

- **IAS 16 and IAS 41 Agriculture: Bearer Plants**
  In accordance with the amendments, bearer plants – such as grape vines, rubber trees and oil palms – which are used to harvest the produce of biological assets over several accounting periods, without being sold as agricultural produce, have to be accounted for in the same way as property, plant and equipment pursuant to IAS 16, since their use is similar. However, the produce growing on bearer plants continues to be accounted for in accordance with IAS 41 in future.

- **IAS 27 Equity Method in Separate Financial Statements**
  As a result of the amendment, the equity method is re-introduced as an accounting option for interests in subsidiaries, joint ventures and associates in separate financial statements of an investor. The existing options for measurement at cost or in accordance with IAS 39/IFRS 9 continue to apply.

- **Annual Improvements Cycle 2012-2014**
  The Annual Improvements Cycle 2012-2014 resulted in a collection of clarifications and minor amendments to different standards. The amendments to IFRS 5 include guidance for cases in which an entity reclassifies an asset directly from "held for sale" to "held for distribution to owners". The presentation and measurement requirements as described in IFRS 5 still apply after direct reclassification. A further amendment concerns IFRS 7, clarifying in which cases servicing contracts – where the selling entity retains any of the contractual rights or obligations inherent in the transferred financial asset – form the basis for continuing involvement within the meaning of IFRS 7. The amendments also specify that there is no explicit disclosure requirement regarding the offsetting of financial assets and liabilities in condensed interim financial statements. The amendment to IAS 19 relates to the interest rate used for discounting defined benefit pension obligations. The amendment clarifies that the depth of the market for high quality corporate bonds should be assessed "at currency level", i.e. corporate bonds from the entire euro zone should be taken into account for assessments relating to the euro

zone. The amendment to IAS 34 affects disclosures "elsewhere in the interim report". Such information may be provided directly in the respective interim report, or in other documents which shall always be subject to a cross-reference provided in the interim report.

- **Amendments to IAS 1: Disclosure Initiative**
  The amendments refer to clarifications of the concept of materiality in relation to the presentation of items in the statement of financial position, the statement of comprehensive income, the statement of cash flows and the statement of changes in equity as well as regarding the Notes. Immaterial disclosures are not required to be made. This also applies when the disclosure is explicitly required pursuant to other standards. In addition, rules for the presentation of subtotals, the systematic ordering or grouping of the Notes, as well as the disclosures of accounting policies, have been added to IAS 1, and previous requirements have been clarified. Moreover, the amendment clarifies the separate presentation of the share of investments accounted for using the equity method in other comprehensive income in the statement of comprehensive income by items that are subsequently reclassified to the income statement and those which are not reclassified to the income statement.

- **Amendments to IFRS 10, IFRS 12 and IAS 28: Investment Entities: Applying the Consolidation Exception**
  The amendments clarify a number of issues. Firstly, it is clarified that exemption from the requirement to prepare consolidated financial statements in accordance with IFRS 10.4(a) also applies to a parent company that itself is a subsidiary of another investment entity. In addition, the standard setter clarifies that an investment entity has to measure at fair value a subsidiary which itself meets the criteria of an investment entity even if the subsidiary provides investment-related services. Finally, it is clarified that a non-investment entity that includes in its consolidated financial statements an investment entity as an associate or a joint venture using the equity method, may continue to use the fair value measurement of subsidiaries applied by the associate or the joint venture.

The revised standards do not have any material consequences for the consolidated financial statements of Aareal Bank Group.

Until 31 December 2016, the following financial reporting standards (IASs/IFRSs) and interpretations (SICs and IFRICs) had been issued by the International Accounting Standards Board (IASB) and adopted by the EU Commission:

New International Financial Reporting Standards/Interpretations		Issued	Endorsed	Effective Date
IFRIC 22	Foreign Currency Transactions and Advance Consideration	December 2016		Financial years beginning on or after 1 January 2018
IFRS 15	Revenue from Contracts with Customers Effective Date of IFRS 15	May 2014 September 2015	September 2016	Financial years beginning on or after 1 January 2018
IFRS 9	Financial Instruments	July 2014	November 2016	Financial years beginning on or after 1 January 2018
IFRS 16	Leases	January 2016		Financial years beginning on or after 1 January 2019

Revised International Financial Reporting Standards		Issued	Endorsed	Effective Date
	Annual Improvements Cycle 2014-2016	December 2016		Financial years beginning on or after 1 January 2017 and 1 January 2018, respectively
IAS 40	Transfers of Investment Property	December 2016		Financial years beginning on or after 1 January 2018
IAS 12	Recognition of Deferred Tax Assets for Unrealised Losses	January 2016		Financial years beginning on or after 1 January 2017
IAS 7	Disclosure Initiative	January 2016		Financial years beginning on or after 1 January 2017
IFRS 15	Revenue from Contracts with Customers	April 2016		Financial years beginning on or after 1 January 2018
IFRS 2	Classification and Measurement of Share-based Payment Transactions	June 2016		Financial years beginning on or after 1 January 2018
IFRS 4	Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts	September 2016		First-time application, depending upon the first-time application of IFRS 9

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

- **IFRS 15 Revenue from Contracts with Customers**
  IFRS 15 governs the recognition of revenue from contracts with customers based on a uniform model. The standard supersedes the current revenue recognition provisions set out in IAS 11 and IAS 18 as well as the related interpretations. IFRS 15 has to be applied by all companies that enter into contracts with customers for the delivery of goods or the provision of services unless these contracts are within the scope of other standards. Accordingly, amongst other things, financial instruments and other contractual rights or obligations within the scope of IAS 39 or IFRS 9 are excluded from the scope of IFRS 15. The core principle of IFRS 15 for revenue recognition is that an entity has to recognise revenue when the performance obligations assumed are satisfied, i.e. when control over the goods and services has been transferred. Revenue has to be recognised in an amount that reflects the consideration that the entity expects to receive in exchange for those goods or services. IFRS 15 introduces a 5-step model based on which the amount and the timing of revenue recognition are determined. In addition, the standard requires additional disclosures, including, amongst other things, a disaggregation of total revenue, performance obligations, a reconciliation of opening and closing balances of contractual net assets and liabilities as well as significant judgements and estimates. In September 2015, the IASB published "Effective Date of IFRS 15", thus delaying the date of first-time application of IFRS 15 to financial years beginning on or after 1 January 2018. In July 2015, additional adjustments and clarifications to the standard were proposed. The changes are the result of discussions within the Transition Resource Group (TRG). The TRG is an advisory body established jointly by the IASB and the FASB addresses issues in relation to the implementation of IFRS 15. Aareal Bank Group is currently reviewing the effects of the new standard on the consolidated financial statements. Within the Group, these changes mainly affect Aareon. Aareon has analysed existing standard agreements and has largely identified the possible effects. According to this analysis, no material impact for the Group as a whole is expected.

- **IFRS 9 Financial Instruments**

  IFRS 9 Financial Instruments introduces new rules for the accounting of financial instruments, and will generally replace IAS 39 Financial Instruments: Recognition and Measurement. The development of IFRS 9 was structured in three phases: ”Classification and Measurement”, ”Impairment” and ”Hedge Accounting”. In July 2014, the final rules of IFRS 9 were published; the stated date for mandatory first-time application was 1 January 2018. The standard was endorsed on 22 November 2016.

  The classification and measurement section of the new standard sets out a new model for the classification and measurement of financial assets. Subsequent measurement of financial assets will be based in future on three categories with different measurement methods and different recognition methods related to changes in value. Apart from the measurement category ”Financial assets measured at amortised cost using the effective interest method”, there will be in future the following categories: ”Financial assets at fair value through profit or loss” as well as “Financial assets at fair value through other comprehensive income”. The classification to the measurement categories is based on the criteria of business model and cash flow characteristics of the financial assets. The structure and allocation of financial instruments to the business models is in the responsibility of the management. This allocation has to be determined by 31 December 2017. The change of the measurement category may result in unrealised gains or losses to be recognised in equity as transition effects for both securities and property loans. We expect that the major portion of the financial instruments will be allocated to the ”amortised cost” measurement category.

  There are special rules for equity instruments as there is an option to measure these either through other comprehensive income or through profit or loss. This is not expected to result in any material transition effects.

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

  The new rules for impairment (expected loss model) will replace the previous incurred loss model. The objective of this is an earlier measurement and recognition of allowances for credit losses. IFRS 9 prescribes three stages which are used to determine the amount of the allowances to be recognised and the recognition of interest. Upon initial recognition of an asset, expected losses are recognised using the present value of a 12-month expected credit loss (Stage 1). If the credit risk increases significantly, the allowance for credit losses is increased to the total amount of lifetime expected credit losses (Stage 2). If there is objective evidence of impairment in relation to a financial asset, a specific valuation allowance has to be recognised and interest revenue has to be recognised based on the net carrying amount (Stage 3). The impairment model set out in IFRS 9 has to be applied to financial assets of the categories ”Measured at amortised cost” and ”Measured at fair value through other comprehensive income” as well as to loan commitments and financial guarantees. In addition, lease receivables and trade receivables are covered by the new impairment rules. To the extent that financial instruments are measured at fair value through profit or loss, no allowance for credit losses is recognised for such financial instruments.

  Portfolio-based allowances for credit losses are already recognised within the Group. Calculation under IFRS 9 continues to be on the basis of a 12-month loss so that we do not expect any material transition effects for Stage 1.

In Stage 2, we expect additions to allowances due to the recognition of an allowance for expected losses over the entire remaining term to be recognised in equity as at the date of transition. The amount depends on the determination of criteria as to when a significant increase of the default risk has occurred.

Specific allowances for credit losses pursuant to IAS 39 are recognised where estimated future cash flows fall below the carrying amount of a loan receivable. This methodology will generally still be used in Stage 3 pursuant to IFRS 9 so that, other things being equal, only minor transition effects are expected.

The third phase of IFRS 9 introduced new rules for hedge accounting. The standard simplifies the hedge accounting rules by establishing a closer relationship between the entity's risk management strategy, the reasons for entering into hedging instruments and the recognition of hedging relationships in the entity's financial statements. In future, non-financial items may also be recognised under hedge accounting rules, and single risk components may be designated for hedge accounting to a larger extent. Generally, groups and net positions will be eligible for hedge accounting. A voluntary discontinuation of hedge accounting – so-called de-designation – is no longer permitted under the new regulations. Hedging relationships may only be discontinued when the objective of risk management has been changed. In contrast, the new IFRS 9 allows for an adjustment of hedging relationships if this is necessary (rebalancing). The requirements regarding effectiveness have been simplified: only qualitative assessments of effectiveness and prospective effectiveness tests have to be performed. Due to the separation of the macro hedge accounting project from IFRS 9 and its postponement, the application of the new hedge accounting rules in IFRS 9, for the time being, allows for the continued application of special rules for fair value hedge accounting for portfolio hedges of interest rate risks in IAS 39. The Group does not currently use this option.

The Group intends to use the simplifications under micro hedge accounting. This is not expected to result in any material transition effects.

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

Measures were initiated to ensure a timely implementation of IFRS 9 and to review the effects and strategic implications of IFRS 9. It is planned to implement the technical and process requirements until the third quarter of 2017. In addition, impact analyses for the management are prepared so that major decisions may be made until 31 December 2017. This includes, among other things, the structure and allocation of financial instruments to the business models and the determination whether and when the default risk is significantly increased. The allocation also influences the future earnings volatility. To the extent that negative transition effects are expected, these are taken into account by means of buffers within the scope of equity planning.

- **IFRS 16: Leases**
  The new financial reporting standard IFRS 16, regarding lease accounting, will replace IAS 17 as well as the related interpretations IFRIC 4, SIC 15 and SIC 7. IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise (in the statement of financial position) any leases and the related contractual rights and obligations with a term of more than twelve months, unless the under-

lying asset is of low value. The lessee recognises a right-of-use asset (representing its right to use the underlying leased asset) and also a lease liability (representing its obligation to make lease payments). Similar to the previous rules set out in IAS 17, the lessor continues to classify its leases as finance or operating leases. The criteria for classification under IFRS 16 equal those of IAS 17. In addition, IFRS 16 sets outs a number of further rules for presentation, disclosures in the Notes and sale-and-lease-back transactions.

- **Annual Improvements Cycle 2014-2016**
  Within the scope of the Annual Improvements Cycles, the IASB publishes clarifications and minor changes to various existing standards.

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

- **Amendments to IAS 12: Recognition of Deferred Tax Assets for Unrealised Losses**
  The amendment to IAS 12 clarifies that an impairment of a debt instrument measured at fair value, resulting from changes in market interest rates, leads to deductible temporary differences. The IASB also clarifies that an entity has to assess – for all of its deductible temporary differences – whether taxable profits are expected to be available in future, in order to utilise and recognise these. Only if and to the extent that tax laws make a distinction between different types of taxable profits, these different types have to be assessed separately. Moreover, IAS 12 introduces rules and examples which clarify how future taxable income has to be determined for the recognition of deferred tax assets.

- **Amendments to IAS 7: Disclosure Initiative**
  Within the scope of the disclosure initiative, amendments to IAS 7 Statement of Cash Flows were issued. The objective is to improve information about changes in an entity's liabilities. In future, an entity will have to provide disclosures about the changes in financial liabilities whose cash receipts and cash payments are reported in the statement of cash flows as cash flows from financing activities. The related financial assets also have to be disclosed (e.g. assets from hedging transactions). The IASB suggests presenting the disclosures in the form of reconciliation between the opening and closing balances in the statement of financial position, but also permits other forms of presentations.

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

- **Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions**
  In June 2016, the IASB issued amendments to IFRS 2 that clarify classification and measurement

of share-based payment transactions. The amendments relate to the following areas: (i) accounting for cash-settled share-based payment transactions that include a performance condition, (ii) the classification of share-based payment transactions with a settlement feature for withholding tax obligations and (iii) accounting for modifications of share-based payment transactions that change the classification from "cash-settled" to "equity-settled".

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

Aareal Bank Group did not opt for early application of these standards in 2016, which are required to be applied in future financial years.

Aareal Bank Group is currently reviewing the effects of the application of the new and amended financial reporting standards on the consolidated financial statements.

(3) Consolidation

Consolidation principles

The consolidated financial statements of Aareal Bank Group include all subsidiaries which are controlled directly or indirectly by Aareal Bank AG. Aareal Bank controls an investee when it has the power to direct the investee's relevant activities, has an exposure or rights to variable returns from its involvement with the investee and has the ability to use its power over the investee to affect the amount of such returns. If control is exercised via voting rights, Aareal Bank assumes that a parent-subsidiary relationship exists if more than half of the voting rights are held directly or indirectly. In cases where voting rights are not conclusive in determining control relationships, other factors are used to assess whether Aareal Bank Group has the power over the company. For this purpose, an assessment is made of the following: purpose and design of an investee, what are the relevant activities of the company, what is the decision-making process in relation to these relevant activities and whether Aareal Bank, by virtue of its rights, currently has the ability to direct these relevant activities. In addition, we assess whether Aareal Bank Group exercises control as principal or as agent or whether a third party acts as agent for the Group. If the assessment shows that Aareal Bank has the sole power over an investee and additionally has the ability to use its power over the investee to affect the amount of the investor's returns, the investee is included in the consolidated financial statements. Currently, all subsidiaries included in the reporting entity structure of Aareal Bank are controlled through a majority of voting rights.

Consolidation of a subsidiary begins from the date the Group obtains control (full consolidation). Subsidiaries are deconsolidated when there is no longer the ability to exercise control.

Any non-controlling interests resulting from full consolidation are shown in the statement of financial position, as a separate item of equity. Further information is included in Note (60) "Equity".

Initial 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 statement of financial position of the company to be consolidated. Any excess of acquisition cost over the Group's interest in the fair value of net assets is recognised as (positive) goodwill. Any negative goodwill determined during this comparison is charged against income.

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

Joint Arrangements are defined as contractual arrangements where two or more parties carry out business activities that are subject to joint control. Joint control only exists when the decisions about the relevant activities require unanimous consent of the parties sharing control. In general, a distinction is made between joint operations and joint ventures. The parties to a joint operation that have joint control have the rights to the assets, and the obligations for the liabilities, relating to the arrangement. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Interests in joint ventures are measured using the equity method.

Associates are companies in which the Group has an equity interest and may exercise significant influence, without having control. Significant influence is deemed to exist when an investor holds 20%-50% of the voting rights of a company. Associates are also measured using the equity method.

In accordance with the equity method, the Group's share in the profit or loss of associates and joint ventures is recognised in the consolidated income statement from the date of acquisition and is included in the carrying amount of the equity investment, taking into account interim distributions. Further information on investments accounted for using the equity method is included in Note (44).

Associates and joint ventures are no longer accounted for using the equity method from the date when Aareal Bank loses significant influence over the company or when joint control ends.

As at the reporting date, Aareal Bank was not exposed to material limitations as regards the access to, or use of, assets of the Group and as regards the liabilities of the Group.

Reporting entity structure

As at 31 December 2016, the reporting entity structure comprised 67 companies (2015: 82), including Aareal Bank AG as well as 62 (2015: 72) subsidiaries, one joint arrangement (2015: two) as well as three associates (2015: seven).

Apart from the disposal of all shares in Aareal Bank's wholly-owned subsidiary Aqvatrium and the addition of Aareal Holding Realty and its three special purpose entities, there were no other material changes to the scope of consolidation during the period under review.

Note 99 "List of Shareholdings" includes an overview of the Group companies.

(4) Currency translation

Individual line items in the financial statements of each Group entity are measured on the basis of the currency of the primary economic environment the respective entity operates in ("functional currency"). The consolidated financial statements are prepared in euro, being both the functional and the reporting currency.

Monetary assets and liabilities denominated in a foreign currency, unsettled cash market/spot transactions and non-monetary items measured at fair value are all translated to the functional currency on the basis of the ECB reference rate prevailing on the balance sheet date. Non-monetary items measured at amortised cost are translated using historical rates. Foreign exchange forward transactions are measured at the forward exchange rate prevailing on the balance sheet date.

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

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

(5) Determination of fair value

The determination of fair value is governed by IFRS 13 and applies to financial instruments and non-financial assets or liabilities. In accordance with IFRS 13.9, the fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The determination of the fair value is based on the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. Another factor to be taken into account is whether Aareal Bank can enter into a transaction for the relevant asset or liability at the price in that market at the measurement date. The principal market is the market with the greatest volume and the highest level of activity for the asset or liability to which Aareal Bank has access. In the absence of a principal market for the financial instrument, the most advantageous market is used to determine the fair value. The most advantageous market is the market that maximises the amount that would be received to sell the asset, or minimises the amount that would be paid to transfer the liability.

In accordance with IFRS 13.72 et seqq., the fair value determination is based on the fair value hierarchy pursuant to which the inputs used are classified into various hierarchy levels on the basis of their respective market proximity and objectivity. The fair value of assets and liabilities is allocated to Level 1 of the fair value hierarchy if it is determined on the basis of unadjusted quoted prices in active markets for identical assets or liabilities. Fair values determined using inputs other than quoted prices included within Level 1 that are observable for the financial instrument, either directly or indirectly, are included in Level 2 of the fair value hierarchy. Fair values determined using valuation techniques where one or more material inputs are not based on observable market data are assigned to Level 3 of the fair value hierarchy. The estimation uncertainties as regards fair value measurement increase the higher the level is.

As a rule, the transaction price equals the fair value at initial recognition. In contrast, there can be differences between the initial fair value determined using a valuation technique and the transaction price. These so-called day-one gains or losses may only be recognised immediately when all the inputs on which the valuation parameters are based are observable in the market. Otherwise, the difference has to be amortised through profit or loss over the term of the transaction. Adjustments for specific counterparty risks (CVA and DVA) are not taken into account for the determination of the present value of derivatives at Aareal Bank, as they are deemed immaterial. Since the derivatives are part of highly effective collateral agreements (Credit Support Annex to the ISDA Master Agreement and Collateral Annex to the German Master Agreement on Financial Derivatives Transactions) which are each subject to a master collateralisation agreement, measurement adjustments to reflect any potential counterparty credit risk or own credit risk are not required. The Bank uses the overnight interest rate swap curve (OIS curve) for the measurement of derivatives secured by cash collateral, and has also used this curve for currency swaps during the year under review The transition effect of this change in estimates, which was applied prospectively, was immaterial.

(6) Recognition and measurement of financial instruments

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

Recognition

Financial instruments (including derivative financial instruments) must be recognised if the reporting entity has become a party to the contractual provisions of such financial instruments. Trade date and settlement date are not the same for regular way purchases and sales of financial assets. Such regular way purchases and sales may be accounted for either at trade date or at settlement date. At Aareal Bank Group, financial instruments classified as held for trading are recognised at the trade date, while all other financial instruments are recognised at the settlement date.

Financial assets are derecognised upon final maturity or when substantially all risks or rewards are transferred, or control over the contractual rights from such assets are transferred. If only a portion of risks and rewards is transferred and a portion of control is retained, the financial asset is recognised only to the extent of its continuing involvement. The extent of the continuing involvement corresponds to the extent to which the Company is exposed to changes in the value of the financial asset. A financial liability is derecognised when it is extinguished, i.e. when the obligation specified in the contract is discharged.

Measurement

In accordance with IAS 39, financial instruments are measured at fair value at initial recognition. Generally, fair value equals the transaction price at initial recognition, i.e. the amount of the consideration received (see Note (5) "Determination of fair value"). Transaction costs that are directly attributable to the acquisition or issuance are recorded as incidental purchase costs, unless financial instruments are measured at fair value through profit or loss. All financial assets and financial liabilities have to be allocated to one of the measurement categories at initial recognition pursuant to IAS 39. Subsequent measurement is based on the measurement category to which the financial instruments were allocated.

Measurement categories in accordance with IAS 39

Loans and receivables (LaR)

The "Loans and receivables" category used within Aareal Bank Group comprises non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market. A financial instrument is deemed quoted on an active market when quoted prices are readily and regularly available and these prices represent actual and regular market transactions. Financial instruments classified as loans and receivables are measured subsequently at amortised cost. Premiums and discounts are amortised over their term using relevant effective interest rates.

Assets of the category "Loans and receivables" are reviewed as at each balance sheet date as to whether there is objective evidence for impairment. The criteria for reviewing property loans for impairment are strong indications for a decline of the borrower's credit quality, arrears with respect to the loan receivable, as well as further indications that not all interest and principal payments can be made as contractually agreed. In this context, meeting one of the criteria is sufficient for a review of objective evidence for impairment. An impairment has occurred if the present value of the estimated future cash flows is below the carrying amount of a receivable. The amount of the impairment loss incurred for a financial asset of the category "Loans and receivables" is determined as being the difference between the carrying amount of the asset and the present value of the expected future cash flows, discounted using the original effective interest rate applicable upon first-time recognition (taking into account the marketability of collateral provided). Collateral is largely provided in the form of land charges or mortgages; these are measured at fair value which is generally based on either the income capitalisation approach, or on the discounted cash flow method plus back-testing. If the asset is subject to variable interest, the current contractually agreed reference interest rate has to be used as the discount rate. The impairment is recognised in the income statement. Where reasons for impairment lapse subsequently, the necessary reversals of impairments (write-backs) are generally recognised in income. The carrying amount after the reversal of an impairment loss may not exceed the asset's (amortised) cost.

In the context of assets measured at amortised cost and not subject to specific allowances for credit losses, portfolio-based allowances for credit losses are recognised for risks which have already materialised, but which cannot be allocated to individual loans and advances due to lack of knowledge. For this purpose, groups of financial assets with comparable default risk profiles are combined in portfolios. The valuation allowances are calculated using a formula-based procedure based on the following Basel III parameters used in the Advanced IRB Approach: expected loss given default (LGD), probability of default (PD) and the LIP factor. The LIP factor is a correction factor to adjust the one-year probability of default (used in Basel III) to the estimated time period, between the date the loss is incurred and the identification of the actual loss. The LIP factor is subject to backtesting and was 1 for all exposure classes in the year under review.

Assets where contractual modifications have been made due to financial difficulties on the part of the counterparty are tested for impairment and continuously monitored. The counterparty's financial difficulties and the change in the credit quality also affect the level of the probability of default for the contracting party. This is taken into account in the amount of the portfolio-based valuation allowance, to the extent that an impairment has not yet been recorded. Concessions made to a counterparty due to financial difficulties are actions that may be initiated within the lending business to secure repayment of the receivable. Above all, such concessions comprise temporary suspension of redemption payments, adjustment of contractual interest rates and prolongation of the credit term. Such contractual modifications are not used in the other business units of Aareal Bank.

Held to maturity (HtM)
Financial instruments allocated to the category "Held to maturity" within Aareal Bank Group are non-derivative financial assets with fixed or determinable payments and fixed maturity, and for which the Bank has the positive intention and ability to hold these financial instruments to maturity. Financial instruments classified as held-to-maturity instruments are measured subsequently at amortised cost. Premiums and discounts are amortised over their term using relevant effective interest rates. The rules for determining any impairment correspond to those used for the category "Loans and receivables".

Financial assets or liabilities at fair value through profit or loss (FVtPL)
A further differentiation is made within the category "Financial assets at fair value through profit or loss" into 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 with the intention of generating a short-term profit, 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). In the past, Aareal Bank Group has used the fair value option for certain structured financial instruments that comprise one or more embedded derivatives. The fair value option has only been exercised with respect to the measurement of financial assets, but not to the measurement of financial liabilities.

Financial instruments allocated to the measurement category "Financial assets or financial liabilities at fair value through profit or loss" are measured subsequently at fair value through profit or loss (see Note (5) "Determination of fair value").

Available for sale (AfS)
The "Available for sale" category used at Aareal Bank Group comprises all financial assets which cannot be classified under any of the preceding categories, or that are held for an unspecified period of time and may be sold if there is a need of liquidity or market conditions have changed. They are measured subsequently at fair value through other comprehensive income (see Note (5) for information on the determination of fair value).

Aareal Bank Group reviews at any balance sheet date whether there is objective evidence of impairment for financial assets of the AfS category. 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 "BB+ or worse", arrears with respect to interest and principal payments, the discontinuance of an active market for bonds of a particular issuer due to significant financial difficulties of such issuer or an increased likelihood of the issuer'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 has been below the average acquisition costs for more than one year. If an impairment of a financial asset of the "Available for sale" category has been identified, the amount of the impairment is calculated as the difference between the asset's (amortised) cost and its current fair value. In the event of such impairment, 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 of the impairment loss (up to amortised cost) is recognised in income 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.

Financial liabilities measured at amortised cost (LaC)

At Aareal Bank Group, 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 so allocated are measured subsequently at amortised cost. Premiums and discounts are amortised over their term using relevant effective interest rates.

Determination of the fair value of financial instruments

Aareal Bank Group determines the fair value of financial instruments based on the hierarchy used for the determination of the fair value.

The existence of observable quoted prices 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 Bank shall rely on transaction prices applicable shortly before the reporting date.

Exchange-traded financial instruments (such as equities, bonds, or other debt securities) as well as exchange-traded derivatives 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, the Bank uses validated valuation models for pricing financial instruments. Pricing using validated 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, if applicable.

Financial instruments are measured within Aareal Bank Group by units which are independent from Trading. These units are responsible for controlling and monitoring the relevant valuation processes. Measurement procedures are reviewed on a regular basis as to their applicability on the various different financial instruments. The pricing data and parameters used in the valuation models are critically reviewed and developed on an ongoing basis. Current market developments are continuously monitored; if necessary, valuation adjustments are made.

Structured products

Structured products involve a derivative which is embedded in a non-derivative financial instrument. In accordance with IAS 39, the embedded derivative has to be recognised separately from the non-derivative financial instrument if certain criteria are met. If the separation requirement as set out in IAS 39.11 applies, the host contract is accounted in line with the rules applicable for the relevant measurement category, while the separated derivative is accounted for separately as part of the trading portfolio. If the separation criteria are not met, the hybrid financial instrument is measured in its entirety based on the rules for the measurement category to which the financial instrument was allocated.

Hedging relationships

Aareal Bank Group uses hedge accounting to hedge risks from changes in the fair value or the cash flows associated with non-trading items. In this context, the risks from hedged items are intended to be hedged by entering into hedging instruments where the fair value changes or the changes in the cash flows have the opposite direction as those of the hedged item. IAS 39 sets out different types of hedging relationships.

The purpose of a fair value hedge is to hedge the fair value changes of hedged items. The derivatives used for hedging are accounted for at fair value through profit or loss. The offsetting fair value changes of the hedged item resulting from the hedged risk are also recognised through profit or loss. The proportion of the fair value changes of the hedged item not attributable to the hedged risk is accounted for in line with the classification of the hedged item. A fully effective hedging relationship results in offsetting measurement results. The hedging relationship may result in adjustments in the carrying amount of the underlying transaction. Such adjustments will only be recognised in income at the end of the transaction term.

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

Hedges of a net investment in a foreign operation are used to hedge currency risks arising on the translation of the net assets of foreign Group companies. The effective portion of measurement gains or losses from the hedging instruments is recognised directly in equity in the currency translation reserve. The ineffective portion of the hedging instrument’s fair value changes have to be recognised in the income statement. The gain or loss on the hedging instrument relating to the effective portion of the hedge that has been recognised directly in equity shall be recognised in profit or loss on disposal of the foreign operation. Any translation differences resulting from the translation of an entity with a different functional currency into the Group currency also have to be recognised directly in equity in the currency translation reserve; they will be reclassified to the income statement upon disposal of the foreign operation.

(7) Cash funds

Cash funds include cash on hand and balances with central banks. Cash funds are allocated to the measurement category ”Loans and receivables” (LaR).

(8) Loans and advances to banks

Loans and advances to banks consist of money market receivables, promissory note loans and other loans and advances to banks, including deferred interest. Loans and advances to banks are allocated to the measurement category "Loans and receivables" (LaR).

(9) Loans and advances to customers

Loans and advances to customers comprise property loans, money market receivables, promissory note loans and other loans and advances to customers, including deferred interest. Loans and advances to customers are allocated to the measurement category "Loans and receivables" (LaR).

(10) Allowance for credit losses

The allowance for credit losses includes specific valuation allowances, flat-rate specific valuation allowances and portfolio-based valuation allowances recorded for risks associated with recognised items.

Specific allowances for credit losses are recognised for significant exposures where estimated future cash flows fall below the carrying amount of a loan receivable. This is reviewed if there is objective evidence that not all interest and principal payments will 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 original effective interest rate. Collateral is largely provided in the form of land charges or mortgages and measured at fair value based on rents agreed, or on prevailing market rents and management costs specific to the property. As a rule, fair value is determined using 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. Time for reletting as well as structural vacancies are taken into account as appropriate. Valuation is based on estimates prepared by in-house or external valuers. It is subject to several uncertainties and often requires significant estimates made by the management in relation to various factors such as local economic conditions, financial position and development of the counterparty, and the value of collateral held for which there is no easily accessible market.

Flat-rate specific allowances for credit losses are recognised for insignificant exposures. If there is objective evidence for an impairment of such exposures, an impairment amount is determined for homogenous groups of exposures on the basis of mathematical-statistical parameters in the calculation of the expected loss.

In the context of assets measured at amortised cost and not subject to specific valuation allowances, portfolio-based valuation allowances are recognised for risks which have already materialised, but which cannot be allocated to individual loans and advances due to lack of knowledge. For this purpose, groups of financial assets with comparable default risk profiles are combined in portfolios. The valuation allowances are calculated using a formula-based procedure based on the following Basel III parameters used in the Advanced IRB Approach: expected loss given default (LGD), probability of default (PD) and the LIP factor. The LIP factor is a correction factor to adjust the one-year probability of default (used in Basel III) to the estimated time period, between the date the loss is incurred and the identification of the actual loss. The LIP factor, which is subject to back-testing, was 1 for all asset classes during the year under review. The formula-based procedures are also subject to various assumptions and estimates.

Recognition and release of allowances for credit losses are directly reflected in income. The balance of allowances for credit losses is shown in an allowance account, separately from the related exposures. The increase of the present value over time of an impaired loan or advance (so-called unwinding) leads to a corresponding change of the allowance account, which 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 provisions recognised previously, or written off directly. Payments on loans previously written off are recognised in income.

(11) Positive market value of derivative hedging instruments / Negative market value of derivative hedging instruments

The items "Positive market value of derivative hedging instruments" and "Negative market value of derivative hedging instruments" include derivatives with positive or negative market values from fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation, including deferred interest.

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 exposures.

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, i.e. at each reporting date.

Hedge accounting is based on clean fair values.

A distinction is made for derivatives used as hedging instruments whether these are part of a fair value hedge, a cash flow hedge or a hedge of a net investment in a foreign operation (see Note 6 for information on hedging relationships).

(12) Trading assets and trading liabilities

Trading assets and liabilities of Aareal Bank Group comprise positive and negative market values of derivative financial instruments which are not part of recognised hedging relationships. They are mainly used to hedge economic market price risks. The derivatives are classified under the measurement category "At fair value through profit or loss". Results from the measurement and the termination of the derivatives are reported in net trading income. Interest received or paid in connection with these derivatives is also recorded generally in net trading income. Interest received or paid for derivatives entered into for hedging purposes which, however, do not meet the formal criteria of hedge accounting is reported in net interest income, together with interest from the hedged items. Effects from the measurement of these derivatives are reported in net trading income, together with the effects from the measurement of the hedged risk.

(13) Non-trading assets

Non-trading assets include securities in the form of bonds and other fixed-income securities as well as equities and other non-fixed income securities. 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 non-trading assets are recognised at cost, plus attributable transaction costs.

Debt and other fixed-income securities reported in non-trading assets are allocated to the measurement categories ”Available for sale” (AfS), ”Loans and receivables” (LaR) and ”Held to maturity” (HtM). Equities and other non-fixed income securities as well as equity investments are classified as ”Available for sale” or ”Designated as at fair value through profit or loss” (dFVtPL).

Premiums and discounts are amortised over the term of the respective asset. Interest and dividends from these assets are reported in net interest income.

(14) Investments accounted for using the equity method

Investments accounted for using the equity method include shares in companies where Aareal Bank Group can exercise significant influence (associates) as well as shares in joint ventures.

Investments in associates included in this item are recognised at cost when the significant influence arises, and subsequently carried at amortised cost whereby, in particular, the share of results of operations of any financial year is recognised in income.

The equity method applied to the major associates was based on the most recent available financial statements prepared under local GAAP.

(15) Intangible assets

The item ”Intangible assets” consists of proprietary software, goodwill and other intangible assets such as purchased software and licenses.

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

Research costs incurred in connection with software development are expensed as they are incurred. Development costs are capitalised from the time when the software development can be regarded as completed from a technical perspective, and several other conditions are fulfilled. Borrowing costs directly attributable to software development are also part of the cost. They are amortised on a straight-line basis, using an estimated economic life of ten years. Purchased software is also deemed to have a limited useful life. The procedure followed for the determination of amortisation of purchased software is the same as the procedure used for proprietary software. Amortisation is recognised in administrative expenses.

Goodwill is defined as the excess of the cost of acquisition over the fair value of the Group’s interest in the net assets of an acquired entity, at the time of acquisition (positive difference). Goodwill is carried at historical cost less accumulated impairments. Any negative goodwill (badwill) arising upon acquisition is immediately charged against income.

In case the annual impairment test shows that there are indications of impairment of intangible assets (as set out in IAS 36) and that the recoverable amount is lower than the carrying amount of the asset concerned, the asset is written down through profit or loss, to the estimated recoverable amount.

If it is impossible to estimate the recoverable amount for a specific asset, the recoverable amount of the cash-generating unit that the asset belongs to must be determined. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Aareal Bank Group defines cash-generating units either on the basis of a single subsidiary or on product level. The recoverable amount of an asset or a cash-generating unit is the higher of fair value less costs to sell and value in use. (Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset or cash-generating unit.) Future cash flows are determined based on medium-term projections. The present value of the future cash flows is determined using discount factors which are in line with the risks involved. Accordingly, the recognition of intangible assets and the impairment test is also subject to estimation uncertainties.

(16) Property and equipment

Property and equipment includes owner-occupied land and buildings, office furniture and equipment as well as a hotel which is operated by Aareal Bank. Property and equipment is measured at cost, less accumulated depreciation and impairment losses. Depreciation and impairment losses are reported under administrative expenses, while those of the owner-operated hotel are shown in net other operating income / expenses.

Owner-occupied buildings reported under property and equipment are depreciated on a straight-line basis, over a period of 25 to 50 years. Owner-occupied land is not depreciated. Please refer to the explanations in the Notes on other assets for the accounting method to be applied for land and buildings which are not owner-occupied. Office furniture and equipment items are depreciated using the straight-line method, applying the following periods:

	Depreciation period
Other property and equipment	
IT equipment	3-7 years
Other office furniture and equipment	5-13 years

Tenant improvements are depreciated based on the principles applicable for the relevant building.

For details on recognising impairments as defined in IAS 36, please refer to the explanations in 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 to purchase property and equipment in the amount of up to € 150.00 (low-value assets) are expensed as they are incurred.

Any items of property and equipment with a cost of more than € 150.00, but not exceeding € 1,000.00, 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 tax assets/Deferred tax liabilities

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

Deferred tax assets are recognised when they are deemed recoverable. The recoverability is assessed using tax planning (internal assessment) on the basis of medium-term Group planning. Accordingly, deferred tax assets are only recognised to the extent that we deem it probable that future taxable profits will be available against which the temporary differences and tax loss carryforwards can be utilised. Deferred taxes are calculated on the basis of country- and company-specific tax rates expected to apply at the time of the realisation of temporary differences and set-off against loss carryforwards.

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

(18) Other assets

The item "Other assets" includes properties, trade receivables and miscellaneous assets. Properties reported under other assets are intended for short-term disposal, though the IFRS 5 criteria are not met. They are measured at the lower of cost or net realisable value, in accordance with IAS 2, and therefore are subject to estimation uncertainties. Trade receivables are allocated to the measurement category "Loans and receivables" (LaR).

(19) Liabilities to banks

The item "Liabilities to banks" comprises money market liabilities, registered mortgage Pfandbriefe, registered public sector Pfandbriefe, promissory note loans and other liabilities to banks, including deferred interest. Liabilities to banks are allocated to the measurement category "Liabilities measured at amortised cost" (LaC).

(20) Liabilities to customers

The item "Liabilities to customers" comprises money market liabilities, registered mortgage Pfandbriefe, registered public sector Pfandbriefe, promissory note loans and other liabilities to customers, including deferred interest. Liabilities to customers are allocated to the measurement category "Liabilities measured at amortised cost" (LaC).

(21) Certificated liabilities

The item ”Certificated liabilities” includes bearer mortgage Pfandbriefe, bearer public sector Pfandbriefe and other bonds, including deferred interest. Certificated liabilities are allocated to the measurement category ”Liabilities measured at amortised cost” (LaC).

(22) Provisions

The item ”Provisions” comprises provisions for pensions and similar obligations, provisions for staff expenses and non-staff operating costs, provisions for risks related to unrecognised items in the lending business, provisions for legal or tax risks, as well as other provisions. Provisions are recognised when there is a present legal or constructive obligation towards third parties arising from a past event, the outflow of resources to meet this obligation is probable and the amount of the obligation can be reliably estimated. Provisions, including uncertain tax positions, are measured on the basis of the best estimate of expenditure (the most probable value) required to settle the obligation, in accordance with IAS 37.36. In the context of acquisitions in accordance with IFRS 3, contingent liabilities, including uncertain tax obligations, were also recognised at their expected value. These are released when the reasons for their recognition cease to exist.

Measurement is subject to several uncertainties and often requires significant estimates made by the management in relation to various factors that may not apply subsequently. The final amount of the liabilities may deviate significantly from the measurement previously made in accounting. For example, the outcome of individual legal proceedings may not be predicted with certainty.

If utilisation in the short term, i.e. within twelve months, from the obligation is not expected, the provision will be recognised at present value.

Provisions for pensions and similar obligations

Aareal Bank Group maintains various pension plans as defined in IAS 19. For the purpose of reporting pension obligations, IAS 19 makes a distinction between defined contribution plans and defined benefit plans.

Under defined contribution plans, an enterprise pays fixed contributions into a separate entity or a fund and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. Contributions paid to the statutory pension insurance scheme are also classified as defined contribution plans. The contributions paid to a defined contribution plan are recorded as staff expenses.

Defined benefit obligations are all pension obligations that do not meet the criteria of a defined contribution obligation. The amount of obligations usually depends on one or several factors, including age, length of service, and salary.

The Group’s obligations under defined benefit plans are recognised as a provision in the consolidated statement of financial position. These are based on company agreements on an employee pension scheme, individual agreements with executive staff as well as individual agreements concluded with the members of the Company’s senior management. Projected economic and demographic developments as well as salary trends must be applied to the calculation of the provisions. Calculating the amount of provisions in the Group is based on actuarial opinions which are prepared by external actuaries on the basis of Aareal Bank-specific and Group-wide standardised parameters.

Provisions for pensions and similar obligations under defined benefit plans are determined in accordance with IAS 19 on the basis of the projected unit credit method; the various defined benefit plans are measured separately. The fair value of the plan assets is deducted from the present value of the pension obligation, taking into account, if applicable, the rules for the asset ceiling in relation to a surplus of plan assets over the benefit obligation. The resulting amount represents the net defined benefit liability (provision) or the net defined benefit asset. The net interest expense in the financial year is determined by applying the discount factor calculated at the beginning of the financial year to the net liability calculated as at that date. The discount rate used to determine the present value of the obligation is based on the capital market rate of high quality corporate bonds at the reporting date. Determination is based on the Global-Rate:Link method by Willis Towers Watson. The data basis consists of corporate bonds recorded by Bloomberg which have a rating of at least "AA" and are denominated in the same currency as the underlying pension obligation. Actuarial gains and losses (remeasurements), which – in connection of the amount of obligations – arise on changes in expectations regarding life expectancy, pension increases, salary development, discount rate compared to the estimation made at the beginning of the period or compared to the actual trend during the period, are recorded in other comprehensive income in the item "Changes in the reserve from remeasurements of defined benefit plans". Actuarial gains and losses (remeasurements) recorded in other comprehensive income may not be reclassified subsequently to profit or loss (recycling). Differences between the expected return on plan assets, determined at the beginning of the period using the then applicable discount rate, and the actual return on plan assets (remeasurement) at the end of the period are also recognised in other comprehensive income. Actuarial gains and losses as well as the difference between expected and actual return on plan assets are included in other reserves. They are reported separately in the statement of changes in equity. Accordingly, the recognition of pension obligations is also subject to estimation uncertainties.

Share-based payment

Aareal Bank Group maintains share-based payment plans subject to cash settlement in accordance with IFRS 2. We refer to the remuneration report as part of the Notes to the consolidated financial statements, which includes a detailed description of the plans and their scope as well as information on the valuation model applied and the effects of share-based payments on the Group's financial position and performance.

Provisions for obligations arising from share-based remuneration plans have been recognised under administrative expenses, in the amount of the fair value of the relevant obligation at the reporting date.

(23) Other liabilities

Other liabilities include, among other items, liabilities from outstanding invoices, trade payables, as well as liabilities from other taxes.

(24) Subordinated capital

The item ”Subordinated capital” consists of subordinated liabilities, profit-participation certificates and contributions by silent partners. Subordinated funds raised do not provide for any early repayment obligation. In the event of liquidation or insolvency, claims on interest and principal from these liabilities are subordinated to the claims of all other creditors, which are not subordinated themselves. Pursuant to the terms and conditions of issue, holders of profit-participation certificates have a claim on interest payments which takes precedence over the profit entitlements of shareholders. To the extent that a distribution would cause a net loss, said interest claim would be reduced, possibly down to zero, creating a claim for backpayment during the term of the certificates at the same time. Repayment takes place at the nominal amount (subject to any loss sharing), on the day after the Annual General Meeting passing resolutions regarding the relevant financial year. The profit-participation certificates evidence creditors' rights; they do not grant any share in the liquidation proceeds.

Items of subordinated capital are allocated to the measurement category ”Liabilities measured at amortised cost” (LaC).

(25) Equity

Equity comprises subscribed capital, capital reserves, retained earnings and other reserves. Other reserves include the reserve from remeasurements of defined benefit plans, the revaluation surplus, hedging reserves and currency translation reserves. In addition, the item ”Equity” includes non-controlling interests as well as the so-called Additional Tier 1 bond (AT1 bond). The AT1 bond is classified as equity since there is neither an obligation to repay the bond nor is there an obligation for ongoing debt service (payment of a dividend). The transaction costs directly attributable to the issue of the AT1 bond as well as dividends paid are deducted directly from equity, net of taxes.

(26) Financial guarantee contracts

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when due. A guarantor recognises a financial guarantee contract as a liability at the date of addition, using the fair value of the guarantee obligation. The obligation is subsequently measured at the greater of a provision recorded in accordance with IAS 37 and the original amount, less any accumulated amortisation. Within Aareal Bank Group, financial guarantee contracts are presented based on the present value of the claim resulting from the future premium payments of the holder, and offset with the obligation for the guarantee (net basis).

Notes to the Statement of Comprehensive Income

(27) Net interest income

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015[1]
Interest income from		
Property loans	752	867
Public-sector loans	7	12
Other lending and money market operations	61	81
Debt and other fixed-income securities	27	57
Current dividend income	0	–
Total interest income	**847**	**1,017**
Positive interest from financial liabilities	**3**	**0**
Interest expenses for		
Bonds issued	32	69
Registered mortgage bonds	12	22
Promissory note loans	41	61
Subordinated capital	30	34
Money market transactions	20	33
Other interest expenses	2	13
Total interest expenses	**137**	**232**
Negative interest from financial assets	**12**	**4**
Total	**701**	**781**

[1] Previous year's figures were adjusted due to separate disclosure of negative interest

Net interest income decreased to € 701 million. This is largely attributable to the reduction of the non-strategic lending businesses, and to lower one-off income from early loan repayments.

Interest income from property loans includes income from impaired loans (so-called unwinding) in the amount of € 32 million (2015: € 22 million).

(28) Allowance for credit losses

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Additions	152	183
Reversals	44	69
Direct write-offs	19	21
Recoveries on loans and advances previously written off	30	7
Total	**97**	**128**

The additions to the allowance for credit losses comprise specific valuation allowances in an amount of € 149 million (2015: € 183 million) and portfolio-based valuation allowances amounting to € 3 million (2015: € –). Reversals of allowances for credit losses include € 40 million (2015: € 17 million) for specific valuation allowances and individually recognised provisions for off-balance sheet risks within the lending business as well as € 4 million (2015: € 52 million) for portfolio-based valuation allowances and provisions recognised on a portfolio level for off-balance sheet risks in the lending business.

(29) Net commission income

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Commission income from		
Consulting and other services	211	184
Trustee loans and administered loans	2	3
Securities transactions	–	–
Other lending and money market operations	8	8
Other commission income	13	9
Total commission income	**234**	**204**
Commission expenses for		
Consulting and other services	32	22
Trustee loans and administered loans	–	–
Securities transactions	1	1
Securitisation transactions	–	0
Other lending and money market transactions	2	1
Other commission expenses	6	5
Total commission expenses	**41**	**29**
Total	**193**	**175**

Net commission income increased to € 193 million (2015: € 175 million), which was mainly due to higher sales revenue at Aareon.

The net amount of commission income and commission expenses from financial assets and financial liabilities not measured at fair value amounts to € 5 million (2015: € 6 million).

(30) Net result on hedge accounting

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Ineffective portion of fair value hedges	0	7
Ineffective portion of cash flow hedges	0	1
Ineffective portion of net investment hedges	0	0
Total	**0**	**8**

This item contains the measurement gains or losses from hedging instruments and the associated hedged items in the context of hedging relationships.

(31) Net trading income / expenses

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Net income / expenses from positions held for trading	19	19
Currency translation	0	-6
Total	**19**	**13**

Net trading income / expenses are primarily attributable to the measurement and realisation of derivatives used to hedge interest rate and currency risks.

(32) Results from non-trading assets

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Result from debt securities and other fixed-income securities	5	-17
of which: Loans and receivables (LaR)	5	-9
Held to maturity (HtM)	–	-5
Available for sale (AfS)	0	-3
Result from equities and other non-fixed income securities	1	0
of which: Available for sale (AfS)	1	0
Designated as at fair value through profit or loss (dFVtPL)	0	0
Results from equity investments (AfS)	61	0
Total	**67**	**-17**

The net result from non-trading assets amounted to € 67 million (2015: € -17 million) of which an amount of € 61 million was due to the disposal of all shares in Aareal Bank's wholly-owned subsidiary, Aqvatrium which is the owner of a commercial property located in Stockholm. Moreover, the sale of the remaining asset-backed securities (ABS) yielded realised profits of € 5 million.

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

In the past financial year, there were no material expenses resulting from investments accounted for using the equity method (2015: € 0 million).

(34) Administrative expenses

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Staff expenses	339	332
Wages and salaries	285	275
Social security costs	33	32
Pensions	21	25
Other administrative expenses	187	201
Depreciation, amortisation and impairment of property and equipment and intangible assets	21	20
Total	**547**	**553**

Staff expenses include contributions to defined contribution plans in the amount of € 14 million (2015: € 15 million).

Other administrative expenses include administrative costs for research and development not eligible for capitalisation in the amount of € 4 million (2015: € 5 million).

This item also includes the total fees charged by the auditor of the consolidated financial statements in the financial year 2016, which consists of the following sub-items:

€ 000's	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Auditing fees	5,141	4,252
Other assurance services	93	561
Tax advisory services	54	255
Other services	1,081	3,948
Total	**6,369**	**9,016**

The fees for the financial year are disclosed in accordance with the revised requirements set out in the Accounting Practice Statement IDW RS HFA 36, as amended, issued by the Institute of Public Auditors in Germany (IDW). Accordingly, services directly associated with the audit of financial statements, such as the audit of the securities services and custody business, are reported under "Auditing fees" rather than "Other assurance services".

(35) Net other operating income / expenses

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Income from properties	40	55
Income from the reversal of provisions	66	16
Income from goods and services	1	3
Miscellaneous	24	35
Total other operating income	**131**	**109**
Expenses for properties	48	45
Write-downs of trade receivables	–	0
Expenses for other taxes	4	3
Miscellaneous	49	20
Total other operating expenses	**101**	**68**
Total	**30**	**41**

Net other operating income / expenses of € 30 million include net income from the successful settlement of legal disputes with holders of profit-participation certificates of the former Corealcredit. This positive effect is offset by a tax expense of virtually the same amount.

In addition, the owner-operated hotel was subject to an impairment loss of € 12 million, which was recognised due to revised income expectations.

(36) Income taxes

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Current income taxes	36	53
Deferred taxes	96	43
Total	**132**	**96**

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

€ mn	1 Jan - 31 Dec 2016	1 Jan - 31 Dec 2015
Operating profit (before income taxes)	366	470
Expected tax rate	31.7 %	31.4 %
Calculated income taxes	**116**	**148**
Reconciliation to reported income taxes		
Different foreign tax burden	-2	6
Tax attributable to tax-exempt income	-18	-47
Tax attributable to non-deductible expenses	46	9
Remeasurement of deferred taxes	25	11
Taxes for previous years	-28	-26
Effect of changes in tax rates	-2	–
Non-controlling interests	-6	-6
Other tax effects	1	1
Reported income taxes	**132**	**96**
Effective tax rate	36 %	20 %

The expected tax rate of 31.7 % (2015: 31.4 %), including a trade tax rate of assessment of 453 %, comprises trade taxes (15.9 %), corporation taxes (15 %) and the solidarity surcharge (0.825 %; 5.5 % of corporation tax).

Notes to the Statement of Financial Position

(37) Cash funds

€ mn	31 Dec 2016	31 Dec 2015
Cash on hand	0	0
Balances with central banks	1,786	1,282
Total	**1,786**	**1,282**

(38) Loans and advances to banks

€ mn	31 Dec 2016	31 Dec 2015
Money market receivables	1,458	1,509
Promissory note loans	119	192
Securities repurchase agreements	–	150
Other loans and advances	6	42
Total	**1,583**	**1,893**

(39) Loans and advances to customers

€ mn	31 Dec 2016	31 Dec 2015
Property loans [1)]	26,833	29,344
Promissory note loans	1,442	1,457
Other loans and advances	2,928	3,765
Total	**31,203**	**34,566**

[1)] Excluding € 1.1 billion in private client business (31 December 2015: € 1.5 billion) and € 0.6 billion in local authority lending business by WestImmo (31 December 2015: € 0.6 billion), which are reported under "Other loans and advances".

(40) Allowance for credit losses

31 December 2016

€ mn	Specific valuation allowances	Portfolio impairment allowance	Total allowance for credit losses for recognised items	Provisions in the lending business for unrecognised items	Total allowance for credit losses and provisions in the lending business
Allowance for credit losses as at 1 January	**412**	**116**	**528**	**14**	**542**
Additions	149	3	**152**	0	**152**
Write-downs	58	–	**58**	1	**59**
Reversals	36	–	**36**	8	**44**
Unwinding	32	–	**32**	–	**32**
Reclassifications	–	–	**–**	–	**–**
Changes in basis of consolidation	–	–	**–**	–	**–**
Currency adjustments	0	0	**0**	0	**0**
Balance as at 31 December	**435**	**119**	**554**	**5**	**559**

31 December 2015

€ mn	Specific valuation allowances	Portfolio impairment allowance	Total allowance for credit losses for recognised items	Provisions in the lending business for unrecognised items	Total allowance for credit losses and provisions in the lending business
Allowance for credit losses as at 1 January	**333**	**147**	**480**	**18**	**498**
Additions	183	–	**183**	0	**183**
Write-downs	68	–	**68**	1	**69**
Reversals	17	50	**67**	2	**69**
Unwinding	22	–	**22**	–	**22**
Reclassifications	–	–	**–**	-1	**-1**
Changes in basis of consolidation	–	19	**19**	–	**19**
Currency adjustments	3	0	**3**	0	**3**
Balance as at 31 December	**412**	**116**	**528**	**14**	**542**

The allowance for risks associated with recognised items relates to loans and advances to customers and loans and advances to banks classified as "Loans and receivables" (LaR). These allowances are reported under allowance for credit losses on the asset side of the statement of financial position. The provisions for risks associated with unrecognised items relate to contingent liabilities and loan commitments. These provisions are reported under provisions on the liability side of the statement of financial position.

(41) Positive market value of derivative hedging instruments

€ mn	31 Dec 2016	31 Dec 2015
Positive market value of fair value hedges	2,169	2,159
Positive market value of cash flow hedges	29	26
Pro rata interest receivable	283	313
Total	**2,481**	**2,498**

(42) Trading assets

€ mn	31 Dec 2016	31 Dec 2015
Positive market value of trading assets	502	638
Total	**502**	**638**

(43) Non-trading assets

€ mn	31 Dec 2016	31 Dec 2015
Debt and other fixed-income securities	9,728	10,499
of which: Loans and receivables (LaR)	3,259	3,630
Held to maturity (HtM)	522	604
Available for sale (AfS)	5,947	6,265
Equities and other non-fixed income securities	1	7
of which: Available for sale (AfS)	1	7
Designated as at fair value through profit or loss (dFVtPL)	–	–
Interests in affiliated companies (AfS)	–	–
Other investments (AfS)	1	1
Total	**9,730**	**10,507**

The item ”Debt and other fixed-income securities” mainly consists of public-sector bonds as well as asset-covered bonds (Pfandbriefanleihen) and bank bonds. The remaining asset-backed securities (ABS) were sold in the year under review (nominal amount in 2015: € 124 million).

(44) Investments accounted for using the equity method

Aareal Bank holds interests in associates that are accounted for using the equity method. During the year under review and the previous year, interests in associates were insignificant for the Group.

The sum total of the carrying amounts of the equity investments that are immaterial on an individual basis amounted to € 0 million (31 December 2015: € 1 million). The sum total of the Group's share in the total comprehensive income of companies accounted for using the equity method amounted to € 0 million in the year under review (2015: € 0 million).

(45) Intangible assets

€ mn	31 Dec 2016	31 Dec 2015
Goodwill	76	75
Proprietary software	22	19
Other intangible assets	28	32
Total	**126**	**126**

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

€ mn	31 Dec 2016 Goodwill	31 Dec 2015[1] Goodwill
Business divisions		
Germany	28	28
International Business	48	47
Total	**76**	**75**

[1] The allocation of goodwill within the scope of Aareon Smart World was adjusted.

Goodwill is generally tested for impairment in the fourth quarter of each year. The basis for the valuation is the present value of future cash flows (value in use), which are determined using medium-term projections. In this context, the projected pre-tax cash flows – determined on the basis of the three-year plan adopted by Aareon AG's Management Board and approved by the Supervisory Board – are used. Accordingly, there is an individual planning of revenue and expense items within the first three years. The parameters underlying the major assumptions are based on internal and external factors as well as on past experience. The major basis is the previous year's planning. Revenue projections are largely subject to assumptions in relation to migration plans, new business, as well as renewals of contracts and follow-up business with existing customers. At the same time, these represent the key sources for estimation uncertainty. Regular sales revenues, such as maintenance and fees from transactions with existing customers, are normally not subject to estimation uncertainty. The projections for cost of materials are derived from revenue projections. These projections for staff expenses predominantly take into account the number of employees, as well as wage and salary trends. Other costs are projected based on the previous year's figures, taking into account known one-off effects. Estimation uncertainties in relation to costs arise as a result of unplanned price increases or unforeseeable one-off effects. In principle, estimation uncertainty increases if assumptions are made further into the future. Cash flows beyond the three-year horizon are determined by way of a perpetual annuity.

The present values of future cash flows were determined consistently throughout the Group on the basis of a risk-adequate discount factor of 5.2 % before taxes. The discount factor is calculated based on a risk-free basic interest rate of 0.8 % plus a company-specific risk premium of 6 %, multiplied with a beta factor of 0.7. Due to the uncertainties surrounding the planning beyond the three-year horizon, we assume constant values, i.e. no further growth, to reflect our cautious view of the market environment. The recoverable amounts show a significant excess compared to the carrying amounts, which means that a deficit is not considered possible, even if the above-mentioned assumptions change dramatically. To that extent, even a likely increase of the risk-adequate discount factor by 1.0 % as well as a reduction in EBIT included in the cash flows by 5.0 % does not result in an impairment loss in the reporting period. There was no need to recognise impairment losses in the year under review.

Intangible assets developed as follows:

	2016				2015			
€ mn	Goodwill	Proprietary software	Other intangible assets	Total	Goodwill	Proprietary software	Other intangible assets	Total
Cost								
Balance at 1 January	**132**	**82**	**84**	**298**	**123**	**77**	**77**	**277**
Additions	2	6	5	**13**	9	5	10	**24**
Transfers	–	–	0	**0**	–	–	0	**0**
Disposals	0	0	9	**9**	–	0	6	**6**
Changes in basis of consolidation	–	–	–	**–**	–	–	2	**2**
Currency translation differences	-1	-1	-2	**-4**	0	0	1	**1**
Balance as at 31 December	**133**	**87**	**78**	**298**	**132**	**82**	**84**	**298**
Amortisation and impairment losses								
Balance at 1 January	**57**	**63**	**52**	**172**	**57**	**60**	**50**	**167**
Amortisation and impairment losses	–	2	7	**9**	–	3	7	**10**
of which: impairment losses	–	–	–	**–**	–	–	–	**–**
Write-ups	–	–	–	**–**	–	–	–	**–**
Transfers	–	–	–	**–**	–	–	–	**–**
Disposals	0	–	9	**9**	–	0	5	**5**
Changes in basis of consolidation	–	–	–	**–**	–	–	–	**–**
Currency translation differences	0	0	0	**0**	0	–	0	**0**
Balance as at 31 December	**57**	**65**	**50**	**172**	**57**	**63**	**52**	**172**
Carrying amount as at 1 January	**75**	**19**	**32**	**126**	**66**	**17**	**27**	**110**
Carrying amount as at 31 December	**76**	**22**	**28**	**126**	**75**	**19**	**32**	**126**

(46) Property and equipment

€ mn	31 Dec 2016	31 Dec 2015
Land and buildings and construction in progress	220	245
Office furniture and equipment	32	22
Total	**252**	**267**

Development of property and equipment:

€ mn	2016 Land and buildings and construction in progress	2016 Office furniture and equipment	2016 Total	2015 Land and buildings and construction in progress	2015 Office furniture and equipment	2015 Total
Cost						
Balance at 1 January	**292**	**68**	**360**	**103**	**64**	**167**
Additions	14	8	**22**	4	8	**12**
Transfers	-10	10	**0**	151	0	**151**
Disposals	8	5	**13**	0	4	**4**
Changes in basis of consolidation	0	0	**0**	34	0	**34**
Currency translation differences	0	0	**0**	0	0	**0**
Balance as at 31 December	**288**	**81**	**369**	**292**	**68**	**360**
Amortisation and impairment losses						
Balance at 1 January	**47**	**46**	**93**	**28**	**43**	**71**
Amortisation and impairment losses	21	8	**29**	5	6	**11**
of which: impairment losses	12	–	**12**	–	–	**–**
Write-ups	–	–	**–**	–	–	**–**
Transfers	–	–	**–**	–	–	**–**
Disposals	0	5	**5**	–	3	**3**
Changes in basis of consolidation	–	–	**–**	14	–	**14**
Currency translation differences	0	0	**0**	0	0	**0**
Balance as at 31 December	**68**	**49**	**117**	**47**	**46**	**93**
Carrying amount as at 1 January	**245**	**22**	**267**	**75**	**21**	**96**
Carrying amount as at 31 December	**220**	**32**	**252**	**245**	**22**	**267**

(47) Income tax assets

Income tax assets in a total amount of € 68 million as at 31 December 2016 (2015: € 20 million) include € 7 million (2015: € 4 million) expected to be realised after a period of more than twelve months.

(48) 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 € 736 million (2015: € 722 million).

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

€ mn	31 Dec 2016	31 Dec 2015
Loans and advances to banks / to customers	–	0
Positive and negative market value of derivative hedging instruments	4	30
Trading assets and trading liabilities	64	93
Non-trading assets	–	–
Intangible assets	0	1
Property and equipment	0	–
Other assets / liabilities	20	1
Liabilities to banks / to customers, and certificated liabilities	669	678
Provisions	84	117
Subordinated capital	27	22
Tax loss carryforwards	2	19
Deferred tax assets	**870**	**961**

Of the deferred taxes on loss carryforwards, an amount of € 1 million (2015: € 18 million) is attributable to foreign permanent establishments. The existing loss carryforwards may be carried forward for an unlimited period. Deferred taxes on losses carried forward were recognised to the extent that they are expected to be realised within the next five years.

The deferred tax assets not recognised or not subject to valuation adjustments amount to € 68 million (2015: € 43 million).

Deferred tax assets in the amount of € 16 million (2015: € 13 million) were reported under other reserves.

(49) Other assets

€ mn	31 Dec 2016	31 Dec 2015
Properties	234	263
Trade receivables (LaR)	50	42
Miscellaneous	113	134
Total	**397**	**439**

In the year under review, all of the shares held in the wholly-owned subsidiary Aqvatrium, which is the owner of a commercial property located in Stockholm, were sold (€ 249 million). In addition, Aareal Holding Realty was founded, which owns three commercial properties in the United States, and a commercial property portfolio in Belgium was acquired (aggregate value of € 220 million).

(50) Liabilities to banks

€ mn	31 Dec 2016	31 Dec 2015
Money market liabilities	813	925
Promissory note loans	352	414
Registered mortgage Pfandbriefe	496	457
Registered public-sector Pfandbriefe	21	51
Other liabilities	21	51
Total	**1,703**	**1,898**

(51) Liabilities to customers

€ mn	31 Dec 2016	31 Dec 2015
Money market liabilities	13,696	13,179
Promissory note loans	6,369	7,038
Registered mortgage Pfandbriefe	6,066	6,852
Registered public-sector Pfandbriefe	2,945	3,291
Other liabilities	1	–
Total	**29,077**	**30,360**

(52) Certificated liabilities

€ mn	31 Dec 2016	31 Dec 2015
Bearer mortgage Pfandbriefe	5,956	8,529
Bearer public-sector Pfandbriefe	45	71
Other debt securities	2,345	2,219
Total	**8,346**	**10,819**

(53) Negative market value of derivative hedging instruments

€ mn	31 Dec 2016	31 Dec 2015
Negative market value of fair value hedges	2,357	2,554
Negative market value of cash flow hedges	5	7
Negative market value of net investment hedges	12	1
Pro rata interest payable	155	158
Total	**2,529**	**2,720**

(54) Trading liabilities

€ mn	31 Dec 2016	31 Dec 2015
Negative market value of trading assets	652	663
Total	**652**	**663**

(55) Provisions

€ mn	31 Dec 2016	31 Dec 2015
Provisions for pensions and similar obligations	359	333
Other provisions and contingent liabilities	321	450
Total	**680**	**783**

Provisions for pensions and similar obligations

The pension obligations result mainly from retirement benefit plans maintained at Aareal Bank, Aareon, BauGrund and WestImmo, which are classified as defined contribution plans or defined benefit plans in accordance with IAS 19.

Aareal Bank contributed assets held to cover the Bank's existing pension obligations into a Contractual Trust Arrangement (CTA). This is to ensure improved insolvency protection of the pension claims as a result of the limited protection provided by the German Pension Guarantee Association (Pensionssicherungsverein; PSVaG). For this purpose, a bilateral trust was agreed between Aareal Bank AG (trustor) and Aareal Pensionsverein e.V. as legally independent third party (trustee). The trustee is registered at the Wiesbaden District Court.

The trustee holds in trust the special fund for the trustor (administrative trust). Simultaneously, but senior to the administrative trust, the trustee holds the special fund for all beneficiaries on trust to secure the recorded entitlements (security trust).

The security trust is established in the interest of the beneficiaries by way of a genuine agreement for the benefit of third parties (section 328 (1) of the German Civil Code (Bürgerliches Gesetzbuch – "BGB")). On the basis of this security trust, the beneficiaries may request from the trustee that the trustee holds and manages this special fund pursuant to the regulations of this trust agreement for the purpose of securing the recorded entitlements. Upon the occurrence of an insured event, the beneficiaries may, based on the security trust, request from the trustee that the trustee satisfies their recorded entitlements pursuant to the regulations of this trust agreement out of the special fund.

The Bank is the economic beneficiary of the assets. The assets are managed by HSBC INKA in a special fund under German investment law ("Spezialfonds"). Based on an investment guideline, HSBC INKA takes investment decisions for staff pensions. A joint investment committee was established, comprising staff from HSBC and Aareal Bank. The Bank transfers new assets to be invested to Aareal Pensionsverein on an annual basis, which in turn acquires additional units in the special fund. The fund manager invests interest income during the course of the year.

The Bank has taken out reinsurance policies for a portion of the benefit entitlements of active members of the Management Board and former Management Board members. These policies were also transferred to Aareal Pensionsverein e.V. on a trust basis. The Bank provides corresponding funds for contribution paid to these policies.

Transferring assets to Aareal Pensionsverein e.V. on the one hand secures benefit entitlements and claims under occupational pension schemes, and on the other hand creates plan assets within the meaning of IAS 19 which may be offset with benefit obligations of the trustor.

Brief description of the material pension plans

DePfa Bank Betriebsvereinbarung dated 14 December 1999 (BV 97)

BV 97 applies for new joiners since 1 January 1997. The following benefits are granted after a waiting period of five pensionable service years: old-age pension after completing the 65th year of age (also after any previous disability), early old-age pension, disability pension until completing the 65th year of age, as well as widow(er)'s pension.

The Bank shall grant its employees a basic pension from own contributions and additional benefits in the form of corresponding individual agreements on deferred compensation. The basic pension for the pensionable service period is calculated based on an annual benefit expense of 3.5 % for portions of the pensionable income below the contribution ceiling (Beitragsbemessungsgrenze, BBG) and 10 % for portions of pensionable income above the contribution ceiling. The employer contributions thus calculated as well as the contributions from deferred compensation are contributed into a CTA at the end of each financial year. The benefit assets, including any allocated surpluses, bear interest at a rate of at least 4 %. The annual benefit payments are calculated based on an annuitisation of the benefit assets upon occurrence of the insured event, using a fixed annuitisation table.

The pensionable service period is deemed to be the period from completing the 20th year of age to completing the 65th year of age. Pensionable income is the gross remuneration within the year.

Any actuarial deductions upon claiming old-age pensions before completing the 65th year of age are taken into account through an annuitisation of the benefit assets. The widow(er)'s pension amounts to 60 % of the employee pension. The Bank increases the current benefit payments annually by 1 %; there is no obligation to provide for an inflation adjustment.

Management Board

The five Management Board members receive their benefits based on individual commitments (a total of seven individual benefit commitments).

Five individual benefit commitments are fixed amount commitments related to monthly benefit payments upon retirement and disability, including a widow(er)'s pension of 60 % of the beneficiary's pension entitlement. The current benefit payments are adjusted based on the development of standard wages within the private banking sector.

Two individual benefit commitments of 23 December 2011 are aligned to the fixed annual employer contributions and the amounts from deferred compensation, which are paid to the relevant benefit account and bear interest at a rate of 4 %. The benefit assets and the assets from deferred compensation are translated into a lifelong old-age or disability pension upon the occurrence of an insured event, using actuarial principles. Annuitisation is based on biometric principles and a notional interest rate of 4 % p.a. and takes into account a guaranteed pension increase of 1 % p.a. The widow pension amounts to 60 % of the beneficiary's pension entitlement. The current benefit payments are increased annually by 1 %; there is no obligation to provide for an inflation adjustment. The old-age pension benefits based on this commitment were secured through reinsurance policies. These reinsurance policies include benefits in the case of disability or death.

DePfa Bank Dienstvereinbarung dated 30 December 1955 (DePfa 55)
DePfa 55 is a pay-related benefit commitment for new entrants before 31 December 1988. It provides for benefit payments after completing the 65th year of age after a waiting period of five service years and benefits paid in case of occupational incapacity (disability) as well as benefits for surviving dependants, each in form of a monthly annuity.

The amount of the entitlement is based on the following increases: 5 % of the last annual salary for the first five service years each, 2 % of the last annual salary for the next 20 service years each, and 1 % of the last annual salary for any following service year, up to a maximum percentage of 75 % of the last annual salary after 35 service years. The widow(er)'s pension amounts to 60 % of the old-age or disability pension. Benefits paid by social security insurance and VBL / Gerling are charged to the benefit entitlements. DePfa 55 does not include any provision allowing for an early payout of old-age pensions or for an adjustment of current benefit payments.

These commitments are based on final salary. The obligation resulting from the respective benefit commitment is therefore very sensitive to unexpected salary changes.

Current benefits are not subject to a fixed adjustment rate; therefore, the adjustment is made pursuant to section 16 of the German Occupational Pensions Act (BetrAVG). Accordingly, an inflation adjustment has to be made every three years given an appropriate economic situation of the Bank. Changes in inflation and, hence, pension increases have an impact on the benefit volume as regards these commitments.

BauBoden agreement dated 1 July 1968 (BauBoden 68)
This agreement applies to employees after completing their 18th year of age who were employed by the Bank on 1 January 1967 or joined the Bank not later than on 31 December 1983. The following benefits are granted after a waiting period of ten service years: old-age pension after completing the 65th year of age, early old-age pension, (total) occupational incapacity pension as well as widow(er)'s pension.

Benefits consist of an overall pension, comprising the statutory pension insurance scheme, the additional pension insurance scheme at VBL or BVV (which is taken into account), or the group insurance contracts and the bank subsidy. The overall pension amounts to 55 % of the pensionable salary after ten years of service. The overall pension is increased by 1 % of the pensionable salary for any further service year, up to the maximum rate of 75 %. The pensionable salary is the last monthly gross salary received during service.

No actuarial deductions are made upon claiming old-age pensions before completing the 65th year of age. The widow(er)'s pension amounts to 60 % of the bank subsidy. The current pension payments are adjusted pursuant to section 16 of the German Company Pensions Act (Betriebsrentengesetz).

These commitments are based on final salary. The obligation resulting from the respective benefit commitment is therefore very sensitive to unexpected salary changes.

Current benefits are not subject to a fixed adjustment rate; therefore, the adjustment is made pursuant to section 16 of the German Occupational Pensions Act (BetrAVG). Accordingly, an inflation adjustment has to be made every three years given an appropriate economic environment. Changes in inflation and, hence, pension increases have an impact on the benefit volume as regards these commitments.

BauBoden agreement dated 12 December 1984 (BauBoden 84) and DePfa Bank Versorgungsordnung dated 28 November 1990 (DePfa 90)

BauBoden 84 applies to employees who joined the Company after 31 December 1983 and have completed their 20th year of age. DePfa 90 applies to employees who joined the Company after 31 December 1988. The following benefits are granted after a waiting period of ten service years: old-age pension and early old-age pension, (total) occupational incapacity pension as well as widow(er)'s pension.

The benefit entitlements of the employees vest after completing their 65th year of age. The amount of the monthly pension entitlement is calculated for each pensionable service year (up to a maximum of 40 service years) as follows: 0.6 % of pensionable salary up to the contribution ceiling, 2 % of the portion of pensionable salary exceeding the contribution ceiling, with pensionable salary and contribution ceiling being calculated using the average for the last twelve months. Benefits paid by BVV are charged to the benefit entitlements under BauBoden 84.

The Bank does not make any actuarial deductions upon claiming early old-age pensions. The widow(er)'s pension amounts to 60 % of the entitlements to benefit payments. The current pension payments are adjusted pursuant to section 16 of the German Company Pensions Act (Betriebsrentengesetz).

These commitments are based on final salary. The obligation resulting from the respective benefit commitment is therefore very sensitive to unexpected salary changes.

Current benefits are not subject to a fixed adjustment rate; therefore, the adjustment is made pursuant to section 16 of the German Occupational Pensions Act (BetrAVG). Accordingly, an inflation adjustment has to be made every three years given an appropriate economic situation of the Bank. Changes in inflation and, hence, pension increases have an impact on the benefit volume as regards these commitments.

AHB – General works agreement on additional pension benefits (company pension scheme) of former Corealcredit

The pension benefits to former employees of Allgemeine Hypothekenbank AG, whose employment relationship began prior to 1 January 1994, are governed by the additional benefit arrangement dated 29 August 1995 on the basis of the complementing general works agreement dated 7 March 1995.

This benefit commitment is based on aggregate benefits derived from pension benefits for civil servants. After a waiting period of five years of service, the aggregate benefit rate is 50 % of pensionable income. For each year after completing the 37th year of age, the aggregate benefit rate increases by 1 % of pensionable income, up to a maximum 75 % of pensionable income. The entitlement amounts to at least 65 % of pensionable income in the case of (total) occupational incapacity and 75 % of pensionable income in the case of workplace accidents. Pensionable income is the annual income (calculated on the basis of 14 monthly salaries), divided by 12.

The pension benefits of the statutory pension insurance and the BVV Versicherungsverein des Bankgewerbes a.G., which are based on mandatory contributions, are taken into account in the pension determined as described. To that extent, the benefit obligation directly depends on the development of the level of pensions from the statutory pension insurance on the one hand and from the BVV on the other.

As a result of the German Pension Reform Act of 1992 and the associated cuts in statutory pension insurance, the pension scheme was restructured in 1995. The main pillar of the new structure is the limitation of the Bank's deficiency guarantee for the declining level of statutory pensions due to deduction factors applied at early retirement (Rentenzugangsfaktor) and the lower adjustment of the pension value. Accordingly, the Bank continues to assume the deficiency guarantee on a pro-rata basis for the periods of service until the restructuring on 31 December 1995 in relation to the deduction factors applied at early retirement and for the reduced level of the current pension value (net adjustment factor). The reduction in the level of statutory pensions that occurred during the service periods from the restructuring date until retirement is taken into account at the expense of the beneficiary.

From the start of retirement, the AHB pension is decoupled from the development of the statutory pension and the BVV pension already prior to the restructuring since only the AHB pension is adjusted for inflation on an annual basis.

Accordingly, the obligation for the pension commitment during the qualification period is, on the one hand, directly dependent upon the development of the statutory pension and the BVV pension. On the other hand, it is fully dependent upon salary development for all years of service, even including past service. The volume of the obligation also depends upon the fluctuation of inflation and hence pension increases.

Rheinboden Hypothekenbank AG – pension scheme in the version dated 1 December 1991 of former Corealcredit

The former employees of Rheinboden Hypothekenbank AG are entitled to old-age and disability pensions as well as surviving dependant's benefits in accordance with the pension schemes in the version dated 1 December 1991.

The monthly benefits for employees who commenced service prior to 1 October 1978 amount to 5 % of pensionable remuneration (most recent monthly salary based on collective or individual agreements) after ten service years and increase by 0.5 % of pensionable remuneration for each service year, up to 14 % of pensionable remuneration after 15 service years. The monthly benefit entitlement increases by 0.3 % of pensionable remuneration for any additional service years, up to a maximum of 20 %. The BVV benefits are taken into account in such entitlement to the extent that these are based on employer contributions.

The benefits for employees who commenced service after 30 September 1978 amount to 0.15 % of pensionable remuneration up to the contribution ceiling as well as 1.5 % of pensionable remuneration above the contribution ceiling for each year of service between the 25th and 65th year of age. The maximum number of recognisable service years is 35.

The old-age pension under the Rheinboden pension schemes is paid after completing the 65th year of age or upon commencement of old-age pension under the statutory pension insurance scheme (full pension). In case of early retirement, the benefits are subject to deductions of 0.3 % per month of early retirement prior to the age of 65 as a partial compensation for the additional costs associated with early retirement. The surviving dependant's benefits amount to 60 % of the employee's pension entitlement for widow(er)s as well as 15 % for half-orphans and 20 % for orphans, however, in aggregate not exceeding the amount of the employee's pension entitlement.

Supplementary individual contractual arrangements were agreed with individual pensioners and leavers with vested benefits for the purpose of the transition from the old to the new Rheinboden pension scheme and the application of the BVV benefits.

In addition, individual contractual commitments apply to former management board members and general managers – currently pensioners and one leaver with vested benefits.

The adjustment of current pensions on the basis of the Rheinboden commitments is performed on the basis of the inflation allowance set out in section 16 of the German Occupational Pensions Act (BetrAVG), with the exception of a small group of approximately ten pensioners where adjustment is made pursuant to the collective agreement for banks.

WestImmo – Pension fund rules dated 1 October 1995
The pension fund rules dated 1 October 1995 represent a defined contribution scheme. The following benefits are paid after a waiting period of five year of service: old-age pension, early old-age pension, (total) occupational incapacity pension as well as widow(er)'s and orphan's pension.

The amount of the old-age pension, the early old-age pension and the (total) occupational incapacity pension is calculated based on the sum of the pension components earned during the pensionable service period. If the pensionable service period exceeds 40 years, the monthly pension is calculated based on the sum of the highest 40 pension components earned during the pensionable service period. The amount of one pension component is derived from multiplying the reference contribution (since 2014: € 260), the personal earnings relation (relation between pensionable income and contribution ceiling of the German statutory pension insurance; earnings components above the contribution ceiling are weighted with a factor of 3.75) and the annuitisation factor in the relevant age pursuant to the annuitisation table. The amount of the early old-age pension is reduced by 0.5 % for each month in which annuity is paid prior to completing the 65th year of age. The widow(er)'s pension entitlement amounts to 60 %.

If necessary, the determination of the amount of pension obligations is based on the following actuarial assumptions applied consistently throughout the Group:

	31 Dec 2016	31 Dec 2015
Calculation method	Projected unit credit	Projected unit credit
Calculation basis	Actuarial tables issued by K. Heubeck in 2005	Actuarial tables issued by K. Heubeck in 2005
Actuarial assumptions (in %)		
Interest rate used for valuation	1.81	2.28
Development of salaries	2.00	2.25
Pension increase	1.86	1.86
Rate of inflation	2.00	2.00
Staff turnover rate	3.00	3.00

Development of net pension liabilities:

€ mn	Present value of pensions obligations	Fair value of plan assets	Net pension liability
Balance as at 1 Jan 2016	**396**	**-63**	**333**
Pension expense	**17**	**-1**	**16**
Current service cost	8	–	8
Net interest cost	9	-1	8
Payments	**-10**	**-9**	**-19**
Pension benefits paid	-12	0	-12
Employer's contributions	–	-7	-7
Contributions made by beneficiaries of defined benefit plans	2	-2	–
Remeasurements	**29**	**–**	**29**
due to experience adjustments	-5	–	-5
due to changes in financial assumptions	34	–	34
due to changes in demographic assumptions	–	–	–
Difference between actual return and return calculated using an internal rate of interest (plan assets)	–	0	0
Changes in basis of consolidation	**–**	**–**	**–**
Balance as at 31 Dec 2016	**432**	**-73**	**359**

€ mn	Present value of pensions obligations	Fair value of plan assets	Net pension liability
Balance as at 1 Jan 2015	**352**	**-57**	**295**
Pension expense	**20**	**-1**	**19**
Current service cost[1)]	12	–	12
Net interest cost	8	-1	7
Payments	**-9**	**-5**	**-14**
Pension benefits paid	-11	0	-11
Employer's contributions	–	-3	-3
Contributions made by beneficiaries of defined benefit plans	2	-2	–
Remeasurements	**-22**	**–**	**-22**
due to experience adjustments	-1	–	-1
due to changes in financial assumptions	-19	–	-19
due to changes in demographic assumptions	-2	–	-2
Difference between actual return and return calculated using an internal rate of interest (plan assets)	–	0	0
Changes in basis of consolidation	**55**	**–**	**55**
Balance as at 31 Dec 2015	**396**	**-63**	**333**

[1)] Due to Dr Schumacher's leaving the Bank, with effect from 30 September 2015, € 4,023,736 was recognised in benefit expenses, in line with his pension agreement, thus increasing the Bank's pension obligations.

The weighted duration of pension liabilities is 18.9 years as at 31 December 2016 (2015: 18.4 years).

Expected maturities of the defined benefit obligation (DBO):

€ mn	31 Dec 2016	31 Dec 2015
Up to 1 year	12	12
More than 1 year and up to 5 years	54	52
More than 5 years and up to 10 years	77	75
Total	**143**	**139**

Contributions in the amount of € 8 million (2015: € 8 million) are expected to be paid in the financial year 2017.

Sensitivity of the defined benefit obligation (DBO) compared to the central actuarial assumptions

Based on the qualitative plan description, the valuation parameters significant for calculating the amount of the obligation were derived and corresponding calculations were made as regards sensitivity:

		Defined benefit obligation 2016 € mn	Change %	Defined benefit obligation 2015 € mn	Change %
Present value of obligations		**432**		**396**	
Interest rate used for valuation	Increase by 1.0 percentage points	362	-16	332	-16
	Decrease by 1.0 percentage points	524	21	477	20
Development of salaries	Increase by 0.5 percentage points	439	2	403	2
	Decrease by 0.5 percentage points	424	-2	387	-2
Pension increase	Increase by 0.25 percentage points	442	2	403	2
	Decrease by 0.25 percentage points	419	-3	386	-3
Life expectancy	Increase by 1 year	453	5	412	4
	Decrease by 1 year	410	-5	375	-5

The sensitivity analysis takes into account, in each case, the change of an assumption, while the other assumptions remain unchanged compared to the original calculation, i.e. any potential correlation effects between the individual assumptions are not taken into consideration.

Plan assets can be broken down as follows:

€ mn	31 Dec 2016	31 Dec 2015
Cash	0	0
Equities	–	–
Investment funds	47	38
Bonds	–	–
Reinsurance	26	25
Total	**73**	**63**

Apart from the usual actuarial risks, the risks associated with defined benefit obligations primarily relate to financial risks in connection with plan assets. Amongst others, these may include counterparty credit risks and market price risks. These risks are taken into account in the risk management of Aareal Bank Group. The measurement of investment funds is allocated to Level 2 of the fair value hierarchy.

Other provisions

Other provisions developed as follows:

€ mn	Provisions for staff expenses and non-staff operating costs	Provisions in the lending business for unrecognised items	Provisions for legal and tax risks	Miscellaneous other provisions	Total
Carrying amount as at 1 Jan 2016	**166**	**14**	**236**	**34**	**450**
Additions	108	0	8	9	**125**
Utilisation	70	1	68	15	**154**
Reversals	10	8	74	2	**94**
Interest	1	–	1	0	**2**
Reclassifications	-8	–	–	0	**-8**
Changes in basis of consolidation	–	–	–	0	**0**
Currency translation differences	0	0	–	0	**0**
Carrying amount as at 31 Dec 2016	**187**	**5**	**103**	**26**	**321**

€ mn	Provisions for staff expenses and non-staff operating costs	Provisions in the lending business for unrecognised items	Provisions for legal and tax risks	Miscellaneous other provisions	Total
Carrying amount as at 1 Jan 2015	**101**	**18**	**269**	**30**	**418**
Additions	85	0	5	27	**117**
Utilisation	57	1	7	19	**84**
Reversals	19	2	34	5	**60**
Interest	0	–	2	0	**2**
Reclassifications	1	-1	-1	1	**0**
Changes in basis of consolidation	52	–	2	0	**54**
Currency translation differences	3	0	–	0	**3**
Carrying amount as at 31 Dec 2015	**166**	**14**	**236**	**34**	**450**

Other provisions of € 321 million include € 74 million expected to be realised after a period exceeding twelve months.

Provisions for staff expenses and non-staff operating costs refer to personnel provisions in the amount of € 89 million (2015: € 78 million) and provisions for non-staff operating costs in the amount of € 98 million (2015: € 88 million). Personnel provisions consist of, among other things, provisions for bonuses, partial retirement, severance pay and existing working hours accounts. Provisions for non-staff operating expenses mainly include provisions for professional and legal advice.

Provisions for staff expenses and non-staff operating costs include € 80 million in provisions for severance pay, and € 2 million in restructuring expenses for non-staff operating costs related to the former Frankfurt branch and WestImmo.

The provisions for legal and tax risks include, amongst others, contingent liabilities that were recognised within the framework of the acquisition of the former Corealcredit in the amount of € 1 million (2015: € 131 million).

As a result of the favourable settlement of material litigation of the former Corealcredit, provisions recognised in this matter were reduced. Holders of profit-participation rights of the former Corealcredit had sued it in connection with a reduction of repayment claims under profit-participation certificates, for the financial years 2005 to 2008.

Provisions for tax risks were recognised largely to cover risks in connection with ongoing tax audits at the former Corealcredit. In the year under review, provisions from the risk protection that are no longer required were partially released. We anticipate a long duration of proceedings for the remaining portion.

Concerning the part of the credit portfolio of the former Corealcredit that was acquired subject to credit-related purchase price discounts, as at 31 December 2016, compensation payments to the seller may occur in the future, in an amount of not more than € 3.7 million plus interest; such payments would also be recognised directly in equity. The potential level of such compensation payments largely corresponds to the surplus amount of future borrower payments relative to the carrying amount of the corresponding accounts receivable. Compensation payments made to the seller to date (and recognised directly in equity) totalled € 61 million. The carrying amount of the contingent considerations is € 1 million (2015: € 5 million). The item "Provisions in the lending business for unrecognised items" includes portfolio-based valuation allowances in the amount of € 2 million (2015: € 6 million).

(56) Income tax liabilities

Income tax liabilities in a total amount of € 71 million as at 31 December 2016 (2015: € 102 million) include € 6 million (2015: € 44 million) expected to be realised after a period of more than twelve months.

(57) 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 € 736 million (2015: € 722 million).

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

€ mn	31 Dec 2016	31 Dec 2015
Loans and advances to banks/to customers	155	148
Positive and negative market value of derivative hedging instruments	124	133
Trading assets and trading liabilities	81	104
Non-trading assets	370	370
Investments accounted for using the equity method	–	–
Intangible assets	7	8
Property and equipment	3	3
Other assets/liabilities	20	-22
Liabilities to banks/to customers, and certificated liabilities	–	7
Provisions	2	3
Subordinated capital	2	2
Deferred tax liabilities	**764**	**756**

(58) Other liabilities

€ mn	31 Dec 2016	31 Dec 2015
Liabilities from outstanding invoices	10	12
Deferred income	15	14
Liabilities from other taxes	17	18
Trade payables (LaC)	30	16
Other liabilities (LaC)	55	54
Total	**127**	**114**

(59) Subordinated capital

€ mn	31 Dec 2016	31 Dec 2015
Subordinated liabilities	1,122	1,164
Profit-participation certificates	50	53
Contributions by silent partners	194	194
Total	**1,366**	**1,411**

(60) Equity

€ mn	31 Dec 2016	31 Dec 2015
Subscribed capital	180	180
Capital reserves	721	721
Retained earnings	1,734	1,633
AT1 bond	300	300
Other reserves		
Reserve from remeasurements of defined benefit plans	-100	-80
Revaluation reserve	29	28
Hedging reserves	17	13
Currency translation reserves	6	7
Non-controlling interests	242	242
Total	**3,129**	**3,044**

Subscribed capital

Aareal Bank AG's subscribed capital amounted to € 180 million as at the reporting date (2015: € 180 million). It is divided into 59,857,221 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.

Treasury shares

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

Furthermore, the General Meeting held on 20 May 2015 authorised the Management Board, pursuant to section 71 (1) no. 8 of the AktG, to purchase treasury shares with a volume of up to 10 % of the issued share capital for purposes other than securities trading. This authorisation expires on 19 May 2020. Shares may be acquired via the stock exchange or by means of a public offer to buy directed at all shareholders, and at purchase prices stipulated in the authorisation and based on the prevailing market price of the Company's shares. This authorisation may be exercised, in full or in part, on one or more occasions.

The shares acquired in accordance with this or an earlier authorisation may be sold, subject to Supervisory Board approval, outside the stock exchange and without an offer directed at all shareholders, subject to the exclusion of shareholders' pre-emptive rights, when the shares sold do not exceed 10 % of the share capital and the issue price is not significantly below the prevailing stock exchange price or in the event of a sale against contributions in kind, or when the shares sold are used to service rights from convertible bonds or bonds with warrants. This also applies to shares issued by subsidiaries. The treasury shares may also be given to the holders of conversion or option rights in lieu of new shares from a contingent capital increase. The shares can also be withdrawn, without this withdrawal or its implementation requiring a further resolution by the General Meeting.

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

Authorised capital

Aareal Bank has authorised capital pursuant to the resolution by the Annual General Meeting held on 23 May 2012. The Annual General Meeting authorised the Management Board to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 89,785,830 (Authorised Capital 2012) by issuance of new bearer shares for contribution in cash or in kind, subject to the approval of the Supervisory Board; this authority will expire on 22 May 2017. In the event of a capital increase against cash contributions, the shareholders shall be granted a subscription right, unless the Management Board exercises its authority to exclude shareholder's pre-emptive subscription rights. The Management Board may exclude shareholders' subscription rights, subject to approval by the Supervisory Board and the conditions set out below:

a) In the event of a capital increase against cash contributions, provided that the issue price of the new shares is not significantly below the prevailing stock exchange price of the Company's listed shares at the time of the final determination of the issue price. However, this authorisation shall be subject to the proviso that the aggregate value of shares sold to the exclusion of shareholders' subscription rights, in accordance with section 186 (3) sentence 4 of the AktG, shall not exceed 10 % of the issued share capital at the time said authorisation comes into effect or – if lower – at the time it is exercised. Any shares that were issued or sold during the term and prior to the exercising of said authorisation, in direct or analogous application of section 186 (3) sentence 4 of the AktG, shall count towards the above threshold of 10 % of the issued share capital. Said ten-per-cent threshold shall also include shares the issuance of which is required under the terms of debt securities with embedded conversion or option rights on shares issued pursuant to section 186 (3) sentence 4 of the AktG (excluding shareholders' subscription rights), which were (or may be) issued during the validity of this authorisation;

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

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

d) for an amount of up to € 4,000,000, to offer employees (of the Company or its affiliated companies) shares for subscription.

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.

When exercising this authorisation, the Management Board will restrict the exclusion of shareholders' pre-emptive rights to a total of 20 % of the Company's registered share capital. Accordingly, the aggregate exclusion of shareholders' subscription rights upon exercise of this authorisation must not exceed 20 per cent (20 %) of the issued share capital at the time said authorisation comes into effect or is exercised. This limit also includes shares that are issued by the Company on the basis of the authorisation by the Annual General Meeting on 23 May 2012, under convertible bonds and/or bonds with warrants issued excluding the pre-emptive rights of shareholders.

The authorised capital has not been utilised.

Conditional capital

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

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

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

The new shares will be issued at the conversion price to be set as defined in the resolution passed by the General Meeting on 21 May 2014.

To date, the Conditional Capital has not yet been utilised.

Capital reserves

The capital reserves contain premiums received upon the issuance of shares. Costs incurred within the framework of a capital increase reduce capital reserves.

Retained earnings

Retained earnings are comprised of statutory reserves (pursuant to section 150 of the AktG) of € 5 million (2015: € 5 million) and of other retained earnings of € 1,729 million (2015: € 1,628 million).

Additional Tier 1 bond (AT1 bond)

On 13 November 2014, the Management Board issued notes in an aggregate nominal amount of € 300 million with a denomination of € 200,000 and an initial interest rate of 7.625 %, based on the authorisation granted by the Annual General Meeting on 21 May 2014.

The notes bear interest of 7.625 % per annum from the interest commencement date to 30 April 2020. The rate of interest for any interest period commencing on or after 30 April 2020 shall be equal to the reference rate (one-year EUR swap rate) determined on the relevant interest determination date plus a margin of 7.18 % per annum.

The notes constitute unsecured and subordinated obligations of the issuer.

Upon the occurrence of a trigger event, the redemption amount and the principal amount of each note shall be reduced by the amount of the relevant write-down. The write-down shall be effected pro rata with all other Additional Tier 1 instruments within the meaning of the CRR, the terms of which provide for a write-down upon the occurrence of the trigger event. A trigger event occurs if the Common Equity Tier 1 capital ratio, pursuant to Article 92 (1) (a) CRR or a successor provision, and determined on a consolidated basis, falls below 7.0 %. After a write-down has been effected, the principal amount and the redemption amount of each note, unless previously redeemed or repurchased and cancelled, may be written up in each of the financial years of the issuer subsequent to such write-down until the full initial principal amount has been reached.

The notes may be redeemed, in whole but not in part, at any time at the option of the issuer, subject to the prior consent of the competent supervisory authority, upon not less than 30 and not more than 60 days' prior notice of redemption at their redemption amount (taking into account a potential write-down) together with interest accrued until the redemption date (to the extent that interest payment is not cancelled or ruled out in accordance with the terms and conditions of the notes), when the tax or regulatory reasons set out in the terms and conditions of the notes apply. The issuer may also redeem the notes, in whole but not in part, at any time, subject to the prior consent of the competent supervisory authority, upon not less than 30 days' notice of redemption with effect as at 30 April 2020 for the first time and, thereafter, with effect as at each interest payment date at their redemption amount together with interest (if any) accrued to the redemption date.

Revaluation surplus

The revaluation surplus comprises effects from fair value measurement of financial instruments of the measurement category "Available for sale (AfS)".

Non-controlling interests

€ 250 million (2015: € 250 million) in preference shares issued by, among others, Aareal Capital Funding Trust, Wilmington, Delaware, USA were outstanding at the end of the financial year. The equity interest of Aareal Bank Group held in this company amounts to 0.01 %, while the remaining 99.99 % are held by non-controlling interests. Aareal Bank Group holds 100 % of the voting rights in the company. The preference 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 (2015: € 18 million). The tax relief resulting from distributions leads to a reduction of income taxes as reported in the statement of comprehensive income.

Distributions

The Management Board of Aareal Bank AG proposes to the Annual General Meeting that a partial amount of € 119,714,442.00 of Aareal Bank AG's net retained profit of € 122,214,442.00 for the financial year 2016, as reported under the German Commercial Code (HGB), be used to distribute a dividend of € 2.00 per notional no-par value share.

In addition, on 30 April 2017, the Management Board will resolve on a distribution in relation to the AT1 instruments, pursuant to the terms and conditions of the notes.

Notes to Financial Instruments

A detailed description of the system in place at Aareal Bank AG to measure, limit, and manage risks throughout 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 arising from financial instruments in accordance with IFRS 7 are included (in part) in the risk report.

(61) 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:

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Result from loans and receivables	-102	-142
Result from held-to-maturity investments	0	-5
Result from financial instruments held for trading	19	20
Result from assets designated as at fair value through profit or loss	0	0
Result from assets available for sale	58	11
of which: directly recognised in equity	-4	13
Result from financial guarantee contracts	8	2

The net result from available-for-sale assets comprises € 62 million in net result from non-trading assets (largely due to the disposal of all shares in Aareal Bank's wholly-owned subsidiary Aqvatrium, which is the owner of a commercial property located in Stockholm), and € -4 million in measurement amounts included in the revaluation surplus. The net result on hedge accounting amounted to € 0 million in the year under review (2015: € 8 million). The result from currency translation amounted to € 0 million in the year under review (2015: € -6 million).

The net results include measurement gains and losses, realised gains / losses on disposal, subsequent recoveries on loans and advances previously written off in relation to all financial instruments of the respective 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 hedge result from hedged items is aggregated with the hedge result from derivative hedging instruments in one line item and, similarly to the result from currency translation, shown separately.

(62) Impairment losses on financial assets

The following overview shows the impairment losses recognised for financial assets by measurement category during the year under review:

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Loans and advances to customers (LaR)	171	204
Non-trading assets (AfS)	–	6
Other assets (LaR)	0	0
Total	**171**	**210**

(63) Fair value hierarchy in accordance with IFRS 13

All financial instruments for which a fair value is disclosed have to be allocated to one of the levels of the fair value hierarchy in accordance with IFRS 13. The classification into the individual hierarchy levels is based on the inputs used for fair value measurement. A description of the fair value hierarchy is included in Note (5) "Determination of fair value" in the section on accounting policies.

Determination of the fair value for financial instruments carried at fair value in the statement of financial position

Non-trading assets available for sale:
Fixed-income securities and equity instruments for which stock exchange turnover in a meaningful volume can be observed on or shortly before the reporting date are allocated to Level 1 of the fair value hierarchy.

In case of fixed-income securities or equities for which no current market price is available, the fair value is determined on the basis of comparable market prices to the extent possible. To this end, quoted prices on active markets for largely identical or quoted prices on inactive markets for identical or similar securities are used by adjusting the last available market price or the current fair value of another largely identical instrument, to take into account any changes in risk or new information known as at the measurement date. In the absence of comparable market prices for securities, they are measured through an analysis of future payments using the fully-capitalised earnings value approach, where the inputs are based on observable market data. These approaches include the discounted cash flow (DCF) method which is used to determine the present value of contractual cash flows until the expected end of the term. The present value is determined based on the benchmark curve applicable for the relevant market, taking into account mark-ups based on credit quality and liquidity. The valuation model used for options included in the transaction is the commonly used Black-Scholes model or appropriate numerical procedures. These valuation models exclusively include inputs observable in the market, so that the securities concerned are allocated to Level 2 of the fair value hierarchy. In case the fair value of unlisted equity instruments cannot be determined reliably, the instruments are accounted for using cost.

Positive and negative market value of derivative hedging instruments as well as from derivatives held for trading:

Exchange-traded derivatives are measured at their quoted market price and allocated to Level 1 of the fair value hierarchy. Aareal Bank currently does not hold any listed derivatives in its portfolio.

The fair value of OTC derivatives included in the trading portfolio as well as of OTC hedging derivatives is determined on the basis of sector-specific standardised measurement models, such as the present value method or option pricing models. These techniques are based on inputs quoted on active markets, such as interest rates, yield curves and credit spreads. The fair value of foreign exchange forwards is generally based on current forward exchange rates quoted on active markets. These derivatives are allocated to Level 2 of the fair value hierarchy.

The carrying amounts of financial instruments held by Aareal Bank Group which are reported at fair value in the statement of financial position are presented in the following table according to the three-tier fair value hierarchy pursuant to IFRS 13.72 et seq. The presentation is made for each class of financial instrument:

31 December 2016

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Positive market value of derivative hedging instruments	**2,481**	**–**	**2,481**	**–**
Assets held for trading	**502**	**–**	**502**	**–**
Trading derivatives	502	–	502	–
Non-trading assets available for sale	**5,948**	**5,918**	**30**	**–**
Fixed-income securities	5,947	5,917	30	–
Equities/funds	1	1	–	–
Negative market value of derivative hedging instruments	**2,529**	**–**	**2,529**	**–**
Liabilities held for trading	**652**	**–**	**652**	**–**
Trading derivatives	652	–	652	–

31 December 2015

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Positive market value of derivative hedging instruments	**2,498**	**–**	**2,498**	**–**
Assets held for trading	**638**	**–**	**638**	**–**
Trading derivatives	638	–	638	–
Non-trading assets available for sale	**6,272**	**6,240**	**32**	**–**
Fixed-income securities	6,265	6,235	30	–
Equities/funds	7	5	2	–
Negative market value of derivative hedging instruments	**2,720**	**–**	**2,720**	**–**
Liabilities held for trading	**663**	**–**	**663**	**–**
Trading derivatives	663	–	663	–

During the financial year 2016, no fixed-income securities of the AfS category were reclassified from Level 2 to Level 1 (2015: € 48 million). There was no reclassification of fixed-income securities of the same category from Level 1 to Level 2 in the reporting year (2015: € –).The end of the reporting period is relevant for reclassification.

Determination of the fair value for financial instruments carried at amortised cost in the statement of financial position

Cash on hand and balances with central banks:

Cash funds are recognised at the IFRS carrying amount, which is considered an appropriate fair value.

Loans and advances to banks and customers classified as ”Loans and receivables” as well as liabilities to banks and customers measured at amortised cost:

The property finance portfolio included in loans and advances to customers of the ”Loans and receivables” category is measured using the discounted cash flow method for the purpose of the determination of fair value. Discounting of future cash flows of a transaction is based on transaction-specific risk-adjusted interest rates. These are derived on the basis of a virtually risk-free market interest rate for each currency depending on the relevant term, taking into account add-ons for risks specific to the counterparty as well as credit costs. In the case of loans subject to fixed interest rates, the contractually agreed payments are used as future cash flows. The future cash flows for floating-rate loans are derived using the future forward interest rates, taking into account the relevant spread for customer-specific terms and conditions.

Amortised cost is an adequate estimate of fair value for short-term money market transactions, current account balances and other short-term receivables and liabilities included in these classes. Quoted market prices are normally not available for promissory note loans of the ”Loans and receivables” category. Therefore, they are measured through discounting the future cash flows using the currency-specific benchmark curve. The liquidity and creditworthiness components are taken into account using issuer-specific spreads.

Registered profit-participation certificates of the ”Liabilities measured at amortised cost” category which are backed through assets (covered issues) are also measured using the discounted cash flow method on the basis of the benchmark curve. In addition, we take into account quoted covered bond spreads. Future contractual cash flows of uncovered issues are discounted using an interest rate adequate for Aareal Bank.

Generally, there are no quoted market prices available for the products included in loans and advances, and liabilities to banks and customers. They are allocated either to Level 2 or Level 3 of the fair value hierarchy, depending on the inputs included in the measurement model.

Non-trading assets of the “Loans and receivables” and “Held to maturity” categories:
These classes include fixed-income bonds and debt securities whose fair value is determined following the same procedure for available-for-sale non-trading assets, based on prices on active markets or valuation methods such as the discounted cash flow method; they are classified accordingly into the fair value hierarchy. They are allocated either to Level 1 or Level 2 of the fair value hierarchy, depending on whether or not sufficient stock exchange turnover is observable as at the reporting date.

Certificated liabilities measured at amortised cost:
Unless prices on active markets are available, the fair value for bearer securities is determined in accordance with the procedure used for registered securities, with a distinction being made between covered and uncovered issues. To the extent that quoted market prices are available for securities issued by Aareal Bank, such securities are allocated to Level 1 of the fair value hierarchy. Securities for which there are no active market prices are allocated to Level 2 since the valuation methods do not use inputs not observable in the market.

Subordinated capital equity measured at amortised cost:
Subordinated promissory note loans, subordinated bearer debt securities as well as other hybrid instruments of the ”Liabilities measured at amortised cost” category are also measured on the basis of the present value method using market-based credit quality premiums with respect to the relevant benchmark curves. If quoted prices on active markets are available, such prices are used as the fair value. Subordinated securities not actively traded in the market are allocated either to Level 2 or Level 3 of the fair value hierarchy, depending on the inputs included in the measurement model.

The market values of financial instruments held by Aareal Bank Group which are reported at amortised cost in the statement of financial position are presented in the following table according to the three-tier fair value hierarchy pursuant to IFRS 13.72 et seq. The presentation is made for each class of financial instrument.

31 December 2016

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Cash on hand and balances with central banks	**1,786**	**–**	**1,786**	**–**
Loans and advances to banks (loans and receivables)	**1,590**	**–**	**1,590**	**–**
Money market receivables from banks	1,468	–	1,468	–
Promissory note loans to banks	122	–	122	–
Other receivables from banks	–	–	–	–
Loans and advances to customers (loans and receivables)	**32,697**	**–**	**1,533**	**31,164**
Property loans to customers	28,201	–	0	28,201
Money market receivables from customers	977	–	9	968
Promissory note loans to customers	1,525	–	1,524	1
Other receivables from customers	1,994	–	–	1,994
Non-trading assets (loans and receivables)	**3,144**	**2,323**	**821**	**–**
Fixed-income securities	3,144	2,323	821	–
Non-trading assets held to maturity	**525**	**525**	**–**	**–**
Fixed-income securities	525	525	–	–
Liabilities to banks measured at amortised cost	**1,719**	**–**	**1,655**	**64**
Money market liabilities to banks	808	–	808	–
Registered mortgage Pfandbriefe to banks	505	–	505	–
Registered Public Sector Pfandbriefe to banks	21	–	21	–
Promissory note loans to banks	361	–	297	64
Other liabilities to banks	24	–	24	–
Liabilities to customers measured at amortised cost	**29,040**	**–**	**20,134**	**8,906**
Money market liabilities to customers	13,724	–	4,818	8,906
Registered mortgage Pfandbriefe to customers	6,139	–	6,139	–
Registered Public Sector Pfandbriefe to customers	2,979	–	2,979	–
Promissory note loans to customers	6,197	–	6,197	–
Other liabilities to customers	1	–	1	–
Certificated liabilities measured at amortised cost	**8,361**	**519**	**7,842**	**–**
Bearer mortgage Pfandbriefe	5,990	519	5,471	–
Bearer public-sector Pfandbriefe	45	–	45	–
Other debt securities	2,326	–	2,326	–
Subordinated capital measured at amortised cost	**1,424**	**331**	**841**	**252**

31 December 2015

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Cash on hand and balances with central banks	**1,282**	**–**	**1,282**	**–**
Loans and advances to banks (loans and receivables)	**1,896**	**–**	**1,868**	**28**
Money market receivables from banks	1,672	–	1,672	–
Promissory note loans to banks	196	–	196	–
Other receivables from banks	28	–	–	28
Loans and advances to customers (loans and receivables)	**36,156**	**–**	**1,529**	**34,627**
Property loans to customers	30,695	–	0	30,695
Money market receivables from customers	1,139	–	5	1,134
Promissory note loans to customers	1,526	–	1,524	2
Other receivables from customers	2,796	–	–	2,796
Non-trading assets (loans and receivables)	**3,586**	**2,533**	**1,053**	**–**
Fixed-income securities	3,586	2,533	1,053	–
Non-trading assets held to maturity	**606**	**519**	**87**	**–**
Fixed-income securities	606	519	87	–
Liabilities to banks measured at amortised cost	**1,912**	**–**	**1,832**	**80**
Money market liabilities to banks	924	–	923	1
Registered mortgage Pfandbriefe to banks	464	–	464	–
Registered Public Sector Pfandbriefe to banks	51	–	51	–
Promissory note loans to banks	423	–	345	78
Other liabilities to banks	50	–	49	1
Liabilities to customers measured at amortised cost	**30,335**	**–**	**22,292**	**8,043**
Money market liabilities to customers	13,169	–	5,126	8,043
Registered mortgage Pfandbriefe to customers	6,914	–	6,914	–
Registered Public Sector Pfandbriefe to customers	3,319	–	3,319	–
Promissory note loans to customers	6,933	–	6,933	–
Other liabilities to customers	–	–	–	–
Certificated liabilities measured at amortised cost	**10,870**	**1,041**	**9,829**	**–**
Bearer mortgage Pfandbriefe	8,591	1,041	7,550	–
Bearer public-sector Pfandbriefe	71	–	71	–
Other debt securities	2,208	–	2,208	–
Subordinated capital measured at amortised cost	**1,441**	**323**	**869**	**249**

(64) Comparison of carrying amounts and fair values of the financial instruments

The fair values of financial instruments are compared with their carrying amounts in the following table. The presentation is made for each class of financial instrument:

€ mn	31 Dec 2016 Carrying amount	31 Dec 2016 Fair value	31 Dec 2015 Carrying amount	31 Dec 2015 Fair value
Cash on hand and balances with central banks (LaR)	1,786	1,786	1,282	1,282
Loans and advances to banks (LaR)	1,583	1,590	1,893	1,896
Loans and advances to customers (LaR)	30,649	32,697	34,038	36,156
Non-trading assets (LaR)	3,259	3,144	3,630	3,586
Other assets (LaR)	85	84	93	92
Total loans and receivables	**37,362**	**39,301**	**40,936**	**43,012**
Non-trading assets held to maturity	**522**	**525**	**604**	**606**
Non-trading assets available for sale	**5,948**	**5,948**	**6,272**	**6,272**
Positive market value of derivative hedging instruments	**2,481**	**2,481**	**2,498**	**2,498**
Assets held for trading	**502**	**502**	**638**	**638**
Liabilities to banks (LaC)	1,703	1,719	1,898	1,912
Liabilities to customers (LaC)	29,077	29,040	30,360	30,335
Certificated liabilities (LaC)	8,346	8,361	10,819	10,870
Other liabilities (LaC)	97	96	82	82
Subordinated capital (LaC)	1,366	1,424	1,411	1,441
Total liabilities measured at amortised cost	**40,589**	**40,640**	**44,570**	**44,640**
Negative market value of derivative hedging instruments	**2,529**	**2,529**	**2,720**	**2,720**
Liabilities held for trading	**652**	**652**	**663**	**663**

(65) Credit quality of financial assets

The following overview shows the credit quality of Aareal Bank Group's financial assets by separately disclosing assets neither past due nor impaired, past due assets and impaired assets. The presentation is based on carrying amounts:

€ mn	31 Dec 2016	31 Dec 2015
Financial assets neither past due nor impaired		
Loans and advances to banks	1,583	1,893
Loans and advances to customers	29,685	32,934
Positive market value of derivative hedging instruments	2,481	2,498
Trading assets	502	638
Non-trading assets (LaR)	3,259	3,630
Non-trading assets (AfS)	5,949	6,273
Non-trading assets (HtM)	522	604
Other assets	88	89
Total	**44,069**	**48,559**
Financial assets that are past due but not impaired		
Loans and advances to customers	153	268
Other assets	–	0
Total	**153**	**268**
Financial assets subject to specific valuation allowances		
Loans and advances to customers	1,365	1,364
Other assets	5	19
Total	**1,370**	**1,383**

Information about the recoverability of financial assets neither past due nor impaired are provided in the Risk Report in the section on credit risks. An analysis of the financial assets that are past due and impaired is included in the other disclosures in the Notes.

Please refer to the presentation of the items of the statement of financial position in the section "Notes to the statement of financial position" for information on maximum credit risk exposure since the carrying amount corresponds to the maximum credit risk exposure of Aareal Bank as at the balance sheet date. The collateral received is described in the Risk Report.

At Aareal Bank, property loans subject to intensified handling or handling of problem loans pursuant to the Minimum Requirements for Risk Management (MaRisk) that are not impaired individually were subjected to contractual adjustments due to financial difficulties of the borrower, in order to secure the repayment of the exposure. The portfolio of financings, adjusted during the reporting year and the previous years, totalled € 199 million on 31 December 2016. In 2015, the balance of loans adjusted due to financial difficulties of the borrower amounted to € 118 million. In the financial year 2016, loans with a carrying amount of € 25 million (2015: € 3 million) are no longer part of intensified handling or handling of problem loans due to re-ageing after the end of a two-year period of good conduct, while no specific valuation allowances were recorded for loans (2015: € 30 million). Moreover, loans with a carrying amount of € 48 million were discharged or terminated through realisation of collateral. In the year under review, the volume of financings that were subject to adjustments to be made due to financial difficulties of the borrower amounted to € 159 million (2015: € –). There were decreases in the carrying amounts in relation to existing exposures, by a total of € 5 million (2015: decreases of € 5 million).

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

The following overviews show the amount of property loans past due but not impaired within the category "Loans and advances to customers (LaR)".[1)]

Breakdown by region

31 December 2016

€ mn	Past due more than 9 days up to 1 month	Past due more than 1 month up to 3 months	Past due more than 3 months up to 6 months	Past due more than 6 months up to 1 year	Past due more than 1 year	Total as at 31 Dec 2016
Regions						
Germany	1	0	0	12	15	**28**
Western Europe	0	–	31	–	–	**31**
Northern Europe	–	–	–	–	–	**–**
Southern Europe	19	0	–	21	54	**94**
Eastern Europe	–	–	–	–	–	**–**
Total	**20**	**0**	**31**	**33**	**69**	**153**

31 December 2015

€ mn	Past due more than 9 days up to 1 month	Past due more than 1 month up to 3 months	Past due more than 3 months up to 6 months	Past due more than 6 months up to 1 year	Past due more than 1 year	Total as at 31 Dec 2015
Regions						
Germany	20	6	1	1	3	**31**
Western Europe	0	43	–	–	–	**43**
Northern Europe	3	3	–	–	4	**10**
Southern Europe	–	24	94	1	65	**184**
Eastern Europe	–	–	–	–	–	**–**
Total	**23**	**76**	**95**	**2**	**72**	**268**

[1)] The figures shown are past-due, non-impaired assets that are at least ten days overdue with a minimum amount of € 100 and 2.5 % of the commitment.

Breakdown by borrower group

31 December 2016

€ mn	Past due more than 9 days up to 1 month	Past due more than 1 month up to 3 months	Past due more than 3 months up to 6 months	Past due more than 6 months up to 1 year	Past due more than 1 year	Total as at 31 Dec 2016
Borrower groups						
Companies	19	0	31	33	67	**150**
Private individuals	1	0	–	0	2	**3**
Other	–	–	–	–	0	**0**
Total	**20**	**0**	**31**	**33**	**69**	**153**

31 December 2015

€ mn	Past due more than 9 days up to 1 month	Past due more than 1 month up to 3 months	Past due more than 3 months up to 6 months	Past due more than 6 months up to 1 year	Past due more than 1 year	Total as at 31 Dec 2015
Borrower groups						
Companies	23	72	95	1	62	**253**
Private individuals	0	4	0	1	10	**15**
Other	0	0	0	–	0	**0**
Total	**23**	**76**	**95**	**2**	**72**	**268**

The past-due financial assets were not impaired due to collateral provided.

On the reporting date, the amount of loans and advances of the “Other assets” category did not include any receivables that were past due but not impaired (2015: € 0 million). There were no other financial assets past due but not impaired on the reporting date.

(67) Impaired financial assets

The following overviews indicate the amount of impaired property loans, together with the related allowance for credit losses:

Breakdown by region

31 December 2016

€ mn	Impaired property loans before allowance for credit losses	Balance of specific valuation allowances	Balance of provisions for the lending business
Regions			
Germany	27	6	3
Western Europe	193	40	–
Northern Europe	82	47	–
Southern Europe	919	284	–
Eastern Europe	120	49	–
North America	24	9	–
Total	**1,365**	**435**	**3**

31 December 2015

€ mn	Impaired property loans before allowance for credit losses	Balance of specific valuation allowances	Balance of provisions for the lending business
Regions			
Germany	78	7	8
Western Europe	179	41	0
Northern Europe	88	44	–
Southern Europe	924	298	–
Eastern Europe	95	22	–
North America	–	–	–
Total	**1,364**	**412**	**8**

Breakdown by borrower group

31 December 2016

€ mn	Impaired property loans before allowance for credit losses	Balance of specific valuation allowance	Balance of provisions for the lending business	Changes of specific valuation allowances and specific provisions for the lending business recognised in profit or loss	Direct write-offs
Borrower groups					
Companies	1,363	435	2	77	19
Private individuals	2	0	1	0	0
Other	0	0	0	0	0
Total	**1,365**	**435**	**3**	**77**	**19**

31 December 2015

€ mn	Impaired property loans before allowance for credit losses	Balance of specific valuation allowance	Balance of provisions for the lending business	Changes of specific valuation allowances and specific provisions for the lending business recognised in profit or loss	Direct write-offs
Borrower groups					
Companies	1,353	411	6	149	21
Private individuals	3	–	1	0	0
Other	8	1	1	-2	0
Total	**1,364**	**412**	**8**	**147**	**21**

As at the reporting date, the amount of portfolio-based valuation allowances for recognised items was € 119 million (2015: € 116 million) and for financial guarantees and loan commitments € 2 million (2015: € 6 million). Net reversals of portfolio-based valuation allowances, which are recognised through profit or loss, amounted to € 1 million (2015: net reversals of € 52 million) in the year under review. Payments on loans and advances previously written off amounted to € 30 million in the year under review (2015: € 7 million).

The amount of impaired receivables of the "Other assets" category as at the reporting date was € 5 million (2015: € 19 million). The related impairment allowance amounts to € 3 million (2015: € 17 million).

In the financial year, assets of € 220 million were acquired within the context of the realisation of collateral (2015: € –).

(68) Reclassification of financial assets

In 2008 and 2009, Aareal Bank Group made use of the possibility to reclassify financial assets into another measurement category, in accordance with IAS 39.50A et seq.

The following table is a comparison of the carrying amounts and the fair values of the reclassified securities and also shows the measurement effects which would have arisen without reclassification in the current financial year and in the previous year:

	Reclassified assets, total				Results from fair value measurement without reclassification			
€ mn	Carrying amount at reporting date 31 Dec 2016	Fair value at reporting date 31 Dec 2016	Carrying amount previous year 31 Dec 2015	Fair value previous year 31 Dec 2015	Effect on the income statement 1 Jan - 31 Dec 2016	Effect on the revaluation surplus 1 Jan - 31 Dec 2016	Effect on the income statement 1 Jan - 31 Dec 2016	Effect on the revaluation surplus 1 Jan - 31 Dec 2016
from AfS to LaR	**3,044**	**2,921**	**3,262**	**3,202**	**–**	**-51**	**–**	**113**
Asset-backed securities	–	–	27	27	–	-1	–	0
Senior unsecured bank bonds	46	47	138	140	–	-4	–	-6
Covered bank bonds	237	239	298	304	–	-4	–	-12
Public-sector issuers	2,761	2,635	2,799	2,731	–	-42	–	131
from HfT to LaR	**–**	**–**	**85**	**91**	**-6**	**–**	**-1**	**–**
Asset-backed securities	–	–	85	91	-6	–	-1	–
Total	**3,044**	**2,921**	**3,347**	**3,293**	**-6**	**-51**	**-1**	**113**

As in the previous year, no impairment losses had to be recognised for the reclassified financial assets in 2016. The disposal of reclassified securities resulted in the realisation of a gain of € 5 million (2015: loss of € 10 million). Interest income from reclassified assets amounted to € 90 million (2015: € 98 million) in the year under review. Interest income, including current interest from derivatives used to hedge economic market price risks, amounted to € 7 million (2015: € 17 million).

(69) Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount is presented in the statement of financial position when currently there is a legally enforceable right to set off the recognised amounts, and when the Bank intends either to settle on a net basis – or to realise the asset and settle the liability simultaneously.

The following overviews (p. 190) show whether and to what extent financial instruments were actually offset as at the current reporting date. The tables also include disclosures on financial instruments that are part of an enforceable master netting or similar arrangement that do not meet the criteria for offsetting in the statement of financial position.

Financial assets as at 31 December 2016

€ mn	Gross carrying amounts of recognised financial assets	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial liabilities which were not subject to offsetting	Collateral received	Remaining net amount
Derivatives	2,700	–	2,700	1,707	957	36
Reverse repos	–	–	–	–	–	–
Total	**2,700**	**–**	**2,700**	**1,707**	**957**	**36**

Financial liabilities as at 31 December 2016

€ mn	Gross carrying amounts of recognised financial liabilities	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial assets which were not subject to offsetting	Collateral provided	Remaining net amount
Derivatives	3,031	–	3,031	1,707	1,238	86
Repos	–	–	–	–	–	–
Total	**3,031**	**–**	**3,031**	**1,707**	**1,238**	**86**

Financial assets as at 31 December 2015

€ mn	Gross carrying amounts of recognised financial assets	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial liabilities which were not subject to offsetting	Collateral received	Remaining net amount
Derivatives	2,794	–	2,794	1,792	1,002	–
Reverse repos	150	–	150	–	150	–
Total	**2,944**	**–**	**2,944**	**1,792**	**1,152**	**–**

Financial liabilities as at 31 December 2015

€ mn	Gross carrying amounts of recognised financial liabilities	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial assets which were not subject to offsetting	Collateral received	Remaining net amount
Derivatives	3,347	–	3,347	1,792	1,393	162
Repos	–	–	–	–	–	–
Total	**3,347**	**–**	**3,347**	**1,792**	**1,393**	**162**

To reduce counterparty risk, Aareal Bank Group concludes standardised master agreements for financial derivatives and securities repurchase agreements, such as the ISDA Master Agreement, the German Master Agreement on Financial Derivatives or the Master Agreement for Securities Repurchase Transactions. In addition, Aareal Bank enters into collateral agreements (Credit Support Annex to the ISDA Master Agreement and Collateral Annex to the German Master Agreement on Financial Derivatives) in which a mutual collateralisation of all claims between the contracting parties is agreed and which include netting arrangements.

The master agreements for financial derivatives used by Aareal Bank include netting arrangements at a single transaction level (so-called "payment netting"), which provide for a netting of payments when both parties need to make payments in the same currency on the same date, as set out in the contract. Aareal Bank does not offset financial derivatives according to the rules related to payment netting, as the transactions are not settled on a net basis. Aareal Bank Group has not entered into arrangements providing for netting of derivatives across several transactions.

For securities repurchase transactions (repo), depending on the counterparty, payment or delivery netting is made. In line with the rules set out in the master agreement for repo transactions, payments or deliveries of securities may be offset when both counterparties have to make payments in the same currency on the same date, or have to deliver securities of the same type. Transactions effected on the basis of the master agreement for repo transactions generally meet the offsetting requirements of IAS 32. Aareal Bank settles on a net basis in the case of transactions within the framework of GC pooling, which means that these transactions are offset in the statement of financial position.

(70) Assets provided or accepted as collateral

Assets provided as collateral

Aareal Bank Group has provided financial assets as collateral for its liabilities or contingent liabilities. The following overview shows the carrying amount of the collateral provided and the items of the statement of financial position in which they are reported.

€ mn	31 Dec 2016	31 Dec 2015
Loans and advances to banks	1,382	1,393
Non-trading assets	192	238
Total	**1,574**	**1,631**

The protection buyer has no right to sell or re-pledge any of financial assets pledged as collateral (2015: € –). There is a fully cash-collateralised and irrevocable payment obligation in the amount of € 10 million (2015: € 6 million) from the bank levy and, since 2016, also for the deposit guarantee scheme of German banks. Cash collateral is recognised as other assets.

Assets accepted as collateral

Aareal Bank Group accepts financial assets as collateral. These assets may be sold or pledged without the collateral owner being in default. No fixed income securities received as collateral for repo transactions had been accepted as at the reporting date (2015: € 152 million).

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

(71) Transfer of financial assets without derecognition

Aareal Bank Group sells securities subject to a take-back requirement as borrower within the framework of genuine repurchase agreements. Within the scope of such agreements, securities were transferred to lenders without resulting in the securities being derecognised since Aareal Bank Group retains the substantial risks and rewards from the securities. The risks to which Aareal Bank Group is still exposed comprise the default risk, the interest rate risk and other price risks. The equivalent values received as hedges during the transfer of securities are accounted for as liabilities to banks, or liabilities to customers. Within the context of securities repurchase transactions, the unrestricted title and the unrestricted power of disposition is transferred to the lender upon delivery of the securities. The lender has the right to sell or pledge these securities, however, he is required to retransfer securities of the same type and in the same amount as at the repurchase date.

As in previous year, no securities were part of repurchase agreements as at the balance sheet date.

(72) Derivative financial instruments

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 meet the hedge accounting criteria are reported in the statement of financial position 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 to assume credit risks for the purpose of portfolio diversification.

Counterparty risks in derivative transactions are monitored by means of counterparty limits, provision of collateral and a uniform lending policy. Limits are set in accordance with the counterparty classification in internally-defined credit classes as well as ratings of Fitch IBCA, Moody's and Standard & Poor's. Collateral is generally provided in the form of cash collateral, which is released to the pledger as soon as the purpose of collateralisation ceases to exist.

Derivative transactions are generally entered into on the basis of the German Master Agreement for Financial Derivatives, or the ISDA Master Agreements only. Such master agreements provide for the netting of claims and liabilities in the event of insolvency or counterparty default, and thus further reduce counterparty risk.

Fair value hedges

Fair value hedges are entered into by Aareal Bank Group in order to hedge interest rate and currency risks inherent in securities, mortgage loans, promissory note loans, money market instruments, registered covered bonds (Namenspfandbriefe), certificated liabilities, and subordinated capital. 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:

€ mn	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Result from hedging instruments	-96	-165
Result from hedged items	96	172
Total	**0**	**7**

Cash flow hedges

Cash flow hedges are used within Aareal Bank Group exclusively to hedge future cash flows from variable-rate financial assets and liabilities.

The hedged portion of the cash flows from hedged items which are part of cash flow hedges is as follows:

Cash flows from hedged items – Cash flow hedges as at 31 December 2016

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Cash inflows and outflows from hedged assets (+/-)	-12	-32	-63	24	**-83**

Cash flows from hedged items – Cash flow hedges as at 31 December 2015

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Cash inflows and outflows from hedged assets (+/-)	-7	-24	-15	43	**-3**

In 2016, gains/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 (2015: gains of € 21 million).

€ 4 million (2015: € 0 million) was transferred from the cash flow hedge reserve to net interest income.

An amount of € 0 million (2015: € 1 million) was recognised directly in income due to inefficiencies of cash flow hedges.

In addition, derivatives were entered into within Aareal Bank Group to hedge net investments in foreign operations. These derivatives are used to hedge the currency risk arising on translating the net assets of foreign Group companies to the Group's reporting currency (euro).

€ 0 million (2015: € 0 million) was recognised directly in the income statement as the ineffective portion of hedges of net investments in foreign operations.

Overview of market values of derivatives

The following table shows positive and negative market values (including pro-rata interest) of derivative financial instruments:

	Fair value as at 31 Dec 2016		Fair value as at 31 Dec 2015	
€ mn	positive	negative	positive	negative
Trading derivatives				
Interest rate instruments				
OTC products				
Interest rate swaps	456	401	592	507
Swaptions	–	0	–	0
Caps, floors	7	8	13	13
Total interest rate instruments	**463**	**409**	**605**	**520**
Currency-related instruments				
OTC products				
Spot and forward foreign exchange transactions	11	66	24	15
Cross-currency swaps	28	177	8	128
Total currency-related instruments	**39**	**243**	**32**	**143**
Other transactions				
OTC products				
Credit default swaps [1]	–	–	1	–
Total other transactions	**–**	**–**	**1**	**–**
Total trading derivatives	**502**	**652**	**638**	**663**
Fair value hedge derivatives				
Interest rate instruments				
OTC products				
Interest rate swaps	2,194	1,948	2,404	1,911
Total interest rate instruments	**2,194**	**1,948**	**2,404**	**1,911**

[1] This includes a derivative subject to the country risk of Hungary and embedded in an Austrian bank bond.

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€ mn	Fair value as at 31 Dec 2016 positive	Fair value as at 31 Dec 2016 negative	Fair value as at 31 Dec 2015 positive	Fair value as at 31 Dec 2015 negative
Currency-related instruments				
OTC products				
Spot and forward foreign exchange transactions	–	–	–	–
Cross-currency swaps	258	564	68	801
Total currency-related instruments	**258**	**564**	**68**	**801**
Total derivatives from fair value hedges	**2,452**	**2,512**	**2,472**	**2,712**
Derivatives from cash flow hedges				
Currency-related instruments				
OTC products				
Cross-currency swaps	29	5	26	7
Total currency-related instruments	**29**	**5**	**26**	**7**
Total derivatives from cash flow hedges	**29**	**5**	**26**	**7**
Derivatives used as net investment hedges				
Currency-related instruments				
OTC products				
Cross-currency swaps	–	12	–	1
Total currency-related instruments	**–**	**12**	**–**	**1**
Total derivatives used as net investment hedges	**–**	**12**	**–**	**1**
Total	**2,983**	**3,181**	**3,136**	**3,383**

Derivatives have been entered into with the following counterparties:

€ mn	Fair value as at 31 Dec 2016 positive	Fair value as at 31 Dec 2016 negative	Fair value as at 31 Dec 2015 positive	Fair value as at 31 Dec 2015 negative
OECD banks	2,533	3,122	2,548	3,295
Companies and private individuals	450	59	588	88
Total	**2,983**	**3,181**	**3,136**	**3,383**

The following overview (p. 196) shows the cash flows of derivative financial instruments, based on the contractual maturity. The amounts shown in the table represent the contractually agreed future undiscounted cash flows. The procedure for measuring and monitoring liquidity risk is described in the Risk Report.

31 December 2016

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Interest rate instruments					
Interest rate swaps					
Cash inflows	215	542	1,586	599	2,942
Cash outflows	180	373	1,141	460	2,154
Swaptions					
Cash inflows	–	–	–	–	–
Cash outflows	–	0	0	–	0
Caps, floors					
Cash inflows	0	1	5	1	7
Cash outflows	0	1	5	1	7
Currency-related instruments					
Spot and forward foreign exchange transactions					
Cash inflows	2,690	261	104	–	3,055
Cash outflows	2,748	261	103	–	3,112
Cross-currency swaps					
Cash inflows	46	1,943	5,852	1,043	8,884
Cash outflows	77	2,260	6,344	1,004	9,685
Other transactions					
Credit default swaps					
Cash inflows	–	–	–	–	–
Cash outflows	–	–	–	–	–
Total cash inflows	**2,951**	**2,747**	**7,547**	**1,643**	**14,888**
Total cash outflows	**3,005**	**2,895**	**7,593**	**1,465**	**14,958**

31 December 2015

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Interest rate instruments					
Interest rate swaps					
Cash inflows	245	656	2,073	732	3,706
Cash outflows	200	430	1,592	614	2,836
Swaptions					
Cash inflows	–	–	–	–	–
Cash outflows	–	0	0	0	0
Caps, floors					
Cash inflows	0	1	8	4	13
Cash outflows	0	1	8	4	13

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€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Currency-related instruments					
Spot and forward foreign exchange transactions					
Cash inflows	2,458	287	112	–	2,857
Cash outflows	2,450	287	112	–	2,849
Cross-currency swaps					
Cash inflows	13	1,008	6,014	1,514	8,549
Cash outflows	30	1,191	6,961	1,575	9,757
Other transactions					
Credit default swaps					
Cash inflows	–	0	–	–	0
Cash outflows	–	–	–	–	–
Total cash inflows	**2,716**	**1,952**	**8,207**	**2,250**	**15,125**
Total cash outflows	**2,680**	**1,909**	**8,673**	**2,193**	**15,455**

(73) Day-one profit or loss

Aareal Bank Group has entered into transactions that were not effected on the principal market or the most advantageous market for the asset or liability concerned. In these cases the transaction price does not correspond to the fair value of the asset or liability, because the determination of the fair value using a valuation technique which assumes a transaction on a principal market results in a fair value that deviates from the transaction price. The financial instruments are carried at the transaction price upon initial recognition. The difference between the transaction price and the fair value measured based on the valuation model (the so-called day-one profit or loss) is amortised over the term of the transaction in the income statement, since the fair value of these financial instruments of the trading portfolio is determined using valuation models whose inputs are not fully based on observable market factors.

The table below shows the development of the day-one profit or loss during the year under review. The day-one profit or loss is recognised as an item to be deducted from the carrying amount of the respective underlying derivative position:

€ mn	2016	2015
Balance as at 1 January	**27**	**42**
Additions from new transactions	-1	-3
Reversals through profit or loss in the period	14	16
Changes in basis of consolidation	–	4
Balance as at 31 December	**12**	**27**

(74) Maturities of financial liabilities

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

Maturities as at 31 December 2016

€ 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	832	64	97	395	389	**1,777**
Liabilities to customers	7,092	4,335	4,415	5,787	10,459	**32,088**
Certificated liabilities	–	280	2,260	4,607	1,593	**8,740**
Subordinated capital	–	39	47	654	922	**1,662**
Financial guarantee contracts	113	–	–	–	–	**113**
Loan commitments	1,333	–	–	–	–	**1,333**

Maturities as at 31 December 2015

€ 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	975	57	76	472	396	**1,976**
Liabilities to customers	6,646	3,790	4,141	7,245	12,133	**33,955**
Certificated liabilities	–	813	2,254	6,674	1,443	**11,184**
Subordinated capital	–	19	87	340	1,274	**1,720**
Financial guarantee contracts	162	–	–	–	–	**162**
Loan commitments	1,227	–	–	–	–	**1,227**

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

Segment Reporting

(75) Operating segments of Aareal Bank

In the financial year 2016, segment reporting by Aareal Bank was prepared in accordance with IFRS 8 Operating Segments.

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

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

The **Structured Property Financing** segment comprises the property financing and refinancing activities. In this segment, Aareal Bank facilitates property investments for its domestic and international clients, and is active in this respect in Europe, North America and Asia. It offers commercial property financing solutions, especially for office buildings, hotels, retail, logistics and residential properties. Its particular strength lies in its success in combining local market expertise and sector-specific know-how. In addition to local experts, the Bank also has industry specialists at its disposal, to create financing packages for logistics properties, shopping centres and hotels. This enables Aareal Bank to offer tailor-made financing concepts that meet the special requirements of its national and international clients. What makes Aareal Bank special are its direct client relationships, which – in very many cases – it has maintained for many years.

Aareal Bank has a broad and solid refinancing base. It has established itself as an active issuer of Pfandbriefe (German covered bonds), which account for a major share of the Bank's long-term funding. The AAA rating of the Pfandbriefe additionally confirms the quality of the cover assets pool. To cater to a broad investor base, Aareal Bank covers a wide range of other refinancing tools, including promissory notes and debt securities. Private placements are the focal point of the Bank's capital market activities. These are complemented by larger, public placements that are issued depending on market conditions. The Bank also generates deposits from the housing industry, which represent an important additional source of funding. Furthermore, it has recourse to institutional money market investor deposits. The success of our capital and money market activities, and the business with housing industry clients, are the results of a combination of a sustainable business model with a sound understanding of the capital markets, and the quality of the cover assets pool.

The **Consulting/Services** segment offers the housing and commercial property industries services and products for managing property portfolios and processing payment flows. Within this segment, our subsidiary Aareon AG and the Bank's Housing Industry division work together closely.

We operate our IT system consultancy and related advisory services for the housing and commercial property sector through our Aareon AG subsidiary, which can call upon more than 60 years in the business. Aareon offers its customers reliable, pioneering solutions in the fields of consulting, software and services to optimise IT-supported business processes in the digital age. The ERP (Enterprise Resource Planning) systems, which are tailored to the needs of the respective market, may be supplemented by further digital solutions for purposes of process optimisation. The majority of these integrated systems forms the digital ecosystem "Aareon Smart World". It connects property companies with customers, employees and business partners as well as technical ”equipment” in apartments and buildings. Aareon Smart World can be used to restructure and optimise processes. The applications may help to reduce costs, enable the creation of new business models by providing links between all participants and offer more ease-of-use in the dialogue between tenants and employees of the housing industry.

Aareon offers software solutions both in Germany and abroad that may be used in various types of operating environments: in-house services, hosting und Software as a Service (SaaS) from the exclusive Aareon Cloud. Data from Aareon‘s Cloud Computing is held in Aareon‘s certified data-processing centre in Mainz, which guarantees data security and protection at high level. After successful consulting, implementation and training, the customer receives a maintenance model which covers regular support.

In its Housing Industry division, Aareal Bank offers its customers process optimisation, electronic banking and asset management. Aareal Bank distributes BK 01, the leading procedure in the German housing and property management sector for the automated settlement of mass payments. The procedure is integrated in licensed bookkeeping systems. Therefore, customers in Germany may process their payment transactions and account management from the administration software employed. Apart from the German residential and commercial property sector, the German energy and waste disposal industry is a second important customer group of the Bank’s Housing Industry division. This enables the offer of further products, facilitating the cross-sector cooperation of target groups and realising synergy effects via end-to-end digital processes. The use of the payment transaction products of Aareal Bank generates deposits that contribute significantly to Aareal Bank Group’s refinancing base. The interest rate contribution is reported in the segment’s net commission income and then transferred to net interest income.

(76) Segment results

	Structured Property Financing		Consulting/ Services		Consolidation/ Reconciliation		Aareal Bank Group	
	2016	2015	2016	2015	2016	2015	2016	2015
€ mn								
Net interest income	716	783	0	0	-15	-2	701	781
Allowance for credit losses	97	128					97	128
Net interest income after allowance for credit losses	**619**	**655**	**0**	**0**	**-15**	**-2**	**604**	**653**
Net commission income	10	6	171	169	12	0	193	175
Net result on hedge accounting	0	8					0	8
Net trading income/expenses	19	13	0	0			19	13
Results from non-trading assets	66	-17	1				67	-17
Results from investments accounted for using the equity method		0	0	0			0	0
Administrative expenses	346	359	204	197	-3	-3	547	553
Net other operating income/expenses	27	37	3	5	0	-1	30	41
Negative goodwill from acquisitions WestImmo		150						150
Operating profit	**395**	**493**	**-29**	**-23**	**0**	**0**	**366**	**470**
Income taxes	143	106	-11	-10			132	96
Consolidated net income	**252**	**387**	**-18**	**-13**	**0**	**0**	**234**	**374**
Consolidated net income attributable to non-controlling interests	16	16	3	3			19	19
Consolidated net income attributable to shareholders of Aareal Bank AG	236	371	-21	-16	0	0	215	355
Allocated equity	1,553	1,616	143	136	763	549	2,459	2,301
Cost/income ratio (%)	41.2	43.2	116.4	113.4			54.1	55.2
RoE before taxes (%)	22.9	28.1	-22.2	-19.1			13.2	18.6
Employees (average)	**1,014**	**1,040**	**1,783**	**1,679**			**2,797**	**2,719**
Segment assets	**37,873**	**42,653**	**9,835**	**9,295**			**47,708**	**51,948**
Investments accounted for using the equity method	0	1		0			0	1
Segment investments	21	11	14	25			35	36
Segment depreciation/amortisation	16	9	11	11			27	20

(77) Results by geographical region

	Germany		International		Consolidation/ Reconciliation		Aareal Bank Group	
	2016	2015	2016	2015	2016	2015	2016	2015
€ mn								
Net interest income	202	276	499	505			701	781
Allowance for credit losses	-21	-13	118	141			97	128
Net interest income after allowance for credit losses	**223**	**289**	**381**	**364**			**604**	**653**
Net commission income	125	120	68	55			193	175
Net result on hedge accounting	0	5	0	3			0	8
Net trading income/expenses	19	5	0	8			19	13
Results from non-trading assets	1	-5	66	-12			67	-17
Results from investments accounted for using the equity method		0	0	0			0	0
Administrative expenses	318	329	229	224			547	553
Net other operating income/expenses	40	34	-10	7			30	41
Negative goodwill from acquisitions WestImmo		150						150
Operating profit	**90**	**269**	**276**	**201**			**366**	**470**
Allocated equity	604	610	1,092	1,142	763	549	2,459	2,301
Cost/income ratio (%)	82.1	75.6	36.7	39.6			54.1	55.2
RoE before taxes (%)	13.1	42.3	22.5	14.9			13.2	18.6
Employees (average)	**1,687**	**1,683**	**1,110**	**1,036**			**2,797**	**2,719**

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

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

€ mn			Income statement classification – bank										
			Net interest income	Net commission income	Net trading income/expenses	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**
	2016		0	171	0	1	0	204	3		**-29**	-11	**-18**
	2015		0	169	0		0	197	5		**-23**	-10	**-13**
Income statement classification – industrial enterprise													
Sales revenue	2016	206		206									
	2015	193		193									
Own work capitalised	2016	6						6					
	2015	4						4					
Changes in inventory	2016	0							0				
	2015	0							0				
Other operating income	2016	7			0	1			6				
	2015	9			0				9				
Cost of materials purchased	2016	35		35									
	2015	24		24									
Staff expenses	2016	144						144					
	2015	139						139					
Depreciation, amortisation and impairment losses	2016	11						11					
	2015	12						12					
Result from investments accounted for using the equity method	2016	0					0						
	2015	0					0						
Other operating expenses	2016	58						55	3				
	2015	54						50	4				
Interest and similar income/expenses	2016	0	0										
	2015	0	0										
Operating profit	**2016**	**-29**	**0**	**171**	**0**	**1**	**0**	**204**	**3**				
	2015	**-23**	**0**	**169**	**0**		**0**	**197**	**5**				
Income taxes	2016	-11										-11	
	2015	-10										-10	
Segment result	**2016**	**-18**											
	2015	**-13**											

Remuneration Report

The remuneration report for the 2016 financial year contains detailed information on the remuneration of Aareal Bank AG Management Board members, its senior executives, and its employees. As a significant institution, Aareal Bank publishes a description of its remuneration systems (qualitative disclosure) in the Group Annual Report for the financial year 2016 in accordance with section 16 (1) of the German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – "InstVergV"), as well as the Capital Requirements Regulation (CRR). The Supervisory Board and the Management Board carried out the annual review of the remuneration systems, involving the Human Resources division, the Remuneration Officer, and internal control units in line with their respective functions, and supported by external legal and remuneration advisors. External advisors were retained, amongst other things, for examining the appropriateness of remuneration systems, and remuneration for members of the Management Board and employees, as well as regarding the design of the Group-wide remuneration strategy. The quantitative disclosures on the remuneration of Management Board members, employees as well as senior executives required according to the CRR will be disclosed on Aareal Bank AG's homepage by the end of June in the following year at the latest.

According to Article 450 (1) of the CRR, institutions shall additionally disclose the information specified in the Regulation regarding the remuneration policy and practices of the institution for those categories of staff whose professional activities have a material impact on their risk profile (so-called risk takers). The following section provides information on the remuneration system for Management Board members of Aareal Bank AG applicable as at 1 January 2014.

(79) Remuneration system for the Management Board

Responsibilities and procedures of Aareal Bank AG regarding remuneration policies

The Supervisory Board determines the structure and amount of remuneration for members of the Management Board.

The Remuneration Control Committee (Vergütungskontrollausschuss) fulfils the requirements according to section 25d (12) of the German Banking Act (Kreditwesengesetz – KWG) and section 15 of the InstitutsVergV, and held six meetings throughout the 2016 financial year.

The Supervisory Board defines – at the beginning, but no later than immediately after the beginning of every financial year – the Management Board members' targets with respect to performance-related remuneration components. The Supervisory Board assesses Management Board members' success and performance after the end of every financial year.

Success criteria and parameters

Aareal Bank AG has entered into fixed-term service contracts with the members of its Management Board. Besides their fixed annual salary, Management Board members receive a performance-related remuneration that is determined using an assessment basis extending over several years.

Performance-related remuneration

Remuneration parameters

The level of this performance-related remuneration is determined by reference to the personal performance of each Management Board member, which is measured by the degree to which targets set in advance by the Supervisory Board are achieved, based on contractually agreed initial values for a 100 % target achievement. The targets which are relevant for performance-related remuneration include annual targets and multiple-year targets. The measurement of multiple-year targets is undertaken retrospectively, over a time period of three years. The weighting of annual to multiple-year targets is fixed for each financial year, with a weighting of 45 % (annual target) to 55 % (multiple-year target) taken as a guideline. Until now, the target system envisaged a weighting of 60 % for the annual target and 40 % for the preceding three-year target period.

For each financial year, the Supervisory Board sets a target level for the Common Equity Tier 1 ratio (CET 1 ratio) as the measurement threshold in order to secure adherence of the regulatory capital adequacy and a suitable liquidity measure (Liquidity Coverage Ratio – LCR). No variable remuneration will be determined for any financial year where these two targets have not been achieved. The Supervisory Board also defines the sectional and individual targets for every member of the Management Board, for each financial year.

Annual targets and multiple-year targets are integrated into the Bank's overall strategy and are geared towards achieving the objectives set out in the Bank's business and risk strategies. The targets comprise quantitative components and qualitative components, which are also related to non-financial parameters. In this context, the Group's overall performance, the performance of the section the Management Board member is responsible for, and the individual performance contributions of the Management Board member concerned, are all taken into consideration, with a weighting of one-third for every component towards the annual target. Aareal Bank Group's overall performance is determined using the categories of consolidated operating profit/loss before taxes and risk-weighted assets.

The initial value of the performance-related remuneration may increase – depending on the Management Board member's degree of target achievement – up to a maximum of 150 % of the target value. If the overall target achievement level exceeds 150 %, the initial value of the performance-related remuneration will not increase any further (cap). If the overall target achievement level is 0 %, no performance-related remuneration will be awarded for the financial year concerned. Unconscionable behaviour or behaviour in breach of duties cannot be balanced out by positive performance contributions in other areas and will automatically lead to an appropriate reduction in the variable remuneration. The variable remuneration generally depends on the Supervisory Board's decision to provide for the applicable financial year an amount sufficient for all (computed) variable remuneration components to be paid out according to section 45 (2) sentence 1 no. 5a of the KWG and section 7 of the InstitutsVergV.

Retention of variable remuneration components and penalty criteria

To ensure that the remuneration system provides long-term incentives, variable remuneration is awarded at the end of the financial year, according to the following principles:

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

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

- 30 % of the variable remuneration is retained (cash deferral), with interest accruing pro rata temporis, and disbursed in equal proportions over a three-year period.

- The remaining 30 % of variable remuneration is credited, as a cash amount, to a virtual account maintained on behalf of each Management Board member, and forms part of the share deferral plan.

With regard to the portion of the variable remuneration that is deferred initially as a cash deferral or a share deferral, the Supervisory Board makes a decision regarding the granting of one third of the amount, as well as the associated interest, in the three years following the determination of the performance-related remuneration (retention period). Until the end of the retention period, there is no right to the relevant remuneration components. Once the deferred remuneration components for Management Board members are vested, the cash deferral is paid out in cash and the share deferral is converted into phantom shares, subject to a two-year holding period.

In making its determination about the amount to be awarded, the Supervisory Board particularly takes into account any negative aspects of the Management Board member's performance, that of his section, as well as any weakness in the performance of Aareal Bank Group (backtesting). The existence of a negative aspect in the performance of a Management Board member is to be assumed, in particular, if serious breaches of duty and/or performance deficiencies are discovered, which lead to the performance contributions – which were initially assumed to be positive – being later shown to have not been sustained. A negative performance contribution on the part of the section within the respective Management Board member's responsibility, or of Aareal Bank Group, is to be assumed if significant assumptions which formed the basis of the calculation of the variable remuneration are later proven to be incorrect or unsustainable. The Supervisory Board may award the deferred variable remuneration components in full, partially, or not at all. If the full amount of the bonus is not awarded, the remaining sum is forfeited, i.e. it is not carried forward into subsequent years. An award of the deferred variable remuneration components will not be made insofar and for so long as the German Federal Financial Supervisory Authority ("BaFin") forbids this according to section 45 (2) sentence 1 nos. 5a and 6 of the KWG. The entitlement no longer exists if BaFin so orders by way of a final and conclusive decision pursuant to section 45 (5) sentences 5 to 8 of the KWG.

A variable remuneration component may not be vested (share deferral) or disbursed (cash deferral) if the Supervisory Board believes that the Management Board member's performance on the whole was so poor that it would make awarding performance-related remuneration inappropriate. In particular, this is to be assumed if significant breaches of the duty of care have been determined, which would give rise to an extraordinary termination of the appointment to the Management Board contract. Further, this is to be assumed if the member of the Management Board was causally and negligently actively involved in behaviour which has led to considerable losses, or for which losses the Management Board member was causally and negligently responsible.

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

Share Bonus Plan

According to the rules for the share bonus plan, a portion of the variable remuneration will be converted into an equivalent number of virtual shares and credited to the beneficiary. The calculation of the number of virtual shares is henceforth based on the weighted average price on the basis of five (Xetra®) exchange trading days after publication of the preliminary results for the respective financial year (subscription price). The date of publication of the preliminary results is used as the reference date. The virtual shares so determined are paid into a virtual account and are automatically and without delay converted into a cash amount and paid out following the Supervisory Board meeting which resolves to accept the annual financial statements for the third financial year following the financial year for which the virtual shares were granted ("holding period"). The conversion will be effected using the weighted average price calculated on the basis of the five (Xetra®) exchange trading days following the publication of the preliminary business figures for the year preceding the payout. Since the 2013 financial year, the payout amount of the share bonus of a given financial year may vary depending on the share price development and has been limited to a maximum of 300 % of the agreed initial value (ceiling).

The virtual shares granted for the financial years prior to the 2014 financial year will continue to have as the applicable subscription price the weighted average price on the basis of the five (Xetra®) exchange trading days following publication of the annual financial statements for the respective financial year. The ceiling is not applicable to these virtual shares, with the exception of those virtual shares granted for the 2013 financial year.

If dividends are paid on the Company's shares during the time period between the reference date and the date of conversion into the Company's shares, a payout is made as a salary component in an amount equivalent to the dividends and the proportion of the phantom shares.

Share Deferral Plan

Under the Share Deferral Plan, a portion of the variable remuneration is credited to the beneficiary. This credit, however, does not convey an entitlement or a claim regarding a later payout or grant of virtual shares. Interest accrues on the amount credited in the form of a share deferral. The reference rate is the interest rate of the European Central Bank for deposits from private households with a term of up to one year. As above, the credit of interest does not convey an entitlement or a claim regarding the interest amount. In the three years following the credit (retention period), the Supervisory Board decides whether in each case a third of the share deferral, including interest, should be converted.

The question as to whether a third of the virtual shares is converted and, if yes, in which amount, is based on the principles set out above (see section on Retention of variable remuneration components and penalty criteria). In particular, the Supervisory Board checks the application of the penalty rules provided. Equivalent provisions to the share bonus plan are applied in the calculation of the amount of the virtual shares – except for the holding period, which is reduced from three years to two years. The ceiling value is applicable for the conversion of the virtual shares which were granted for the 2013 financial year and the following financial years, with the proviso that the payout amount following the conversion of the virtual shares of a tranche (plus interest) into a cash payment must not exceed 300 % of the share deferral (30 % of the granted variable remuneration) set for the respective financial year (which may have been reduced following the application of a penalty rule or as a result of an instruction by BaFin). The payout amount for virtual shares which were granted for prior financial years or are yet to be granted, respectively, are not subject to any ceiling.

Remuneration

The requirements according to section 25a (5) of the KWG – regarding a ratio of variable to fixed remuneration for members of the Management Board of 1:1, and the maximum target achievement threshold – are complied with at all times.

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

Remuneration granted	Hermann J. Merkens – Chairman of the Management Board			
	2015[1]	2016	2016 (min)[2]	2016 (max)[3]
€				
Fixed remuneration	1,214,667	1,300,000	1,300,000	1,300,000
Ancillary benefits	46,594	38,511	38,511	38,511
Total	**1,261,260**	**1,338,511**	**1,338,511**	**1,338,511**
Variable remuneration based on a single-year assessment	226,071	280,000	–	420,000
Variable remuneration based on a multiple-year assessment				
Cash deferral 2016 (March 2020)	–	420,000	–	630,000
Share bonus 2016 (March 2020)	–	280,000	–	420,000
Share deferral 2016 (March 2022)	–	420,000	–	630,000
Cash deferral 2015 (March 2019)	339,107	–	–	–
Share bonus 2015 (March 2019)	226,071	–	–	–
Share deferral 2015 (March 2021)	339,107	–	–	–
Total	**1,130,356**	**1,400,000**	**–**	**2,100,000**
Benefit expense	329,035	1,032,350	1,032,350	1,032,350
Total remuneration	**2,720,651**	**3,770,861**	**2,370,861**	**4,470,861**

Remuneration granted	Dagmar Knopek			
	2015[1]	2016	2016 (min)[2]	2016 (max)[3]
€				
Fixed remuneration	880,000	880,000	880,000	880,000
Ancillary benefits	34,087	41,449	41,449	41,449
Total	**914,087**	**921,449**	**921,449**	**921,449**
Variable remuneration based on a single-year assessment	160,000	160,000	–	240,000
Variable remuneration based on a multiple-year assessment				
Cash deferral 2016 (March 2020)	–	240,000	–	360,000
Share bonus 2016 (March 2020)	–	160,000	–	240,000
Share deferral 2016 (March 2022)	–	240,000	–	360,000
Cash deferral 2015 (March 2019)	240,000	–	–	–
Share bonus 2015 (March 2019)	160,000	–	–	–
Share deferral 2015 (March 2021)	240,000	–	–	–
Total	**800,000**	**800,000**	**–**	**1,200,000**
Benefit expense	357,210	526,355	526,355	526,355
Total remuneration	**2,071,297**	**2,247,804**	**1,447,804**	**2,647,804**

[1] Details differ partially from the previous year's figures, due to the fact that in the previous year, variable remuneration amounts granted were calculated on the basis of the individual target achievement of each member of the Management Board. Dr Wolf Schumacher was granted a total remuneration in the amount of € 13,911,704 in the previous year.

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

[3] Maximum amount of the remuneration component granted in the year under review

Remuneration granted	Christiane Kunisch-Wolff [4]			
	2015 [1]	2016	2016 (min) [2]	2016 (max) [3]
€				
Fixed remuneration	–	561,244	561,244	561,244
Ancillary benefits	–	27,595	27,595	27,595
Total	**–**	**588,839**	**588,839**	**588,839**
Variable remuneration based on a single-year assessment	–	102,120	–	153,180
Variable remuneration based on a multiple-year assessment				
Cash deferral 2016 (March 2020)	–	153,180	–	229,770
Share bonus 2016 (March 2020)	–	102,120	–	153,180
Share deferral 2016 (March 2022)	–	153,180	–	229,770
Cash deferral 2015 (March 2019)	–	–	–	–
Share bonus 2015 (March 2019)	–	–	–	–
Share deferral 2015 (March 2021)	–	–	–	–
Total	**–**	**510,601**	**–**	**765,902**
Benefit expense	–	51,707	51,707	51,707
Total remuneration	**–**	**1,151,147**	**640,546**	**1,406,448**

Remuneration granted	Thomas Ortmanns			
	2015 [1]	2016	2016 (min) [2]	2016 (max) [3]
€				
Fixed remuneration	880,000	880,000	880,000	880,000
Ancillary benefits	33,259	35,945	35,945	35,945
Total	**913,259**	**915,945**	**915,945**	**915,945**
Variable remuneration based on a single-year assessment	160,000	160,000	–	240,000
Variable remuneration based on a multiple-year assessment				
Cash deferral 2016 (March 2020)	–	240,000	–	360,000
Share bonus 2016 (March 2020)	–	160,000	–	240,000
Share deferral 2016 (March 2022)	–	240,000	–	360,000
Cash deferral 2015 (March 2019)	240,000	–	–	–
Share bonus 2015 (March 2019)	160,000	–	–	–
Share deferral 2015 (March 2021)	240,000	–	–	–
Total	**800,000**	**800,000**	**–**	**1,200,000**
Benefit expense	363,678	725,906	725,906	725,906
Total remuneration	**2,076,937**	**2,441,851**	**1,641,851**	**2,841,851**

[1] Details differ partially from the previous year's figures, due to the fact that in the previous year, variable remuneration amounts granted were calculated on the basis of the individual target achievement of each member of the Management Board. Dr Wolf Schumacher was granted a total remuneration in the amount of € 13,911,704 in the previous year.
[2] Minimum amount of the remuneration component granted in the year under review
[3] Maximum amount of the remuneration component granted in the year under review
[4] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.

Remuneration granted	Christof Winkelmann[4]			
	2015[1]	2016	2016 (min)[2]	2016 (max)[3]
€				
Fixed remuneration	–	352,000	352,000	352,000
Ancillary benefits	–	12,125	12,125	12,125
Total	**–**	**364,125**	**364,125**	**364,125**
Variable remuneration based on a single-year assessment	–	64,000	–	96,000
Variable remuneration based on a multiple-year assessment				
Cash deferral 2016 (March 2020)	–	96,000	–	144,000
Share bonus 2016 (March 2020)	–	64,000	–	96,000
Share deferral 2016 (March 2022)	–	96,000	–	144,000
Cash deferral 2015 (March 2019)	–	–	–	–
Share bonus 2015 (March 2019)	–	–	–	–
Share deferral 2015 (March 2021)	–	–	–	–
Total	**–**	**320,000**	**–**	**480,000**
Benefit expense	–	66,747	66,747	66,747
Total remuneration	**–**	**750,872**	**430,872**	**910,872**

[1] Details differ partially from the previous year's figures, due to the fact that in the previous year, variable remuneration amounts granted were calculated on the basis of the individual target achievement of each member of the Management Board. Dr Wolf Schumacher was granted a total remuneration in the amount of € 13,911,704 in the previous year.
[2] Minimum amount of the remuneration component granted in the year under review
[3] Maximum amount of the remuneration component granted in the year under review
[4] Christof Winkelmann was appointed to the Management Board on 1 July 2016.

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

Remuneration paid	Hermann J. Merkens Chairman of the Management Board		Dagmar Knopek		Christiane Kunisch-Wolff[1]		Thomas Ortmanns	
	2016	2015	2016	2015	2016	2015	2016	2015
€								
Fixed remuneration	1,300,000	1,214,667	880,000	880,000	561,244	–	880,000	880,000
Ancillary benefits	38,511	46,594	41,449	34,087	27,595	–	35,945	33,259
Total	**1,338,511**	**1,261,261**	**921,449**	**914,087**	**588,839**	**–**	**915,945**	**913,259**
Variable remuneration based on a single-year assessment	299,544	202,400	212,640	201,920	–	–	211,360	200,800
Variable remuneration based on a multiple-year assessment	–	–	–	–	–	–	–	–
Cash deferral 2012 (April 2016)	104,797	–	–	–	–	–	104,797	–
Cash deferral 2013 (April 2016)	110,985	–	64,741	–	–	–	110,985	–
Cash deferral 2014 (April 2016)	102,111	–	101,869	–	–	–	101,304	–
Share bonus 2012 (May 2016)	328,146	–	–	–	–	–	328,146	–
Share deferral 2011 (April 2016)	–	–	–	–	–	–	–	–
Share deferral 2012 (April 2016)	167,896	–	–	–	–	–	167,896	–

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Remuneration paid	Hermann J. Merkens Chairman of the Management Board		Dagmar Knopek		Christiane Kunisch-Wolff [1]		Thomas Ortmanns	
	2016	2015	2016	2015	2016	2015	2016	2015
€								
Cash deferral 2011 (April 2015)	–	–	–	–	–	–	–	–
Cash deferral 2012 (April 2015)	–	102,411	–	–	–	–	–	102,411
Cash deferral 2013 (April 2015)	–	109,269	–	63,740	–	–	–	109,269
Share bonus 2011 (May 2015)	–	370,183	–	–	–	–	–	370,183
Share deferral 2011 (April 2015)	–	–	–	–	–	–	–	–
Dividends	73,961	47,428	38,522	13,228	–	–	68,575	47,380
Total	**1,187,440**	**831,691**	**417,772**	**278,888**	**–**	**–**	**1,093,063**	**830,043**
Benefit expense	1,032,350	329,035	526,355	357,210	51,707	–	725,906	363,678
Total remuneration	**3,558,301**	**2,421,987**	**1,865,576**	**1,550,185**	**640,546**	**–**	**2,734,914**	**2,106,980**

Remuneration paid	Christof Winkelmann [2]		Dr Wolf Schumacher [3]		Dirk Große Wördemann [4]	
	2016	2015	2016	2015	2016	2015
€						
Fixed remuneration	352,000	–	–	1,012,500	–	–
Ancillary benefits	12,125	–	90	26,177	–	–
Total	**364,125**	**–**	**90**	**1,038,677**	**–**	**–**
Variable remuneration based on a single-year assessment	–	–	275,940	7,207,069	–	–
Variable remuneration based on a multiple-year assessment	–	–	–	–	–	–
Cash deferral 2012 (April 2016)	–	–	176,804	–	85,080	–
Cash deferral 2013 (April 2016)	–	–	187,244	–	–	–
Cash deferral 2014 (April 2016)	–	–	178,270	–	–	–
Share bonus 2012 (May 2016)	–	–	553,620	–	266,409	–
Share deferral 2011 (April 2016)	–	–	–	–	179,144	–
Share deferral 2012 (April 2016)	–	–	283,260	–	136,308	–
Cash deferral 2011 (April 2015)	–	–	–	–	–	97,015
Cash deferral 2012 (April 2015)	–	–	–	172,779	–	83,143
Cash deferral 2013 (April 2015)	–	–	–	184,350	–	–
Share bonus 2011 (May 2015)	–	–	–	370,183	–	488,267
Share deferral 2011 (April 2015)	–	–	–	–	–	250,492
Dividends	–	–	111,776	80,378	27,954	39,471
Total	**–**	**–**	**1,766,914**	**8,014,759**	**694,895**	**958,388**
Benefit expense	66,747	–	–	4,639,618	–	–
Total remuneration	**430,872**	**–**	**1,767,004**	**13,693,054**	**694,895**	**958,388**

[1] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.
[2] Christof Winkelmann was appointed to the Management Board on 1 July 2016.
[3] Dr Wolf Schumacher resigned with effect from 30 September 2015. € 275,940 in variable remuneration was granted to Dr Schumacher in 2015, as one-year variable remuneration for the 2015 financial year. For the remaining term of the Management Board contract, the contractually agreed fixed remuneration of € 3,354,045.95, lost variable remuneration components of € 3,433,663.00, as well as the equivalent of company-car use of € 66,000 were disbursed as one-off payments. Due to the resignation of Dr Schumacher, with effect from 30 September 2015, € 4,023,736 was recognised in benefit expenses for 2015, in line with his pension agreement, thus increasing the Bank's pension obligations.
[4] Mr Große Wördemann resigned with effect from 31 May 2013.

Pursuant to section 314 (1) no. 6a of the HGB, the following table shows fixed and other remuneration for members of the Management Board as well as the total target achievement amounts of variable remuneration, determined by the Supervisory Board as follows:

€	Year	Fixed remuneration	Variable remuneration				Other remuneration[4]	Total remuneration[5]
			Cash component		Share-based component			
			Cash bonus	Cash deferral[3]	Share bonus	Share deferral[3]		
Hermann J. Merkens	2016	1,300,000	377,720	566,580	377,720	566,580	38,511	3,227,111
	2015	1,214,667	299,544	449,317	299,544	449,317	46,594	2,758,983
Dagmar Knopek	2016	880,000	212,320	318,480	212,320	318,480	41,449	1,983,049
	2015	880,000	212,640	318,960	212,640	318,960	34,087	1,977,287
Christiane Kunisch-Wolff[1]	2016	561,244	135,309	202,964	135,309	202,964	27,595	1,265,385
	2015	–	–	–	–	–	–	–
Thomas Ortmanns	2016	880,000	213,600	320,400	213,600	320,400	35,945	1,983,945
	2015	880,000	211,360	317,040	211,360	317,040	33,259	1,970,059
Christof Winkelmann[2]	2016	352,000	85,120	127,680	85,120	127,680	12,125	789,725
	2015	–	–	–	–	–	–	–
Total	**2016**	**3,973,244**	**1,024,069**	**1,536,104**	**1,024,069**	**1,536,104**	**155,625**	**9,249,215**
	2015	**2,974,667**	**723,544**	**1,085,317**	**723,544**	**1,085,317**	**113,940**	**6,706,329**

[1] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.
[2] Christof Winkelmann was appointed to the Management Board on 1 July 2016.
[3] The deferrals shown are subject to the criteria on retention of variable remuneration components and penalty criteria, as set out above.
[4] Other remuneration includes payments (in particular for company cars) as well as benefits related to social security contributions.
[5] Dr Wolf Schumacher was granted a total remuneration in the amount of € 9,272,086 in the previous year.

No benefits were granted to any member of the Management Board by third parties with respect to his/her Management Board activities during the year under review.

The following initial values for variable remuneration at an overall target achievement level of 100% were agreed upon in the service contracts of the Management Board members:

€	Reference values for variable remuneration 2016	Reference values for variable remuneration 2015
Hermann J. Merkens[1]	1,400,000	1,130,356
Dagmar Knopek	800,000	800,000
Christiane Kunisch-Wolff[2]	510,601	–
Thomas Ortmanns	800,000	800,000
Christof Winkelmann[3]	320,000	–
Dr Wolf Schumacher[4]	–	1,050,000
Total	**3,830,601**	**3,780,356**

[1] Upon the appointment of Hermann J. Merkens as the Chairman of the Management Board, on 17 September 2015, the reference value for variable remuneration was raised to € 1,400,000.
[2] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016; the reference value was set at € 640,000 p.a.
[3] Christof Winkelmann was appointed to the Management Board on 1 July 2016; the reference value was set at € 640,000 p.a.
[4] Dr Schumacher resigned with effect from 30 September 2015.

The following table shows the portion of the variable component attributable to share-based payment arrangements as well as the corresponding number of virtual shares granted in 2016/2015:

		Share-based payment [1]	
	Year	Value (€)	Quantity (number) [2]
Hermann J. Merkens	2016	944,300	26,399
	2015	748,861	27,202
Dagmar Knopek	2016	530,800	14,839
	2015	531,600	19,310
Christiane Kunisch-Wolff [3]	2016	338,273	9,457
	2015	–	–
Thomas Ortmanns	2016	534,000	14,929
	2015	528,400	19,194
Christof Winkelmann [4]	2016	212,800	5,949
	2015	–	–

[1] Dr Wolf Schumacher was granted a total share-based remuneration in the amount of € 689,850 (25,058 shares) in the previous year.
[2] The stated number of virtual shares granted for 2016 is a preliminary figure, based on the price of Aareal Bank AG's share on 31 December 2016 (€ 35.77). The final conversion rate may only be determined after publication of preliminary results for 2016.
[3] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.
[4] Christof Winkelmann was appointed to the Management Board on 1 July 2016.

Other remuneration

Aareal Bank AG provides a company car to every Management Board member, which may also be used for private purposes.

Every Management Board member is covered by the group accident insurance in case of death or invalidity.

In addition, Aareal Bank AG bears the costs incurred for certain security expenses.

The ancillary benefits shown in the tables are equivalent to the total of such other remuneration.

Pensions, retirement benefits and severance pay

The benefit regulations as agreed in the service contract apply to the members of the Management Board. Management Board members who were appointed prior to 1 January 2013 are entitled to claim pension benefits upon completion of their 60th year of age. For members of the Management Board who were appointed after 1 January 2013, claims arise upon completion of their 62nd year of age. In the event of permanent disability, a Management Board member may be entitled to claim benefits prior to turning 60 or 62, respectively.

€ 000's	2016 Pension claims p.a.[1]	2016 Balance of pension obligations (DBO) as at 31 Dec 2016	2016 Increase of pension obligations (DBO) in 2016	2015[4] Pension claims p.a.[1]	2015[4] Balance of pension obligations (DBO) as at 31 Dec 2015	2015[4] Increase of pension obligations (DBO) in 2015
Hermann J. Merkens	265	5,696	1,032	244	4,664	329
Dagmar Knopek	125	1,621	526	125	1,095	357
Christiane Kunisch-Wolff[2]	–	52	52	–	–	–
Thomas Ortmanns	254	5,191	726	242	4,465	364
Christof Winkelmann[3]	–	67	67	–	–	–
Total	**644**	**12,627**	**2,403**	**611**	**10,224**	**1,050**

[1] Pension claims are calculated based on the earliest possible pension payment.
[2] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.
[3] Christof Winkelmann was appointed to the Management Board on 1 July 2016.
[4] The previous year's figures also include pension obligations for Dr Schumacher, who resigned as from 30 September 2015: an additional € 0.441 mn p.a. in pension claims, € 12.285 mn in balance of pension obligations and € 4.640 mn in increase of pension obligations.

The pension claims are adjusted to take account of the development of standard wages within the private banking sector as from the beginning of actual payments of pensions, to the extent that these are based on defined benefit plans. If the payments refer to defined contribution plans, the guaranteed amount is adjusted by 1 % p.a. The pension paid to widows amounts to 60 % of the pension of the member of the Management Board, while pensions to half-orphans and orphans amount to 10 % and not more than 25 %, respectively. Service cost incurred in the 2016 financial year in connection with the pension claims of members of the Management Board totalled € 1.8 million (2015: € 2.8 million). The pension obligations for current members of the Management Board as well as for former members of the Management Board and their surviving dependants increased by € 3.0 million in the year under review (2015: € 4.2 million). The total amount of pension obligations was € 46.4 million (2015: € 43.4 million). Of that amount, € 33.8 million related to former members of the Management Board and their surviving dependants (2015: € 33.1 million). Payments to former Management Board members of Aareal Bank AG and their surviving dependants totalled € 0.9 million (2015: € 0.8 million).

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 an early termination of a Management Board position without good cause within the meaning of section 4.2.3. of the Code, payments (including contractually-agreed benefits) are limited to twice the annual remuneration (severance cap) as well as to the remainder of the term of the contract.

In the case of a termination of a Management Board position due to a change of control, the following provisions are applicable: in the case of a compulsory loss of a Management Board position, the Management Board members are to be paid the fixed remuneration component, the performance-based remuneration as well as the contractually-agreed benefits for the remainder of the term of the contract. The performance-related remuneration is subject to the above-mentioned conditions; that is, in particular the deferral periods, the holding periods and the penalty rules are applicable. In addition, the extent to which sectional and individual targets were achieved on average during the last three years prior to the termination of the Management Board position will be used as a basis to determine the target achievement level for the remaining term of the contract. In the case of a voluntary termination of the Management Board position following a change of control, the members of the Management Board merely receive the fixed remuneration and the contractually agreed benefits. In this case, there is no entitlement to the variable remuneration component.

The total amount of payments in the case of termination due to a change of control is limited to 150 % of the severance cap of an employment contract, in accordance with section 4.2.3. of the Code.

(80) Risk takers (employees and senior executives who exert a material influence on the institution's overall risk profile according to section 18 (1) and (2) of the InstitutsVergV)

The remuneration system for risk takers is subject to the same basic conditions as the remuneration system for Management Board members, and is also aligned with the business and risk strategy of Aareal Bank AG or Aareal Bank Group, respectively. These remuneration systems form part of Aareal Bank AG's efforts to ensure that employees' remuneration is in line with market conditions and the performance achieved. At the same time, they help to align the Bank's remuneration intentions with current regulatory requirements. In this context, Aareal Bank aims to respect the interests of employees, management and shareholders alike, while safeguarding the positive development of the Bank on a sustainable basis. The structure of the variable remuneration does not provide incentives to assume inappropriately high risks: it promotes the performance, target and results orientation of employees and senior executives.

The remuneration of all employee groups consists of a fixed and a variable remuneration, plus other contractually agreed benefits, if applicable. Regarding the group of risk takers, the variable component features particular characteristics in order to provide for the specific requirements of the InstitutsVergV.

The Management Board decides on the total amount of the variable remuneration for employees at the end of the financial year in a formalised, transparent and conceivable process. This total amount also includes the variable remuneration components for risk takers. The pool for the variable remuneration consists of a performance component and a profit component. The performance component takes into account the target-dependant remuneration of all employees, while the profit component takes into account the Group's overall profit by means of including the profit factor. The Group's overall profit depends on Aareal Bank Group's sustainable business results by taking into consideration the operating profit before taxes as well as underlying risk (measured as risk-weighted assets). The so-called profit factor is calculated by multiplying the target achievement regarding the operating profit before taxes with the target achievement regarding risk-weighted assets, finally influencing the profit component. The Bank's Management Board and Supervisory Board jointly determine the target values for the operating profit before taxes and the risk-weighted assets based on the Bank's medium-term planning no later than at the beginning of every financial year. Maximum target achievement regarding operating profit before taxes is limited to 150 %; regarding risk-weighted assets, it is limited to 125 %. In the case of a negative target achievement regarding operating profit before taxes and risk-weighted assets, not only the profit component might be cancelled, but the performance component might also be set to nil. This being the case, the pool for the variable remuneration would be entirely cancelled.

Performance measurement on Group level additionally requires the Common Equity Tier I ratio as a measurement threshold in order to ensure adherence of the regulatory capital adequacy. In the case of a negative overall success of the Bank in the current financial year or an insufficient capital adequacy or liquidity situation, the Management Board may set the pool for the variable remuneration to nil. The capital and liquidity indicators eventually used by the Management Board to gradually reduce the pool for the variable remuneration will be applied according to the requirements of a recovery plan going forward.

The Management Board may take additional quantitative and/or qualitative success factors into account for the adjustment of the overall pool if exceptional and unexpected market developments occur, or substantial special projects need to be conducted during the year.

Cornerstones of the risk analysis carried out

The InstitutsVergV stipulates that the remuneration system of Aareal Bank AG (as a significant institution) needs to fulfil special requirements regarding "employees who exert a material influence on the institution's overall risk profile" (so-called risk takers). In order to identify this group of employees, Aareal Bank carries out an independent risk analysis, selecting the respective employees based on a uniform set of criteria. In addition, Aareal Bank AG (as a parent institution) has to identify risk takers on Group level.

Aareal Bank carried out a risk analysis to identify risk takers in the financial year 2016, covering all employee groups below Management Board level, i.e. senior executives, non-tariff employees and tariff employees of Aareal Bank AG including its branches, representative offices and subsidiaries in Germany and abroad.

The identification of the entities and risk takers affected is being repeated annually to ensure the fulfilment of the InstitutsVergV's requirements at all times. Additional checks are carried out for newly hired employees and in the case of internal changes of function.

Remuneration model for risk takers

The determination of the variable remuneration (total incentive) for risk takers takes into account the Group's overall profit, the individual employee's performance contribution as well as the performance contribution of the organisational unit. The target for risk takers whose activities can clearly be allocated to a single business segment shall be assigned as the pro-rata share of their business segment (Structured Property Financing or Consulting/Services) in the operating profit before taxes. Risk takers whose activities can be allocated to staff and corporate services divisions, or to Credit Management, shall be assigned as target the cost-reduction target of the respective division.

Risk takers' variable remuneration consists of four components:

- cash component,
- share component,
- restricted cash award and
- restricted virtual share award.

The amount of the contractually agreed individual variable remuneration (target total incentives) of a risk taker is limited to 50 % of the fixed remuneration; in case of certain sales functions, it is limited to 100 % of the fixed remuneration following a resolution of the Annual General Meeting pursuant to section 25a (5) of the KWG. This ensures that the variable remuneration of an individual employee does not exceed 100 % of his/her fixed remuneration (or in the case of certain international sales functions, the ratio of 1:2 is respected) if a target achievement of 200 % is achieved.

Risk takers of the second-tier management level are entitled to receive 40 % of the individual total incentives immediately at the end of the reference period (other risk takers: 60 %). The immediate entitlement refers to an amount of 50 % to the cash component, which shall be disbursed in the year following the end of the reference period, and to an amount of 50 % to the share component, which consists of virtual shares entitled to dividends (and forming the ground for cash disbursement claims). However, such cash amounts may only be disbursed after a two-year holding period. The payout amount corresponds to the weighted average price of Aareal Bank AG shares on Xetra® (as shown on Bloomberg) on the five exchange trading days following the publication of the preliminary results for the financial year preceding the payout date. The ceiling value is applicable for the conversion of the virtual shares which were granted for the 2014 financial year and the following financial years, with the proviso that the payout amount following the conversion of the virtual shares of a tranche (plus dividends) into a cash payment must not exceed 300 % of the share component of a given financial year.

An option right shall be given to the risk taker regarding the actual payout date; after the end of the holding period and after the regular payout date, the risk taker may determine further payout dates within a period of three years.

Risk takers of the second-tier management level shall initially be promised (but not granted) 60 %, other risk takers 40 %, of their individual total incentives. 50 % thereof relates to the restricted cash award, which shall be disbursed in equal proportions over a three-year period (interest shall be calculated pro rata temporis) (cash deferral). The remaining 50 % will be included in the restricted virtual share award (share deferral), representing virtual shares entitled to dividends in form of a share component. The risk taker is entitled to receive one third of his claims after one, two and three years, respectively; the earliest possible payout of each tranche takes place after a holding period of at least one year after creation of the entitlement. An option right will be given to the risk taker regarding the actual payout date of each tranche; after the end of the holding period and after the regular payout date, the risk taker may determine further payout dates within a period of three years for each tranche. The payout amount of a tranche is limited to 300 % of the share deferral promised (but not granted) to the risk taker for the respective year under evaluation. The payout amount is calculated based on the number of virtual shares and the corresponding share price (= weighted average price of Aareal Bank AG shares on Xetra® (as shown on Bloomberg) on the five exchange trading days following the publication of the preliminary results for the financial year preceding the first / second / third payout year).

Regarding the creation of entitlements of deferred portions of the variable remuneration, i.e. the tranches of the cash deferral including accrued interest and the tranches of the share deferral including virtual dividends, penalty rules have to be considered. For the purpose of these regulations, a penalty-triggering event shall be defined as a negative performance contribution of the risk taker him / herself, his / her organisational unit or a negative overall performance of the institution or Aareal Bank Group, which may result in a reduction or cancellation of the deferred portions of the variable remuneration. For the purpose of these regulations, a risk taker's negative performance contribution is to be assumed, for instance, if serious breaches of duty and / or performance deficiencies are discovered, which lead to the performance contributions – which were initially assumed to be positive – being later shown to have not been sustained (backtesting). Serious breaches of duty could be, for instance, misconduct giving rise to an extraordinary termination of the employment relationship with the risk taker, a breach of the hedging ban or violations of other fundamental regulations, such as the Code of Conduct or compliance guidelines.

(81) Remuneration governance

Remuneration Control Committee

The Remuneration Control Committee supports the Supervisory Board, according to section 15 of the InstitutsVergV in conjunction with section 25d (12) of the KWG, regarding the appropriate structuring of remuneration systems for Management Board members, as well as for the supervision of the remuneration systems for employees. One of the duties of the Remuneration Control Committee is to monitor the remuneration systems' influence on the risk, capital, and liquidity situation of Aareal Bank – and to ensure an appropriate alignment of the business, risk and remuneration strategies. The Remuneration Control Committee also monitors the appropriateness of the remuneration systems, responds to Supervisory Board enquiries, and reports on the appropriateness of the remuneration system's structure at least once a year by producing a remuneration report. The Remuneration Control Committee shall be convened whenever necessary, but at least four times a year. The composition of the Remuneration Control Committee is outlined in more detail in the chapter "Report of the Supervisory Board / Description of Management Board and Supervisory Board work processes".

Risk Committee

The Risk Committee verifies whether the incentives created by the remuneration system take the Company's risk, capital and liquidity structure into account, as well as the probability and timing of income. The Remuneration Control Committee's duties remain unaffected.

Remuneration Officer

Aareal Bank has appointed a Remuneration Officer, to carry out duties in accordance with section 24 of the InstitutsVergV. These duties include supporting the Supervisory Board and the Remuneration Control Committee in structuring and monitoring the remuneration system. The Remuneration Officer is obliged to respond to queries of the Remuneration Control Committee's Chairman. The Remuneration Officer reports on the appropriate structure of the remuneration systems in the form of a remuneration report at least once a year. Due to the responsibility of monitoring the appropriateness of the remuneration systems on a continuing basis, the Remuneration Officer is being included in the conceptional new drafting (and future development), as well as in the application of the remuneration systems. In particular, the Remuneration Officer plays an active part in the transparent and conceivable process for the determination of the total amount available for variable remuneration, the annual review of penalty rules, the regularly carried out (at least spot checks) review of appropriate compliance structures, the monitoring of the hedging ban (and potential violations), the drafting of the annual remuneration report (pursuant to section 16 of the InstVergV in connection with art. 450 of the CRR) as well as the review of the risk taker analysis.

(82) Remuneration of the Supervisory Board

Remuneration for the services of the Supervisory Board members is specified in Article 9 of the Memorandum and Articles of Association of Aareal Bank AG.

The remuneration system for the Supervisory Board only comprises a fixed remuneration, supplemented by a compensation for attending meetings. In addition, the Supervisory Board members will be reimbursed for their expenses. Where membership in the Supervisory Board falls short of an entire financial year, said remuneration shall be paid on a pro rata temporis basis. Any value-added tax invoiced will also be deemed to be a refundable expense.

The fixed remuneration is € 50,000.00 p.a. for each Supervisory Board member. The Chairman of the Supervisory Board shall receive three times this amount, while the deputy shall receive one and a half times as much as a normal member. The fixed remuneration is increased for each membership in a committee (with the exception of the Committee for Urgent Decisions, which is part of the Risk Committee). This additional fixed remuneration amounts to € 20,000 p.a. for membership of the Risk Committee and the Audit Committee; fixed remuneration is increased by € 40,000 p.a. for the chairmanship of one of these committees. The additional fixed remuneration for membership of other committees amounts to € 15,000 p.a. or € 30,000 p.a. for the chairmanship of such other committee.

The meeting attendance compensation amounts to € 1,000.00 for each meeting attended (except for the Committee for Urgent Decisions).

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

The individual amount of the remuneration for the Supervisory Board is shown in the following table. Statutory value-added tax in the amount of 19 % will be reimbursed on top of the figures shown in the table.

€	Year	Fixed remuneration	Attendance fees	Total remuneration
Marija Korsch	2016	265,000	33,000	298,000
Chairman	2015	279,208	33,000	312,208
Prof. Dr Stephan Schüller	2016	125,000	24,000	149,000
Deputy Chairman (since 20 May 2015)	2015	125,000	25,000	150,000
York-Detlef Bülow	2016	125,000	23,000	148,000
Deputy Chairman	2015	125,000	25,000	150,000
Thomas Hawel	2016	65,000	13,000	78,000
	2015	59,208	9,000	68,208
Dieter Kirsch	2016	85,000	18,000	103,000
	2015	85,000	16,000	101,000
Richard Peters	2016	100,000	21,000	121,000
	2015	80,694	15,000	95,694
Dr Hans-Werner Rhein	2016	85,000	17,000	102,000
(since 20 May 2015)	2015	52,181	10,000	62,181

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€	Year	Fixed remuneration	Attendance fees	Total remuneration
Sylvia Seignette	2016	90,000	13,000	103,000
(since 20 May 2015)	2015	42,972	7,000	49,972
Elisabeth Stheeman[1)]	2016	85,000	16,000	101,000
(since 20 May 2015)	2015	52,181	9,000	61,181
Hans-Dietrich Voigtländer	2016	115,000	25,000	140,000
(since 20 May 2015)	2015	70,597	12,000	82,597
Prof. Dr Hermann Wagner	2016	110,000	19,000	129,000
(since 20 May 2015)	2015	67,528	10,000	77,528
Beate Wollmann	2016	50,000	9,000	59,000
(since 20 May 2015)	2015	30,694	4,000	34,694
Total	**2016**	**1,300,000**	**231,000**	**1,531,000**
	2015[2)]	**1,070,264**	**175,000**	**1,245,264**

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

[2)] Totals for 2015 diverge from the totals shown for 2015, which still included six Supervisory Board members who retired during 2015. Totals for the year under review were € 1,262,764 in fixed remuneration and € 211,000 in meeting attendance fees, leading to total remuneration of € 1,473,764. The previous year's figures were adjusted for VAT.

Depending on the period of service on the Supervisory Board, remuneration is paid on a pro-rata basis.

The members of the Supervisory Board did not provide any consulting or agency services, or other personal services in 2016. Therefore, no additional remuneration was paid.

(83) Additional disclosures pursuant to IFRS 2 regarding share-based payment arrangements

Valuation model and valuation assumptions

The obligations resulting from all of the described share-based payment arrangements as at the balance sheet date correspond to the remuneration granted, discounted to the balance sheet date. The discount period corresponds to the period from the balance sheet date to the earliest exercise or payout date per plan and per tranche. The discount is based on the Euribor swap rate applicable as at the relevant balance sheet date, depending on the term.

Amount of cash-settled share-based payment transactions

The total amount of outstanding virtual shares in relation to the above-mentioned share-based payment arrangements changed as follows (p. 221).

Quantity (number)	2016	2015[1]
Balance (outstanding) at 1 January	**670,965**	**736,089**
granted in the reporting period	282,221	186,226
expired in the reporting period	–	–
exercised in the reporting period	264,518	251,350
Balance (outstanding) at 31 December	**688,668**	**670,965**
of which: exercisable	–	–

[1] The disclosures differ from the previous year's figures, due to slight changes to the presentation, and to the calculation methodology.

The fair value of the virtual shares granted during the reporting period amounted to € 10.1 million (2015: € 5.4 million) as at the balance sheet date.

The virtual shares exercised during the reporting period were converted at a weighted average price of the Aareal Bank AG share of € 27.71 (2015: € 38.30).

The virtual shares outstanding at 31 December 2016 have a limited contract term. The weighted average remaining contract term of these virtual shares amounts to 453.27 days (2015: 389.43 days).

Effects on financial performance

The total amount expensed for share-based payment transactions was € 13.4 million during the financial year 2016 (2015: € 10.0 million). The portion of the total amount expensed attributable to members of the Management Board amounted to € 3.8 million (2015: € 3.3 million) and can be broken down to the individual members of the Management Board as follows:

€	2016	2015
Hermann J. Merkens	1,424,186	860,758
Dagmar Knopek	842,891	593,536
Christiane Kunisch-Wolff[1]	338,273	–
Thomas Ortmanns	946,738	717,971
Christof Winkelmann[2]	212,800	–

[1] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.
[2] Christof Winkelmann was appointed to the Management Board on 1 July 2016.

In addition, € 0.7 million (2015: € 1.1 million) was expensed for former members of the Management Board.

The intrinsic value of the virtual shares exercisable at the reporting date amounted to € 0.0 (2015: € 0.0), since there were no exercisable virtual shares at that date. The obligation from share-based payment transactions as at 31 December 2016 amounted to € 34.9 million (2015: € 28.4 million). It is reported in the statement of financial position in the line item "Provisions".

Remuneration for key executives

The definition of executives in key positions within Aareal Bank Group includes members of management or supervisory bodies of Aareal Bank AG.

Total remuneration of executives in key positions is analysed below:

€ 000's	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Short-term benefits	6,685	6,848
Post-employment benefits	2,403	5,690
Other long-term benefits	1,538	1,468
Termination benefits	–	6,854
Share-based payments	2,560	2,446
Total	**13,186**	**23,306**

Provisions for pension obligations concerning key executives totalled € 12.6 million as at 31 December 2016 (31 December 2015: € 10.2 million).

Other Notes

(84) Assets and liabilities in foreign currency

Foreign currency assets

€ mn	31 Dec 2016	31 Dec 2015
USD	11,120	9,529
GBP	4,112	4,392
SEK	841	1,353
CHF	477	483
DKK	436	447
JPY	0	–
Other	404	417
Total	**17,390**	**16,621**

Foreign currency liabilities

€ mn	31 Dec 2016	31 Dec 2015
USD	11,197	9,551
GBP	4,025	4,326
SEK	822	1,444
CHF	474	478
DKK	471	455
JPY	0	–
Other	393	399
Total	**17,382**	**16,653**

(85) Subordinated assets

In the event of insolvency or liquidation of the issuer, subordinated assets are those subordinate to the claims of all other creditors.

In the financial year 2016, the "Loans and advances to customers" item included € 2 million (2015: € –) in subordinated assets.

(86) Leases

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

Properties leased by the Group are reported under other assets.

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

Maturity of minimum lease payments under operating leases

€ mn	31 Dec 2016	31 Dec 2015
Aareal Bank Group as lessee		
up to 1 year	15	15
longer than 1 year, and up to 5 years	38	41
longer than 5 years	15	20
Total minimum lease payments	**68**	**76**
Aareal Bank Group as lessor		
up to 1 year	18	2
longer than 1 year, and up to 5 years	45	4
longer than 5 years	25	4
Total minimum lease payments	**88**	**10**

In the financial year, lease payments of € 15 million (2015: € 17 million) were recognised as expenses in the financial year.

(87) Contingent liabilities and loan commitments

€ mn	31 Dec 2016	31 Dec 2015
Contingent liabilities	114	162
Loan commitments	1,333	1,227
of which: irrevocable	901	797

Contingent liabilities include the irrevocable payment obligation regarding the bank levy and to the deposit guarantee scheme of German banks. These and the values reported under loan commitments given represent the maximum default risk to which Aareal Bank Group is exposed at the end of the reporting period.

Furthermore, the Bank is involved in legal disputes. Based on a legal analysis, successful outcome of these disputes is more likely than not. Essentially, these are legal disputes with borrowers (or former borrowers) who claim damages against the Bank. These are included in the table above, with a probability-weighted amount of € 49 million (2015: € 40 million), but have not been recognised as liabilities. We estimate the maximum default risk in the low triple-digit million range. The duration of proceedings depends on the complexity of each individual litigation, and the legal remedies available in each case. Likewise, the final amount in the event of defeat may vary considerably, depending upon the duration of proceedings and the legal remedies. Refunds of litigation costs are possible. Accordingly, the recognition of contingent liabilities is also subject to estimation uncertainties.

(88) Consolidated statement of cash flows

Aareal Bank Group's statement of cash flows records cash flows pertaining to the areas of operating activities, investing activities and financing activities for the period under review. The starting point of the consolidated statement of cash flows is the amount of cash and cash equivalents, consisting of cash on hand, balances with central banks as well as public-sector debt instruments and bills of exchange eligible for refinancing at central banks.

The definition of the term "operating activities" is consistent with the composition of the operating profit in the statement of comprehensive income. Cash flows from investing activities include proceeds from and payments in relation to property and equipment, non-trading assets and investment properties. Cash flows from financing activities include cash flows from transactions with providers of equity capital.

(89) Regulatory capital and capital management

As regards meeting minimum capital ratios, Aareal Bank Group has to comply with the capital adequacy requirements set out in the Capital Requirements Regulation (CRR), the Capital Requirements Directive (CRD IV), the German Banking Act (Kreditwesengesetz, KWG) and the German Solvency Regulation (SolvV) pursuant to Basel III. This requires the Bank to maintain own funds including capital conservation buffers of at least 8.625 % of its risk-weighted assets (total capital ratio). Any additional country-specific capital requirements are taken into account. Risk-weighted assets had to be backed by Tier 1 capital of at least 6 % (Tier 1 ratio). Compliance with the capital requirements has to be reported to the competent supervisory authorities on a quarterly basis. The capital requirements were complied with at all times during the reporting period.

The objective of capital management within Aareal Bank Group is compliance with the legal minimum capital requirements, ensuring that internally targeted capital ratios are achieved, taking into account the full implementation of Basel III requirements, as well as the provision of a sufficient capital cushion to ensure, at any time, the Group's capacity to act. Funds are allocated to the individual business segments within the framework of capital management, aiming at optimising the return on equity.

The SREP requirement of Aareal Bank Group as at year-end 2016 was a Common Equity Tier 1 capital ratio (CET 1 ratio), including capital conservation buffer, of 8.75 %.

Given prevailing uncertainty with regard to future regulatory requirements as well as any potential deterioration to economic developments, and considering our dividend policy, we project the fully-phased in Common Equity Tier 1 ratio (CET1 – assuming full implementation of Basel III) by the end of 2017 to be moderately higher than the current level of 15.7 %. This ratio is considerably above the legal minimum requirements. Compliance with the minimum requirements is planned to be ensured through the generation of profits, an active dividend policy, optimisation of the capital structure, and an efficient management of risk assets.

Within the context of capital management, projections are made on a regular basis showing the changes of the individual capital components and risk-weighted assets, as well as the resulting capital ratios. This is reported regularly within the framework of management reporting. The strategic allocation of capital to the individual business segments is incorporated in the Group's annual overall planning process.

Aareal Bank Group's regulatory capital is composed of the following:

€ mn	31 Dec 2016[1]	31 Dec 2015
Tier 1 capital (T1)		
Subscribed capital and capital reserves	899	899
Eligible retained earnings	1,562	1,479
Accumulated other comprehensive income	-76	-47
Amounts to be deducted from CET 1 capital	-34	-33
Sum total of Common Equity Tier (CET 1)	2,351	2,298
AT1 bond	300	300
Silent participations	108	126
Other	145	169
Amounts to be deducted from additional tier 1 capital	-8	-11
Sum total of additional tier 1 (AT1) capital	545	584
Sum total of Tier 1 capital (T1)	**2,896**	**2,882**
Tier 2 capital (T2)		
Silent participations	72	54
Subordinated liabilities	930	965
Profit-participation certificates	4	11
Other	97	72
Amounts to be deducted from tier 2 capital	-5	-7
Sum total of Tier 2 capital (T2)	**1,098**	**1,095**
Total capital (TC)	**3,994**	**3,977**

[1] After confirmation of Aareal Bank AG's financial statements for 2016. The calculation of regulatory capital takes into account the Management Board's proposal for the appropriation of profits for the financial year 2016. The appropriation of profits is subject to approval by the Annual General Meeting.

The regulatory measurement of risk-weighted assets (RWA) in the area of credit risks is based on both the Advanced Internal Ratings Based Approach (AIRBA) and on the standardised approach (CRSA). RWA as at 31 December 2016 can be analysed as follows:

€ mn	EAD 31 Dec 2016	Risk-weighted assets (RWA) AIRBA 31 Dec 2016	CRSA 31 Dec 2016	Total 31 Dec 2016	Regulatory capital requirements 31 Dec 2016	EAD 31 Dec 2015	RWA 31 Dec 2015	Regulatory capital requirements 31 Dec 2015
Credit risks	**48,844**	**9,729**	**2,665**	**12,394**	**991**	**53,053**	**14,658**	**1,173**
Companies	30,094	7,737	1,741	9,478	758	33,463	11,128	890
Institutions	3,819	346	85	431	34	4,455	563	45
Public-sector entities	12,795	0	22	22	2	12,507	20	2
Other	2,136	1,646	817	2,463	197	2,628	2,947	236
Market price risks				**122**	**10**		**124**	**10**
Credit Valuation Adjustment				**254**	**20**		**264**	**21**
Operational risks				**1,770**	**142**		**1,663**	**133**
Total	**48,844**	**9,729**	**2,665**	**14,540**	**1,163**	**53,053**	**16,709**	**1,337**

(90) Related party disclosures in accordance with IAS 24

The group of related parties of Aareal Bank Group (see Note (83) "Remuneration for key executives") comprises the members of management or supervisory bodies and close members of these persons' families. The group of companies related to Aareal Bank Group consists of the companies set out in Note 99 "List of Shareholdings" as well as the companies attributable to the related persons within the meaning of IAS 24.9 (b)(vi).).

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

€ mn	31 Dec 2016	31 Dec 2015
Management Board	–	–
Supervisory Board	0	0
Other related parties	0	–
Total	**0**	**0**

The loan extended to one member of the Supervisory Board in the amount of € 0.04 million has a term of ten years and bears interest at a (nominal) rate of 5.12 %. Collateral was provided in line with usual market practice. Interest received and paid in this context had no material impact on the consolidated financial statements. In addition, the BauGrund / TREUREAL consortium held € 0.4 million in claims against the Group.

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

(91) Events after the Reporting Date

As part of the continued future development of our indirectly-held affiliate WestImmo, the Bank decided that during the course of 2017, WestImmo will surrender its bank licence, as well as its licence to issue Pfandbriefe, and will henceforth perform the role of a service entity for banking business then to be transferred to Aareal Bank.

Aareal Bank Capital Funding Trust will redeem all of the 10,000,000 Trust Preferred Securities on the next scheduled termination date of 31 March 2017, at a redemption price of 100 %, equivalent to a total of € 250 million, plus accrued interest. The purpose of this measure is to optimise Aareal Bank Group's capital structure, in line with corresponding plans.

There were no other material events after the end of the period under review.

(92) 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, this information is available, free of charge, from Aareal Bank AG in Wiesbaden, or from the internet on www.aareal-bank.com/en/about-us/corporate-governance/.

(93) Contingencies

By means of a letter of comfort, Aareal Bank AG guarantees that Aareal Bank Capital Funding LLC, Wilmington, is able to fulfil its 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.

(94) Disclosures pursuant to section 160 (1) no. 8 of the AktG

Pursuant to the German Securities Trading Act (WpHG), any investor whose shareholding in a listed company reaches, exceeds or falls short of certain threshold values in terms of voting rights (whether by purchase, sale or by any other means) must notify the Company and the German Federal Financial Supervisory Authority. The lowest threshold for this notification requirement is 3 %. 100 % of Aareal Bank AG shares are held in free float.

As at 31 December 2016, we were aware of the following shareholders holding a share in the voting rights of at least 3 % pursuant to section 21 (1) of the WpHG:

	Location	Total[1]	Notification date
Responsible entity			
VBL	Karlsruhe	6.50 %	3 February 2015
DEKA	Frankfurt	5.58 %	3 February 2015
Dimensional Fund	Austin	3.04 %	29 May 2012
Government of Norway (via Norges Bank)	Oslo	3.30 %	31 August 2016
Allianz Global Investors	Frankfurt	3.08 %	5 December 2016
Blackrock	Wilmington	3.32 %	9 December 2016

[1] Direct and indirect holdings of voting rights

(95) Declaration of Compliance in accordance with Section 161 of the AktG

The Management Board and the Supervisory Board issued the Declaration of Compliance as stipulated in section 161 of the AktG, and made this Declaration available to shareholders. It is available to the public on the Company's website on http://www.aareal-bank.com/ueber-uns/corporate-governance/entsprechenserklaerung-gemaess-161-aktg/.

(96) Employees

The number of Aareal Bank Group employees[1] as at 31 December 2016 is shown below:

	31 Dec 2016	31 Dec 2015
End-of-year numbers		
Salaried employees	2,566	2,695
Executives	162	166
Total	**2,728**	**2,861**
of which: Part-time employees	503	514

The average number of Aareal Bank Group employees in 2016[2] is shown below:

	1 Jan-31 Dec 2016	1 Jan-31 Dec 2015
Yearly average		
Salaried employees	2,633	2,557
Executives	164	162
Total	**2,797**	**2,719**
of which: Part-time employees	514	487

(97) Nature and extent of interests in unconsolidated structured entities

In accordance with IFRS 12.24, the nature and extent of interests in unconsolidated structured entities as well as the nature of, and changes in, the risks associated with such interests have to be disclosed in the annual report. An interest in a structured entity arises from a contractual and non-contractual involvement which entitles the Group to receive variable returns from the relevant activities of the structured entity. Examples for this are equity or debt instruments of structured entities or the provision of financing, collateral and guarantees to structured entities.

Structured entities are companies where voting rights or similar rights are not the dominant factor to assess control of the company. The relevant activities of structured entities are directed by means of contractual arrangements; any voting rights relate to administrative tasks only. Structured entities are characterised by features or attributes such as restricted activities, a narrow and well-defined objective and/or insufficient equity. In addition, structured entities may relate to financings in the form of multiple contractually linked instruments to investors that create concentrations of credit or other risks. Examples of structured entities are securitisation vehicles, asset-backed financings and some investment funds.

Aareal Bank Group interacts with structured entities such as open-ended property funds and leased property companies. The asset-backed security companies were sold in the year under review. The Group's business relationships are restricted to the provision of financings to structured entities in the form of loans or guarantees and to the holding of debt instruments issued by structured entities. The leased property

[1] This number does not include 56 (2015: 41) employees of the hotel business

[2] This number does not include 175 (2015: 132) employees of the hotel business

companies were established by third parties for the financing of particular transactions and have the legal form of a German private limited company with a limited liability company as general partner (GmbH & Co KG) where Aareal Bank Group holds marginal interests in some cases. In the year under review and the previous year, Aareal Bank Group did not provide any non-contractual support for unconsolidated structured entities.

The following table shows the carrying amounts of assets and liabilities recognised by Aareal Bank Group as at the reporting date as well as the existing off-balance sheet risk exposures that relate to unconsolidated structured entities. The carrying amounts of the assets and off-balance sheet items correspond to the Group's maximum loss exposure from interests in unconsolidated structured entities (without taking into account collateral). The size of the structured entities was determined on the basis of the net fund assets for open-ended property funds and of total assets for leased property companies.

The disposal in financial assets held in asset-backed security companies results from the sale of the remaining portfolio of ABS securities.

31 December 2016

€ mn	Open-ended property funds	Leased property companies	Asset-backed security entities	Total
Assets	**446**	**37**	**–**	**483**
Loans and advances to customers	446	37	–	**483**
Non-trading assets	–	–	–	**–**
Liabilities	**–**	**–**	**–**	**–**
Off-balance sheet risk exposures	**–**	**–**	**–**	**–**
Size range of structured units	**€ 63 million – € 5,741 million**	**€ 15 million – € 50 million**		

31 December 2015

€ mn	Open-ended property funds	Leased property companies	Asset-backed security entities	Total
Assets	**514**	**41**	**118**	**673**
Loans and advances to customers	514	41	–	**555**
Non-trading assets	–	–	118	**118**
Liabilities	**–**	**–**	**–**	**–**
Off-balance sheet risk exposures	**–**	**–**	**–**	**–**
Size range of structured units	**€ 61 million – € 13,195 million**	**€ 14 million – 50 million**	**€ 19 million – € 2,500 million**	

(98) Country-by-Country Reporting

The disclosure requirements refer to information on registered office, revenue, profit or loss, taxes on profit or loss, received government assistance as well as wage and salary earners of Aareal Bank AG, together with its foreign branches and domestic and foreign subsidiaries included in the reporting entity-structure, prior to consolidation.

For this purpose, the Bank's entities – subsidiaries as well as Aareal Bank AG's foreign branches – are allocated to our two business segments, Structured Property Financing and Consulting / Services.

Aareal Bank defines the branch offices' operating profit, which is used as a proxy for revenue, as the sum of the following consolidated income statement items (in accordance with IFRSs):

- net interest income before allowance for credit losses;
- net commission income;
- net result on hedge accounting;
- net trading income / expenses;
- results from non-trading assets;
- results from investments accounted for using the equity method;
- results from investment properties;
- net other operating income / expenses; and
- negative goodwill.

Taxes disclosed are tax expenses in accordance with IFRSs.

The number of wage and salary earners relates to average full-time equivalent staff employed during the financial year.

The following overview shows all countries where Aareal Bank AG has offices, including foreign branches and subsidiaries. Please refer to the list of shareholdings as regards the allocation of individual subsidiaries to the relevant country of domicile. Aareal Bank AG's foreign branches are located in France, Ireland, Italy, Poland, Sweden and the UK.

2016

	Revenues	Profit / loss before taxes	Taxes on profit or loss	Number of wage and salary earners
	€ mn	€ mn	€ mn	Full-time equivalents
Structured Property Financing segment	**837**	**237**	**143**	**1,017**
Belgium	4	3	0	–
France	6	0	2	6
Germany	613	138	128	917
Ireland	9	0	2	7
Italy	51	1	5	31

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Transparency

	Revenues	Profit/loss before taxes	Taxes on profit or loss	Number of wage and salary earners
	€ mn	€ mn	€ mn	Full-time equivalents
Netherlands	–	–	–	–
Poland	11	7	2	6
Singapore	2	0	–	5
Spain	-1	-1	0	–
Sweden	67	64	1	5
Switzerland	0	0	0	–
United Kingdom	8	2	2	7
USA	69	23	1	33
Consolidation	-2	–	–	–
Consulting/Services segment	**173**	**-22**	**-11**	**1,396**
France	20	3	2	170
Germany	106	-32	-14	819
Netherlands	24	4	1	217
Norway	–	–	–	7
Sweden	11	1	0	78
United Kingdom	12	2	0	105
Consolidation	–	–	–	–
Total	**1,010**	**215**	**132**	**2,413**

Government assistance was not received in the financial year 2016.

Aareal Bank Group's return on assets, calculated as the ratio of net profit to total assets, was 0.45% as at the record date.

2015

	Revenues	Profit/loss before taxes	Taxes on profit or loss	Number of wage and salary earners
	€ mn	€ mn	€ mn	Full-time equivalents
Structured Property Financing segment	**982**	**494**	**106**	**1,193**
Belgium	2	-1	–	4
France	8	5	3	6
Germany	815	384	91	1.039
Ireland	1	-5	6	10
Italy	52	35	-13	79
Netherlands	–	–	–	–
Poland	10	6	1	7
Singapore	3	2	–	5

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	Revenues	Profit / loss before taxes	Taxes on profit or loss	Number of wage and salary earners
	€ mn	€ mn	€ mn	Full-time equivalents
Spain	–	–	–	–
Sweden	18	14	1	7
Switzerland	1	1	-1	–
United Kingdom	14	11	2	7
USA	61	42	16	29
Consolidation	-3	–	–	–
Consulting / Services segment	**172**	**-24**	**-10**	**1,281**
France	20	4	1	162
Germany	114	-35	-12	763
Netherlands	18	6	1	171
Norway	–	–	–	6
Sweden	11	1	–	79
United Kingdom	9	–	–	100
Consolidation	–	–	–	–
Total	**1,154**	**470**	**96**	**2,474**

(99) List of shareholdings

The list of shareholdings is disclosed pursuant to section 313 (2) of the HGB. The disclosures in relation to the companies' equity and earnings are retrieved from the financial statements based on the respective local financial reporting principles.

31 December 2016

No.	Company name	Registered office	Shareholding	Equity	Results
			%	€ mn	€ mn
1	Aareal Bank AG	Wiesbaden			
	I. Fully-consolidated subsidiaries				
2	1st Touch Ltd.	Southampton	100.0	GBP 2.2 mn	GBP -0.2 mn 2)
3	Aareal Bank Asia Ltd.	Singapore	100.0	SGD 17.3 mn	SGD 0.4 mn 1)
4	Aareal Bank Capital Funding LLC	Wilmington	0.0	250.0	17.8 5)
5	Aareal Bank Capital Funding Trust	Wilmington	0.0	250.0	17.8 5)
6	Aareal Beteiligungen AG	Frankfurt	100.0	297.8	0.0 3)
7	Aareal Capital Corporation	Wilmington	100.0	USD 219.4 mn	USD 1.5 mn 1)
8	Aareal Estate AG	Wiesbaden	100.0	5.1	2.3 1)
9	Aareal First Financial Solutions AG	Mainz	100.0	3.2	0.0 3)

1) Preliminary figures as at 31 December 2016; 2) Equity and results as at 31 December 2015; 3) Profit transfer agreement / control and profit transfer agreement
4) Different financial year; 5) 100% of voting rights, diverging from the equity interest held; 6) Disclosures in accordance with IFRSs

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No.	Company name	Registered office	Shareholding	Equity	Results	
			%	€ mn	€ mn	
10	Aareal Gesellschaft für Beteiligungen und Grundbesitz Erste mbH & Co. KG	Wiesbaden	94.9	2.5	0.1	1)
11	Aareal Holding Realty LP	Wilmington	100.0	USD 206.1 mn	USD 42.8 mn	6)
12	Aareal Immobilien Beteiligungen GmbH	Wiesbaden	100.0	454.3	0.0	3)
13	Aareal Valuation GmbH	Wiesbaden	100.0	0.5	0.0	3)
14	Aareon AG	Mainz	100.0	94.8	15.9	
15	Aareon Deutschland GmbH	Mainz	100.0	33.9	0.0	3)
16	Aareon France S.A.S.	Meudon-la-Forêt	100.0	7.3	2.5	2)
17	Aareon Immobilien Projekt GmbH	Dortmund	100.0	0.7	0.0	3)
18	Aareon International Solutions GmbH	Mainz	100.0	0.0	0.0	
19	Aareon Nederland B.V.	Emmen	100.0	20.5	1.8	2)
20	Aareon UK Ltd.	Coventry	100.0	GBP 4.4 mn	GBP 0.2 mn	2)
21	Anfield Portfolio GmbH & Co. KG	Mainz	100.0	0.0	0.0	
22	Anfield Verwaltungs GmbH	Mainz	100.0	0.0	0.0	
23	BauContact Immobilien GmbH	Wiesbaden	100.0	27.4	1.0	
24	BauGrund Immobilien-Management GmbH	Bonn	100.0	0.5	0.0	3)
25	BauGrund TVG GmbH	Munich	100.0	0.1	0.0	1)
26	BauSecura Versicherungsmakler GmbH	Hamburg	51.0	3.2	3.1	1)
27	BVG – Grundstücks- und Verwertungsgesellschaft mit beschränkter Haftung	Frankfurt	100.0	217.3	0.0	3)
28	DBB Inka	Dusseldorf	100.0	101.3	-0.1	
29	Deutsche Bau- und Grundstücks-Aktiengesellschaft	Berlin	100.0	1.4	0.1	1)
30	Deutsche Structured Finance GmbH	Wiesbaden	100.0	6.2	1.7	1)
31	DSF Flugzeugportfolio GmbH	Wiesbaden	100.0	0.0	0.0	3)
32	DSF German Office Fund GmbH & Co. KG	Wiesbaden	94.0	0.4	-0.9	1)
33	DSF Vierte Verwaltungsgesellschaft mbH	Wiesbaden	100.0	2.2	0.0	3)
34	Esplanade Realty LP	Wilmington	100.0	USD 23.3 mn	USD 0.6 mn	6)
35	Facilitor B.V.	Enschede	100.0	0.5	0.7	2)
36	GEV Besitzgesellschaft mbH	Wiesbaden	100.0	30.0	0.0	3)
37	GEV Beteiligungsgesellschaft mbH	Wiesbaden	100.0	0.1	0.0	1)
38	GEV GmbH	Wiesbaden	100.0	358.0	0.0	3)
39	GVN-Grundstücks- und Vermögensverwaltungs-gesellschaft mit beschränkter Haftung	Frankfurt	100.0	0.5	0.0	3)
40	Incit AB	Mölndal	100.0	SEK 23.3 mn	SEK 2.6 mn	2)
41	Incit AS	Oslo	100.0	NOK 0.1 mn	NOK -1.1 mn	2)
42	Incit Nederland B.V.	Gorinchem	100.0	-0.1	0.3	2)
43	IV Beteiligungsgesellschaft für Immobilieninvestitionen mbH	Wiesbaden	100.0	2.3	0.0	1)
44	Izalco Spain S.L.	Madrid	100.0	10.2	-0.9	
45	Jomo S.p.r.l.	Brussels	100.0	44.0	-0.6	1)
46	La Sessola Holding GmbH	Wiesbaden	100.0	84.1	-18.8	1)
47	La Sessola S.r.l.	Rome	100.0	119.7	-12.2	1)
48	La Sessola Service S.r.l.	Rome	100.0	2.2	1.5	1)

1) Preliminary figures as at 31 December 2016; 2) Equity and results as at 31 December 2015; 3) Profit transfer agreement / control and profit transfer agreement
4) Different financial year; 5) 100 % of voting rights, diverging from the equity interest held; 6) Disclosures in accordance with IFRSs

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No.	Company name	Registered office	Shareholding	Equity	Results
			%	€ mn	€ mn
49	Manager Realty LLC	Wilmington	100.0	USD 0.0 mn	USD 0.0 mn [6]
50	Mercadea S.r.l.	Rome	100.0	7.1	0.1 [1]
51	Mirante S.r.l.	Rome	100.0	11.2	-2.2 [1]
52	Northpark Realty LP	Wilmington	100.0	USD 86.3 mn	USD 2.3 mn [6]
53	Participation Achte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 [3]
54	Participation Neunte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 [3]
55	phi-Consulting GmbH	Bochum	100.0	1.4	0.2 [1]
56	Real Verwaltungsgesellschaft mbH	Schönefeld	100.0	27.8	0.9 [1]
57	Sedum Grundstücksverwaltungsgesellschaft mbH & Co.Vermietungs KG	Wiesbaden	94.9	-2.4	-1.5 [1]
58	SG2ALL B.V.	Huizen	100.0	0.2	0.2 [2]
59	Square DMS B.V.	Grathem	100.0	0.4	0.6 [2]
60	Terrain-Aktiengesellschaft Herzogpark	Wiesbaden	99.9	4.7	0.0 [3]
61	Terrain Beteiligungen GmbH	Wiesbaden	94.0	50.3	0.5 [1]
62	Westdeutsche ImmobilienBank AG	Mainz	100.0	451.9	0.0 [3]
63	WP Galleria Realty LP	Wilmington	100.0	USD 90.1 mn	USD 1.7 mn [6]
	II. Joint Arrangements				
64	Konsortium BauGrund/TREUREAL	Bonn	50.0	0.0	0.0 [1]
	III. Associates				
65	DSF PP Justizzentrum Thüringen GmbH & Co. KG	Frankfurt	48.4	0.4	0.0 [2]
66	Westhafen Haus GmbH & Co. Projektentwicklungs KG	Frankfurt	25.0	-0.2	0.0 [2]
67	Westhafen-Gelände Frankfurt am Main GbR	Frankfurt	33.3	0.0	0.4 [2]

[1] Preliminary figures as at 31 December 2016; [2] Equity and results as at 31 December 2015; [3] Profit transfer agreement/control and profit transfer agreement
[4] Different financial year; [5] 100 % of voting rights, diverging from the equity interest held; [6] Disclosures in accordance with IFRSs

(100) Offices held by employees of Aareal Bank AG pursuant to section 340a (4) No. 1 of the HGB

This disclosure refers to all offices in statutory supervisory bodies of large corporations held by employees of Aareal Bank AG:

Dr Stefan Lange, Bank Director	
Westdeutsche ImmobilienBank AG	Member of the Supervisory Board

Dr Reinhard Grzesik, Bank Director	
Westdeutsche ImmobilienBank AG	Member of the Supervisory Board

(101) 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 5 of the German Public Limited Companies Act (Aktiengesetz – "AktG")

Supervisory Board

Marija Korsch, Chairman of the Supervisory Board
Former partner of Bankhaus Metzler seel. Sohn & Co. Holding AG

Aareal Bank AG	Chairman of the Supervisory Board
Just Software AG	Member of the Supervisory Board

Prof. Dr Stephan Schüller, Deputy Chairman of the Supervisory Board
Spokesman of the General Partners of Bankhaus Lampe KG

Aareal Bank AG	Deputy Chairman of the Supervisory Board
DePfa Holding Verwaltungsgesellschaft mbH	Deputy Chairman of the Supervisory Board
Universal-Investment-Gesellschaft mbH	Member of the Supervisory Board
Howaldt & Co. Investmentaktiengesellschaft TGV	Chairman of the Supervisory Board

York-Detlef Bülow*, Deputy Chairman of the Supervisory Board
Aareal Bank AG

Aareal Bank AG	Deputy Chairman of the Supervisory Board

Thomas Hawel*
Aareon Deutschland GmbH

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

Dieter Kirsch*
Aareal Bank AG

Aareal Bank AG	Member of the Supervisory Board

Richard Peters
President and Chairman of the Management Board of Versorgungsanstalt des Bundes und der Länder

Aareal Bank AG	Member of the Supervisory Board
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board

Dr Hans-Werner Rhein
German Lawyer (Rechtsanwalt)

Aareal Bank AG	Member of the Supervisory Board
Deutsche Familienversicherung AG	Chairman of the Supervisory Board
Gothaer Allgemeine Versicherung AG	Member of the Supervisory Board

Sylvia Seignette
Former CEO for Germany and Austria, Crédit Agricole CIB (formerly Calyon)

Aareal Bank AG	Member of the Supervisory Board

Elisabeth Stheeman
Senior Advisor, Bank of England, Prudential Regulation Authority

Aareal Bank AG	Member of the Supervisory Board
TLG Immobilien AG	Member of the Supervisory Board
Courno	Senior Advisor

* Employee representative member of the Supervisory Board of Aareal Bank AG

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Hans-Dietrich Voigtländer **Senior Partner of BDG Innovation + Transformation GmbH & Co. KG**	
Aareal Bank AG	Member of the Supervisory Board

Prof. Dr Hermann Wagner, Chairman of the Audit Committee **German Chartered Accountant, tax consultant**	
Aareal Bank AG	Member of the Supervisory Board
btu beraterpartner Holding AG	Member of the Supervisory Board
PEH Wertpapier AG	Member of the Supervisory Board
DEMIRE Deutsche Mittelstand Real Estate AG	Chairman of the Supervisory Board
Squadra Immobilien GmbH & Co. KGaA	Member of the Supervisory Board

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

* Employee representative member of the Supervisory Board of Aareal Bank AG

Composition of Supervisory Board's committees

Executive and Nomination Committee	
Marija Korsch	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
York-Detlef Bülow	Deputy Chairman
Richard Peters	
Dr Hans-Werner Rhein	

Technology and Innovation Committee	
Hans-Dietrich Voigtländer	Chairman
Marija Korsch	Deputy Chairman
Thomas Hawel	
Richard Peters	
Elisabeth Stheeman	

Audit Committee	
Prof. Dr Hermann Wagner	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
York-Detlef Bülow	
Marija Korsch	
Richard Peters	
Hans-Dietrich Voigtländer	

Remuneration Control Committee	
Marija Korsch	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
York-Detlef Bülow	Deputy Chairman
Dieter Kirsch	
Hans-Dietrich Voigtländer	

Risk Committee	
Sylvia Seignette	Chairman
Elisabeth Stheeman	Deputy Chairman
Dieter Kirsch	
Marija Korsch	
Dr Hans-Werner Rhein	
Prof. Dr Hermann Wagner	

Committee for Urgent Decisions
Sylvia Seignette
Elisabeth Stheeman
Dieter Kirsch
Marija Korsch
Dr Hans-Werner Rhein
Prof. Dr Hermann Wagner

Management Board

Hermann Josef Merkens, Chairman of the Management Board
Finance, Participating Interests, Portfolio Management, Regulatory Affairs, Corporate Communications, Investor Relations, Board Office incl. Sustainability, Human Resources, Legal and Audit

Aareal Estate AG	Chairman of the Supervisory Board	
Aareal Capital Corporation	Member of the Board of Directors	until 8 July 2016
Aareal Capital Corporation	Chairman of the Board of Directors	since 8 July 2016
Aareal First Financial Solutions AG	Member of the Supervisory Board	until 4 March 2016
Aareon AG	Deputy Chairman of the Supervisory Board	
Aareal Beteiligungen AG (former Corealcredit)	Chairman of the Supervisory Board	
CredaRate Solutions GmbH	Member of the Advisory Board	
Westdeutsche ImmobilienBank AG	Chairman of the Supervisory Board	

Dagmar Knopek, Member of the Management Board
Credit Management, Workout and Operations

Aareal Bank Asia Limited	Chairman of the Board of Directors	until 29 August 2016
Aareal Capital Corporation	Chairman of the Board of Directors	until 8 July 2016
Aareal Capital Corporation	Member of the Board of Directors	since 8 July 2016
Aareal Capital Corporation	Member of the Board of Directors	until 31 December 2016
Aareon AG	Member of the Supervisory Board	
Westdeutsche ImmobilienBank AG	Member of the Supervisory Board	

Christiane Kunisch-Wolff, Member of the Management Board (since 15 March 2016)
Risk Controlling and Compliance

Westdeutsche ImmobilienBank AG	Member of the Supervisory Board	since 4 May 2016

Thomas Ortmanns, Member of the Management Board
Housing Unit, Treasury, Information Technology and Organisation

Aareal First Financial Solutions AG	Chairman of the Supervisory Board	
Aareon AG	Chairman of the Supervisory Board	
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Chairman of the Supervisory Board	
HypZert GmbH	Member of the Supervisory Board	
Westdeutsche ImmobilienBank AG	Member of the Supervisory Board	

Christof Winkelmann, Member of the Management Board (since 1 July 2016)
Sales Units Structured Property Financing

Aareal Bank Asia Limited	Chairman of the Board of Directors	since 30 August 2016
Aareal Capital Corporation	Member of the Board of Directors	since 1 January 2017
La Sessola Service S.r.l.	Member of the Management Board	
La Sessola S.r.l.	Member of the Management Board	

Responsibility Statement

To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Group Management Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal opportunities and risks associated with the expected development of the Group.

Wiesbaden, 28 February 2017

The Management Board

Hermann J. Merkens **Dagmar Knopek** **Christiane Kunisch-Wolff**

Thomas Ortmanns **Christof Winkelmann**

Independent Auditors' Report

To Aareal Bank AG, Wiesbaden

Report on the Audit of the Consolidated Financial Statements

Audit Opinion on the Consolidated Financial Statements

We have audited the consolidated financial statements of Aareal Bank AG, Wiesbaden, and its subsidiaries (the Group), which comprise the statement of financial position as at 31 December 2016, the income statement, the statement of comprehensive income, statement of changes in equity and of cash flows for the financial year from 1 January to 31 December 2016, and notes to the consolidated financial statements, including a summary of significant accounting policies.

According to § (Article) 322 Abs. (paragraph) 3 Satz (sentence) 1 zweiter Halbsatz (second half sentence) HGB ("Handelsgesetzbuch": German Commercial Code), we state that, in our opinion, based on the findings of our audit, the accompanying consolidated financial statements comply, in all material respects, with IFRS, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB and give a true and fair view of the net assets and financial position of the Group as at 31 December 2016, as well as the results of operations for the financial year from 1 January to 31 December 2016, in accordance with these requirements.

According to § 322 Abs. 3 Satz 1 erster Halbsatz HGB, we state that our audit has not led to any reservations with respect to the propriety of the consolidated financial statements.

Basis for Audit Opinion on the Consolidated Financial Statements

We conducted our audit 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 considered the International Standards on Auditing (ISA). Our responsibilities under those provisions and standards, as well as supplementary standards, are further described in the "Auditors' Responsibilities for the Audit of the Consolidated Financial Statements" section of our report. We are independent of the Group entities in accordance with the provisions under German commercial law and professional requirements, and we have fulfilled our other German ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the financial year from 1 January to 31 December 2016. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our audit opinion thereon, and we do not provide a separate audit opinion on these matters.

In our view, the key audit matters were as follows:

❶ Impairment of Italian mortgage loan portfolio

❷ Impairment of properties acquired from previous loan exposures as reported in the property, plant and equipment and other assets balance sheet items

Our presentation of these key audit matters has been structured as follows:

① Matter and issue
② Audit approach and findings
③ Reference to further information

❶ Impairment of Italian mortgage loan portfolio

① As of 31 December 2016, loans and advances to customers in the amount of € 3.0 billion that are secured by properties in Italy (hereinafter "Italian mortgage loan portfolio") are reported in the consolidated financial statements of Aareal Bank AG. 22 % of these receivables are attributable to development financings. As of 31 December 2016, the allowances for credit losses (specific valuation allowances and portfolio impairment allowances) for the Italian mortgage loan portfolio amounted to a total of € 297 million. Italy's difficult macroeconomic situation has in past years led to a decline in real estate prices and transaction volumes as well as, in part, to financial difficulties and restructuring proceedings for Aareal Bank AG's borrowers. The realisation period of the properties on which the portfolio is based generally takes a number of years depending on their size, location and type. Aareal Bank AG analyzes the financial circumstances of borrowers using, inter alia, the annual financial statements, business plans and business evaluations provided, and generally examines the market values of the associated collateral at least once a year. In the majority of cases, Aareal Bank AG obtains external valuations to determine the market values of the properties pledged as collateral. Property market values are calculated by the appraisers in each case as the present values of future cash flows using the discounted cash flow method or determined on the basis of floor area-related comparative values, with the appraisers deriving the assumptions about future cash flows that can be generated by the property using the information and business plans provided by the borrowers. If it is found when assessing the borrower that there has been a default within the meaning of the regulatory requirements and the income from the collateral is expected to be insufficient, the Company applies a specific valuation allowance. The assessment of borrower-related financial circumstances, the valuations of real estate collateral available and other documents, for example restructuring plans, resulted in a net addition to the risk allowances of € 27 million for the Italian mortgage loan portfolio in the reporting period. When determining the risk allowances for the Italian mortgage loan portfolio, management makes assumptions concerning realisation and completion. Since even relatively small changes in these assumptions have a significant influence on the associated collateral value and the measurements are subject to uncertainties in this regard, this matter was of particular importance during our audit.

② As part of our audit we evaluated, inter alia, the existing documents relating to the financial circumstances in a risk-focused sample of exposures and the recoverability of the pledged collateral. We evaluated the valuations performed by the appraisers in terms of their suitability, up-to-dateness and methodology, as well as the transparency of the value calculation. At the same time, we gained an understanding of the original data, value parameters and assumptions on which the valuations were based, evaluated these critically and assessed whether they were within a justifiable range. In specific cases, we carried out our own property inspections. In addition, we based our assessment of management's assumptions concerning realisation and completion on general and sector-specific market expectations as well as on comprehensive documentation and explanations from management about expected cash inflows and outflows. Furthermore, we examined the relevant credit processes in the Aareal Bank AG's internal control in terms of the appropriateness of their design and tested whether they were functioning. Taking account of the information available, we conclude that the assumptions made by management for testing the impairment of the Italian mortgage loan portfolio and the processes implemented are appropriate.

③ The Company's disclosures regarding the risk allowances for the Italian mortgage loan portfolio are contained in notes 10, 28 and 40 in the notes to the consolidated financial statements.

❷ Impairment of properties acquired from previous loan exposures as reported in the property, plant and equipment and other assets balance sheet items

① In the consolidated financial statements of Aareal Bank AG, properties acquired from previous loan exposures were reported as of 31 December 2016, in the amount of € 133 million in the property and equipment balance sheet line item in accordance with IAS 16 Property, Plant and Equipment and in the amount of € 228 million under the other assets balance sheet line item in accordance with IAS 2 Inventories. The properties were acquired by Aareal Bank AG through fully consolidated real estate special purpose entities. The real estate special purpose entity Aqvatrium AB owned by Aareal Bank AG, was sold in the reporting period at a gain of € 61 million that was reported in results of non-trading assets. Aareal Bank AG tests the properties acquired from former credit exposures at least once a year for impairment using external valuations. The market values of the properties are calculated in each case as the present values of future cash flows using the discounted cash flow method or determined on the basis of floor area-related comparative values, with the appraisers deriving the assumptions about future cash flows using the information and projections provided by management. In addition, management makes assumptions about leasing and marketing. Based on these valuations and further documents, impairment losses in the financial year were € 12 million. Since even relatively small changes in these assumptions have a significant influence on the market values of the properties and the measurements are therefore subject to uncertainties, this matter was of particular importance during our audit.

② As part of our audit, we particularly evaluated the valuations performed by the external appraisers in terms of their up-to-dateness and methodology, as well as the transparency of the value calculation. At the same time we gained an understanding of the original data, value parameters and assumptions on which the valuations were based, evaluated these critically and assessed whether they were within a justifiable range. In this context we involved our own real estate experts. In addition, we based our assessment of the leasing and marketing assumptions made by management on, inter alia, a comparison with general and sector-specific market expectations as well as on comprehensive documentation and explanations from management about expected cash flows. Furthermore, we evaluated the classification of the properties and, therewith, the respective accounting policies to be applied under IAS 2 and IAS 16. For the disposal of the real estate special purpose entity, Aqvatrium AB, we assessed the calculation of the gain on disposal of € 61 million by inspecting the underlying agreements and tracing the derecognition of the property. Taking account of the information available, we conclude that the assumptions made by management for testing the impairment of the properties acquired from former exposures are appropriate and we were able to follow the classifications applied.

③ We refer to the Company's disclosures on property, plant and equipment and other assets contained in notes 16, 18, 35, 46 and 49 in the notes to the consolidated financial statements. The effects of the sale of all shares in the group company, Aqvatrium AB, on the consolidated financial statements are presented in notes 32 and 49 in the notes to the consolidated financial statements.

Other Information

Management is responsible for the other information. The other information comprises

- the Corporate Governance Report according to section 3.10 of the German Corporate Governance Code,
- the Corporate Governance Statement pursuant to § 289a HGB and § 315 Abs. 5 HGB, as well as
- other parts of the annual report of Aareal Bank AG, Wiesbaden, for the financial year ended on 31 December 2016, which were not subject of our audit.

Our audit opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information, and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation of the consolidated financial statements, which comply with IFRS, as adopted by the EU, and the additional German legal requirements applicable under § 315a Abs. 1 HGB, and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. Furthermore, management is responsible for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

The supervisory board is responsible for overseeing the Group's financial reporting process for the preparation of the consolidated financial statements.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objective is to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our audit opinion on the consolidated financial statements. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted 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), under additional consideration of the ISA, will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit 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), under additional consideration of the ISA, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or the group management report or, if such disclosures are inadequate, to modify our audit opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the net assets and financial position as well as the results of operations of the Group in accordance with IFRS, as adopted by the EU, and the additional German legal requirements applicable under § 315a Abs. 1 HGB.

- Obtain sufficient and appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an audit opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our report on the audit of the consolidated financial statements unless law or regulation precludes public disclosure about the matter.

Other Legal and Regulatory Requirements

Report on the Audit of the Group Management Report

Audit Opinion on the Group Management Report

We have audited the group management report of Aareal Bank AG, Wiesbaden, which is combined with the Company's management report, for the financial year from 1 January to 31 December 2016.

In our opinion, based on the findings of our audit, the accompanying group management report as a whole provides a suitable view of the Group's position. In all material respects, the group management report is consistent with the consolidated financial statements, complies with legal requirements and suitably presents the opportunities and risks of future development.

Our audit has not led to any reservations with respect to the propriety of the group management report.

Basis for Audit Opinion on the Group Management Report

We conducted our audit of the group management report in accordance with § 317 Abs. 2 HGB and German generally accepted standards for the audit of management reports promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW). We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management and Those Charged with Governance for the Group Management Report

Management is responsible for the preparation of the group management report, which as a whole provides a suitable view of the Group's position, is consistent with the consolidated financial statements, complies with legal requirements, and suitably presents the opportunities and risks of future development. Furthermore, management is responsible for such policies and procedures (systems) as management determines are necessary to enable the preparation of a group management report in accordance with the German legal requirements applicable under § 315 Abs. 1 HGB and to provide sufficient and appropriate evidence for the assertions in the group management report.

The supervisory board is responsible for overseeing the Group's financial reporting process for the preparation of the group management report.

Auditors' Responsibilities for the Audit of the Group Management Report

Our objective is to obtain reasonable assurance about whether the group management report as a whole provides a suitable view of the Group's position as well as, in all material respects, is consistent with the consolidated financial statements as well as the findings of our audit, complies with legal requirements, and suitably presents the opportunities and risks of future development, and to issue an auditors' report that includes our audit opinion on the group management report.

As part of an audit, we examine the group management report in accordance with § 317 Abs. 2 HGB and German generally accepted standards for the audit of management reports promulgated by the IDW. In this connection, we draw attention to the following:

- The audit of the group management report is integrated into the audit of the consolidated financial statements.

- We obtain an understanding of the policies and procedures (systems) relevant to the audit of the group management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an audit opinion on the effectiveness of these policies and procedures (systems).

- We perform audit procedures on the prospective information presented by management in the group management report. Based on appropriate and sufficient audit evidence, we hereby, in particular, evaluate the material assumptions used by management as a basis for the prospective information and assess the reasonableness of these assumptions as well as the appropriate derivation of the prospective information from these assumptions. We are not issuing a separate audit opinion on the prospective information or the underlying assumptions. There is a significant, unavoidable risk that future events will deviate significantly from the prospective information.

- We are also not issuing a separate audit opinion on individual disclosures in the group management report; our audit opinion covers the group management report as a whole.

Responsible Auditor

The auditor responsible for the audit is Stefan Palm.

Frankfurt/ Main, 1 March 2017

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

Stefan Palm	**ppa. Lukas Sierleja**
Wirtschaftsprüfer	**Wirtschaftsprüfer**
(German Public Auditor)	**(German Public Auditor)**

Responsible and transparent corporate governance is of great importance to Aareal Bank AG, and is considered the essence of prudent commercial conduct by both the Management Board and the Supervisory Board.

Transparency

Corporate Governance Statement pursuant to Section 315 (5) in conjunction with Section 289a of the HGB

Declaration of Compliance in Accordance with Section 161 of the AktG

Aareal Bank AG has complied with the recommendations of the Government Commission "German Corporate Governance Code" (as amended on 5 May 2015) – except for the two restrictions set out below – since the last Declaration of Compliance was issued in December 2015; and will continue to do so, subject to the same restrictions.

In accordance with section 4.2.3 (2) sentence 6 of the German Corporate Governance Code (the "Code"), the amount of Management Board compensation shall be capped, both overall and for variable remuneration components. In March 2014, against the background of changed regulatory requirements, and based upon a proposal by the Remuneration Control Committee, the Supervisory Board approved a new remuneration system for members of the Management Board, with effect from 1 January 2014. The new remuneration system complies with the recommendation in section 4.2.3 (2) sentence 6 of the Code. In this connection, a maximum amount ("cap") was resolved for the variable, performance-related remuneration component of the Management Board – for the 2013 financial year, and for subsequent financial years. As the only exception, no cap applies to virtual shares granted for the 2012 financial year or earlier financial years, or to virtual shares still to be granted under applicable rules governing the deferral of variable remuneration components. However, such virtual shares will be settled and disbursed for the last time in 2018, after expiry of the retention period and any applicable holding or blocking periods, based on the weighted average price (Xetra®) of the five exchange trading days following the expiry of the period. Pursuant to section 25d of the German Banking Act (Kreditwesengesetz – "KWG"), the Executive and Nomination Committee of Aareal Bank AG's Supervisory Board is required to assume additional tasks which are not supposed to be prepared by shareholder representatives on the Supervisory Board alone. Hence, the Executive and Nomination Committee also includes employee representative members, in contravention of the recommendation in section 5.3.3 of the Code. However, the Committee will ensure that the nomination of candidates for election by the Annual General Meeting will be determined exclusively by shareholder representatives on the Committee.

Wiesbaden, December 2016

The Management Board

Hermann J. Merkens **Dagmar Knopek** **Christiane Kunisch-Wolff**

Thomas Ortmanns **Christof Winkelmann**

For the Supervisory Board

Marija Korsch (Chairman)

Corporate Governance Report

Responsible and transparent corporate governance is of great importance to Aareal Bank, and is 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.

The Supervisory Board discusses these amendments; together with the Management Board, the Supervisory Board determines to what extent Aareal Bank AG complies with – or diverges from – the recommendations of the German Corporate Governance Code. Accordingly, 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 compliance, and amended as necessary. Our annual Declaration of Compliance gives information on the extent to which the Bank complies with recommendations. The Declaration of Compliance is adopted by the Management Board and the Supervisory Board, and then published on the Bank's website, where Declarations issued in past years are also archived.

Code of Conduct

We believe that 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. The Code of Conduct contains binding rules governing the legal and ethical conduct of employees vis-à-vis clients, business partners, and colleagues. Aareal Bank's efforts in this context are also motivated by the desire to affirm and further strengthen the confidence placed by stakeholders – our clients, investors, and staff.

Recommendations of the German Corporate Governance Code

During 2016, the German Corporate Governance Code, as amended on 5 May 2015, was applicable. Aareal Bank's Management Board and Supervisory Board issued and signed their most recent Declaration of Compliance pursuant to section 161 of the German Public Limited Companies Act (AktG) on 19 December 2016. The Declaration was published on the Bank's website, and is included in the annual report as part of the Corporate Governance Statement.

In accordance with this Declaration, Aareal Bank AG complies with the Code, subject to the following restrictions:

In accordance with section 4.2.3 (2) sentence 6 of the German Corporate Governance Code (the "Code"), the amount of Management Board compensation shall be capped, both overall and for variable remuneration components. In March 2014, against the background of changed regulatory requirements, and based upon a proposal by the Remuneration Control Committee, the Supervisory Board approved a new remuneration system for members of the Management Board, with effect from 1 January 2014. The new remuneration system complies with the recommendation in section 4.2.3 (2) sentence 6 of the Code. In this connection, a maximum amount ("cap") was resolved for the variable, performance-related remuneration component of the Management Board – for the 2013 financial year, and for subsequent financial years. As the only exception, no cap applies to virtual shares granted for the 2012 financial year or earlier financial years, or to virtual shares still to be granted under applicable rules governing the deferral of variable remuneration components. However, such virtual shares will be settled and disbursed for the last time in 2018, after expiry of the retention period and any applicable holding or blocking periods, based on the weighted average price (Xetra®) of the five exchange trading days following the expiry of the period. Pursuant to section 25d of the KWG, the Executive and Nomination Committee of Aareal Bank AG's Supervisory Board is required to assume additional tasks which are not supposed to be prepared by shareholder representatives on the Supervisory Board alone. Hence, the Executive and Nomination Committee also includes employee representative members, in contravention of the recommendation in section 5.3.3 of the Code. However, the Committee will ensure that the nomination of candidates for election by the Annual General Meeting will be determined exclusively by shareholder representatives on the Committee.

The Management Board

The Management Board is responsible for managing the Company. In doing so, it is obliged to act in the best interests 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 the company strategy, coordinates it with the Supervisory Board, and ensures its implementation. The Management Board ensures appropriate and sustainable risk management and risk control 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 2016 financial year.

Diversity

The Management Board has made an express commitment to diversity in Aareal Bank Group, and published it on the Internet and Intranet. Aareal Bank defines diversity as:

- An appreciation for the uniqueness of every individual and respect for their differences
- Equal opportunities at all levels
- The prevention of discrimination of any kind
- The belief that diversity enriches corporate culture and also represents a success factor in reaching strategic goals

The goals are to promote Aareal Bank Group's image as a modern employer, to strengthen employee commitment and increase employee motivation, to ensure skills and competencies are fostered individually in a way that promotes employee performance, to react to demographic change and an ageing workforce, and to take into account individual circumstances and stages of life.

In order to highlight the significance of diversity and document the fact that the concept of diversity is very important to Aareal Bank Group, the Bank signed the Charter of Diversity (an initiative launched by the German industry in 2006) in 2013.

Aareal Bank Group currently employs people from 28 different countries. When filling positions abroad, the Bank takes care to predominantly appoint local staff.

The share of female employees in Aareal Bank AG was 45.1 % in the 2016 financial year, with women accounting for 22.9 % of executive positions. Within Aareon, the figures were 32.7 % and 21.8 %, respectively.

Severely disabled persons made up 3.9 % of Aareal Bank's staff base in 2016. This employee group is represented in the Group's German entities by a disability representative.

Equal treatment

Aareal Bank Group attaches great importance to the equal treatment of women and men, whether in the context of filling vacant positions, with regard to continuous professional development, or in terms of remuneration. Specifically, any vacancies below senior executive level are generally published throughout the Company, in the form of job advertisements that all members of staff – male or female – may apply for. When setting the remuneration of employees, we do not differentiate by gender but rely exclusively on aspects such as qualification, professional experience or training.

Likewise, qualification is the decisive criterion for the appointment of employees to positions; this is examined regularly by employee representative bodies, within the scope of their co-determination rights. The principle that qualifications and international experience are the primary criteria for choosing a candidate also applies for the Management Board.

In accordance with the German General Equal Treatment Act (Allgemeines Gleichbehandlungsgesetz – "AGG"), Aareal Bank and Aareon have AGG Officers in Germany. Special AGG-related training measures are carried out for all employees. In the US, the employee manual contains rules designed to avoid harassment at the workplace ("Anti-Harassment Rules").

Supervisory Board

The task of the Supervisory Board is to regularly advise and 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 outlined in the "Description of Management Board and Supervisory Board work processes", and in the List of Offices Held, both of which form part of this annual report. The Supervisory Board reports on its duties and the events of the 2016 financial year in its report.

The option of preparing meetings separately with shareholder representatives and employee representatives is used by the Supervisory Board in exceptional cases only. However, some of the meetings have been prepared separately in 2015 for the last time. Meetings were held without employee representatives present (Executive and Nomination Committee meetings preparing the election of shareholder representatives at the Annual General Meeting on 20 May 2015). Moreover, in accordance with the provisions of the KWG, Supervisory Board meetings were held with limited presence of the Management Board during the discussion of selected agenda items.

In line with section 5.2 of the Code, the Chairman of the Supervisory Board does not chair the Audit Committee. This position is held by Prof. Dr Wagner, who is a certified public auditor and tax advisor and who has many years of experience gained as a partner in audit firms.

In its Conflicts of Interest Policy, the Supervisory Board has laid down procedures on how to prevent or handle potential conflicts of interest affecting members of the Management Board or the Supervisory Board. Specifically, the Policy provides that individual Supervisory Board members shall establish transparency even where there is only a potential conflict of interest. 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 regularly reviews the efficiency of its own activities, with support provided by external consultants. In line with the requirements set out in section 25d (11) of the KWG, the Executive and Nomination Committee is in charge of the preparation and execution of the efficiency review. The results of this review serve to further improve the work carried out by the Supervisory Board, as well as enhancing cooperation between the Supervisory Board and Management Board. The Chairman of the Supervisory Board presented the results of the efficiency review for the year 2016 in the meeting on 23 March 2017, and discussed these with the members in detail. The Supervisory Board will incorporate these findings into its work.

The Supervisory Board has the required knowledge, skills, and professional expertise to properly perform its duties. In accordance with section 5.4.5 of the Code, the Supervisory Board members regularly attend continuous professional development measures, and are supported to this effect by the Company.

The Report of the Supervisory Board provides a detailed review of the activities of the Supervisory Board and its Committees.

Guidelines regarding the composition of the Supervisory Board (shareholder representatives)

Key factors taken into account for nomination to the Supervisory Board are the professional aptitude and the experience of candidates – also in relation to the Group's international activities. The Supervisory Board of Aareal Bank AG believes that it is sufficiently independent. Since the elections to the Supervisory Board at the Annual General Meeting 2015, all shareholder representatives to the Supervisory Board have been independent, as defined by section 5.4.2 of the Code.

Within the framework of actual decisions concerning potential members, the Supervisory Board of Aareal Bank AG assesses the independence of the respective candidate, duly taking that independence into account. In particular, it takes care to ensure that individual members are unbiased.

Any individual whose circumstances may give rise to conflicts of interest cannot be considered as a candidate. At the time of election to the Supervisory Board, candidates should generally be less than 70 years old. When selecting suitable candidates, the Supervisory Board considers the target quota of female members of at least 30 %, as well as a variety in terms of age, education and professional experience, with a view to its overall composition. Specifically, the Supervisory Board should not exclusively consist of members who are older than 60 years, nor should all of its members have acquired the majority of their professional experience with banks.

Guidelines regarding the composition of the Management Board

When selecting new members of the Management Board, the Supervisory Board considers the duties at hand, in the context of overall responsibility to be assumed on the Management Board, as well as concerning individual Management Board sections. Each candidate must be reliable and sufficiently qualified to fulfil these duties. In particular, the Supervisory Board considers the target quota of 25 % female Management Board members when selecting candidates. Moreover, where several candidates are available with equal qualifications, the Supervisory Board will additionally consider the objective of ensuring maximum variety in terms of different educational backgrounds and professional experience.

Guidelines for the setting of targets for female quotas

In accordance with the German Act for Equal Participation of Women and Men in Senior Positions in Private Enterprises and the Public Sector (Gesetz für die gleichberechtigte Teilhabe von Frauen und Männern an Führungspositionen in der Privatwirtschaft und im öffentlichen Dienst), Aareal Bank AG has set targets for the share of female members of the Supervisory Board and the Management Board, as well as for the two management levels below the Management Board.

Specifically, the Supervisory Board of Aareal Bank AG has set itself the target of maintaining the 30 % share of women on the Supervisory Board and of 25 % on the Management Board (which the Bank had achieved prior to the Act coming into force), until 30 June 2017. In parallel, the Management Board has set target quotas of 6.3 % for the first and 21.4 % for the second management level below the Management Board; these quotas are also to be achieved by 30 June 2017.

Purchase or sale of the Company's shares

In 2016, members of the Company's executive bodies did not carry out any transactions involving the Company's shares, which would have required publication in accordance with the requirements of Article 19 of the EU Market Abuse Regulation (596/2014/EU), in conjunction with section 15 of the WpHG. At the end of the financial year, aggregate shareholdings of members of executive bodies in the Company's shares were less than 1% of the issued share capital of Aareal Bank AG.

Transactions with related parties

Related party transactions are detailed in the Notes to the financial statements.

Accounting policies

Aareal Bank AG prepares the Group's accounts in accordance with International Financial Reporting Standards (IFRSs). The single-entity financial statements of Aareal Bank AG are prepared in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – HGB). The Management Board prepares the financial statements 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 25 May 2016 appointed PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft, Frankfurt/Main, as the auditors for the 2016 financial year. Having ascertained the independence of the external auditors, the Supervisory Board appointed PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft in this capacity, and defined the key matters of the audit. The external auditors conducted the audit in line with instructions given. The fees paid to the external auditors are shown in the Notes to the financial statements.

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.

PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft (PwC), the auditors of the 2016 financial statements – as elected by the Annual General Meeting 2016 and instructed accordingly by the Supervisory Board – have exercised their audit activities under the management of Messrs Stefan Palm and Lukas Sierleja. In accordance with internal regulations, all employees of the external auditors, including the responsible partners and lead auditors, rotate their assignment to specific audit assignments on a regular basis – in this case, every five years.

Mr Palm, PwC's responsible partner, has audited Aareal Bank since 2013; Mr Sierleja, the responsible lead auditor, since 2016.

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 their Company.

At the Annual General Meeting, the shareholders decide, in particular, on the formal approval for the members of the Supervisory Board and Management Board for the financial year under review, on the appropriation of any net retained profit, amendments to the Memorandum and Articles of Association, and authorisations on capital adjustments. The Annual General Meeting also elects the auditor for the Company.

The Company's shareholders may submit statements or proposals in writing, by fax or e-mail, to the Company. They may also request to speak at the Annual General Meeting. The shareholders may also submit counter or supplemental motions to the agenda items at the Annual General Meeting, so that they participate in structuring and influencing the meeting. The Management Board and the Supervisory Board refer to shareholders' comments made during the general debate, or to motions submitted by shareholders in advance, to respond to questions, or to comment on other contributions.

Communications

Aareal Bank assigns great importance to extensive communications with all of the Bank's stakeholders. We have set ourselves the targets of actively, transparently 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 identical information to all target groups at the same time. All press releases, ad-hoc disclosures, corporate presentations, as well as annual and quarterly reports published by Aareal Bank are available on the Bank's website to any interested person, and may be downloaded from there. In addition, the financial calendar is updated regularly, and provides information about upcoming events.

Aareal Bank publishes details on the financial position and performance five times annually. On these occasions, the Management Board gives a personal account of results, within the scope of press conferences and analysts' events, as well as issuing press releases.

We are not currently broadcasting parts of the Annual General Meeting on the internet, nor is it currently possible to give instructions or cast votes online. This is because, given the low level of acceptance of such a service amongst our shareholders, the related efforts and costs would have been excessive. Aareal Bank will continue to review demand for such a service on a regular basis.

Disclosures regarding Corporate Governance standards

Aareal Bank AG is a public limited company under German law (Aktiengesellschaft – "AG") whose shares are included in the mid-cap MDAX index. Aareal Bank AG's corporate governance practices are governed, inter alia, by legal rules applicable to public limited companies and credit institutions, and by the Company's Memorandum and Articles of Association, which are published on its website and in its Commercial Register entry (under company number HRB 13184). Based on the Memorandum and Articles of Association, the Supervisory Board has adopted internal rules of procedure for itself, and for the Management Board. Aareal Bank AG has also adopted an internal Code of Conduct, providing guidelines for correct, ethical and responsible conduct of employees and executive bodies. Moreover, Aareal Bank's corporate governance is guided by a comprehensive set of internal rules and regulations, which provide concrete guidance on the conduct and processing of the Bank's business, in line with legal and regulatory rules. All members of staff have access to these documents, via common internal communications channels such as the Bank's intranet.

Description of Management Board and Supervisory Board work processes

The Supervisory Board

In accordance with Aareal Bank AG's Memorandum and Articles of Association, the Supervisory Board consists of twelve members. Once elected by the Annual General Meeting, the members of the Supervisory Board elect a Chairman and two Deputy Chairmen from amongst them, for the duration of their term of office. At present, Ms Marija Korsch serves as Chairman of the Supervisory Board. Her deputies are Prof. Dr Stephan Schüller (as shareholder representative) and York-Detlef Bülow (as employee representative). The majority of shareholder representatives to the Supervisory Board were elected by the Annual General Meeting held on 20 May 2015. In the financial year 2010, employee representatives were elected by the special negotiating body, a body representing employees following the merger of Aareal Bank France S.A. into its parent company Aareal Bank AG.

During the financial year under review, the Company's Supervisory Board comprised:

Marija Korsch, Chairman of the Supervisory Board of Aareal Bank AG
Former Partner of Bankhaus Metzler seel. Sohn & Co. Holding AG
Supervisory Board offices held: Just Software AG

Prof. Dr Stephan Schüller, Deputy Chairman of the Supervisory Board of Aareal Bank AG
Spokesman of the General Partners of Bankhaus Lampe KG
Supervisory Board offices held: DePfa Holding Verwaltungsgesellschaft mbH, Universal-Investment-Gesellschaft mbH, Howaldt & Co. Investmentaktiengesellschaft TGV

York-Detlef Bülow*, Deputy Chairman of the Supervisory Board of Aareal Bank AG
Employee of Aareal Bank AG

Thomas Hawel*
Employee of Aareon Deutschland GmbH
Supervisory Board offices held: Aareon Deutschland GmbH

Dieter Kirsch*
Employee of Aareal Bank AG

Richard Peters
President and Chairman of the Management Board of the Versorgungsanstalt des Bundes und der Länder
Supervisory Board offices held: DePfa Holding Verwaltungsgesellschaft mbH

Dr Hans-Werner Rhein
Solicitor
Supervisory Board offices held: Deutsche Familienversicherung AG, Gothaer Allgemeine Versicherung AG

Sylvia Seignette
Former CEO, Germany and Austria, Crédit Agricole CIB (formerly Calyon)

Elisabeth Stheeman
Senior Advisor, Bank of England, Prudential Regulation Authority
Supervisory Board offices held: TLG Immobilien AG, Courno

Hans-Dietrich Voigtländer
Senior Partner at BDG Innovation + Transformation GmbH & Co. KG

Prof. Dr Hermann Wagner, Chairman of the Audit Committee
German Public Auditor and tax advisor
Supervisory Board offices held: btu beraterpartner Holding, PEH Wertpapier AG, DEMIRE Deutsche Mittelstand Real Estate AG, Squadra Immobilien GmbH & Co. KGaA

Beate Wollmann*
Employee of Aareon Deutschland GmbH

* Employee representative to the Supervisory Board of Aareal Bank AG

Reference is made to the Corporate Governance Report concerning the independence of Supervisory Board members, for the purposes of the Corporate Governance Code. The members of the Supervisory Board have sufficient professional knowledge to competently perform their duties. The shareholder representatives have held – or still hold – executive positions in the banking or insurance sectors.

As a German Public Auditor and tax advisor – and hence, an independent financial expert – Professor Dr Hermann Wagner chairs the Audit Committee of Aareal Bank AG's Supervisory Board.

The Supervisory Board conducts its business in the best interests of the Company and its Group entities, in accordance with the law, the Memorandum and Articles of Association, the internal rules of procedure, the German Corporate Governance Code (as amended from time to time), and Aareal Bank AG's Code of Conduct. The Supervisory Board determines which transactions have fundamental importance, and hence require the approval of the Supervisory Board.

The Supervisory Board has established six committees in order to perform its supervisory duties in an efficient manner: the Executive and Nomination Committee, the Remuneration Control Committee, the Risk Committee, the Committee for Urgent

Decisions, the Audit Committee, and the Technology and Innovation Committee.

Executive and Nomination Committee

The Executive and Nomination Committee advises the Management Board and prepares the resolutions of the Supervisory Board. The committee consists of the Chairman of the Supervisory Board, and up to four additional Supervisory Board members.

The committee has the following members:

Marija Korsch	Chairman
York-Detlef Bülow	Deputy Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
Richard Peters	
Dr Hans-Werner Rhein	

The Executive and Nomination Committee prepares the plenary meetings of the Supervisory Board, together with proposed resolutions. The committee's area of responsibility also includes assessing the internal condition of the Group, and issues concerning personnel planning for the Management Board (also regarding the contracts with individual Management Board members, based on the remuneration system prepared by the Remuneration Control Committee and adopted by the plenary meeting of the Supervisory Board). The Executive and Nomination Committee compiles profiles defining the requirements for members of the Management Board and the Supervisory Board; based on an annual evaluation, it determines the extent to which the members of the Management Board or Supervisory Board have a need for further training, or whether other adjustments are required. Furthermore, the Executive and Nomination Committee discusses decision proposals regarding connected-party loans as well as other transactions between members of administrative, management and supervisory bodies and the Company or its subsidiaries.

Remuneration Control Committee

In accordance with section 25d (12) of the KWG, the Remuneration Control Committee monitors whether the structure of the remuneration systems for Management Board members and employees is appropriate, taking into account the impact of remuneration systems on Aareal Bank's overall risk profile. The Remuneration Control Committee prepares corresponding proposals concerning remuneration (including for members of the Management Board) for the plenary meeting of the Supervisory Board. The Remuneration Control Committee receives the information provided by Aareal Bank's Remuneration Officer pursuant to section 23 of the German Regulation on Remuneration in Financial Institutions (InstVergV) as well as the disclosure concerning the remuneration system pursuant to section 16 of the InstVergV. The committee consists of the Chairman of the Supervisory Board, and up to four additional Supervisory Board members.

The committee has the following members:

Marija Korsch	Chairman
York-Detlef Bülow	Deputy Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
Dieter Kirsch	
Hans-Dietrich Voigtländer	

Risk Committee

The Risk Committee consists of the Chairman of the Supervisory Board and up to five additional members. The committee has the following members:

Sylvia Seignette	Chairman
Elisabeth Stheeman	Deputy Chairman
Dieter Kirsch	
Marija Korsch	
Dr Hans-Werner Rhein	
Prof. Dr Hermann Wagner	

The Risk Committee deals with all types of risk Aareal Bank is exposed to in its business activities. Besides credit risks, this also encompasses market risks, liquidity risks, and operational risks, taking into account the Bank's risk-bearing capacity as defined in the Minimum Requirements for Risk Management in Banks (MaRisk). The monitoring of credit risks also includes approving loans which, pursuant to the internal rules of procedure for the Management Board, require the approval of the Supervisory Board. Until December 2016, this also included decisions on connected-party loans pursuant to section 15 (1) nos. 6-12 of the German Banking Act (KWG), unless such loans were dealt with by the Executive and Nomination Committee. Since December 2016, decisions on connected-party loans have been made by the Executive and Nomination Committee.

The committee is also responsible for reviewing the contents of the risk strategy, in accordance with the MaRisk. The submission of the credit risk strategy to the plenary meeting of the Supervisory Board remains unaffected by this function, as is intended by the MaRisk.

Committee for Urgent Decisions

The Committee for Urgent Decisions is a sub-committee of the Risk Committee. Its members are elected from amongst the members of the parent committee.

The committee members are:

Sylvia Seignette
Elisabeth Stheeman
Dieter Kirsch
Marija Korsch
Dr Hans-Werner Rhein
Prof. Dr Hermann Wagner

The Committee for Urgent Decisions takes lending decisions which, pursuant to the internal rules of procedure for the Management Board, require Supervisory Board approval, and which are particularly urgent. Since the committee passes its resolutions by way of circulation, it does not hold any meetings. Any decisions taken between meetings of the Risk Committee are discussed at the subsequent meeting.

Audit Committee

The Audit Committee is concerned with all accounting issues, as well as regarding the audit of Aareal Bank AG and Aareal Bank Group. The committee is chaired by an independent financial expert. The members of the Audit Committee are:

Prof. Dr Hermann Wagner	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
York-Detlef Bülow	
Marija Korsch	
Richard Peters	
Hans-Dietrich Voigtländer	

The committee is responsible for the preparation and conduct of the audit of the financial statements and the consolidated financial statements; it prepares the decisions to be taken by the Supervisory Board on the basis of the committee's analysis of the external auditors' reports. For this purpose, the committee reports to the plenary meeting of the Supervisory Board on the results of its analysis and the assessments derived. Preparing the audit of the financial statements also comprises the preparations for instructing the external auditors (by virtue of the corresponding resolution passed by the Annual General Meeting), verifying the independence of the external auditors, negotiating the auditors' fees, and determining key matters of the audit. The Audit Committee also discusses quarterly and half-yearly financial reports with the Management Board, and obtains the external auditors' report on their review of the half-yearly report. Furthermore, the Audit Committee is responsible for examining the projections submitted by the Management Board; the reports by the Compliance Officer and Internal Audit are addressed to the committee. The committee is also responsible for monitoring the effectiveness of the internal control system.

Technology and Innovation Committee

The Technology and Innovation Committee comprises the following members of the Supervisory Board:

Hans-Dietrich Voigtländer	Chairman
Marija Korsch	Deputy Chairman
Thomas Hawel	
Richard Peters	
Elisabeth Stheeman	

The committee deals with issues concerning information technology used within the Company, and with issues related to IT products created and distributed by Aareal Bank Group entities.

The Management Board

The Management Board manages Aareal Bank AG's business in accordance with the law, the German Corporate Governance Code, the internal rules of procedure for the Management Board adopted by the Supervisory Board, and the Code of Conduct of Aareal Bank AG. The Management Board develops the overall company strategy, discusses it with the Supervisory Board, and ensures its implementation.

The members of the Management Board, and their respective areas of responsibility, are outlined in Note (99).

The Management Board informs the Supervisory Board regularly, without delay and comprehensively, orally and in writing, on all issues in respect of which the Supervisory Board requires information to fully perform its duties and obligations.

Report of the Supervisory Board of Aareal Bank AG, Wiesbaden

Dear shareholders,

Once again, the financial year 2016 under review was a very eventful one for Aareal Bank – whose activities in a persistently volatile environment were accompanied by historically low interest rates and continued regulatory uncertainty. In this context, Aareal Bank not only generated very good results. The Bank also broke new ground in order to find answers to the issues raised by the fundamental changes associated with digitalisation proceeding at high speed.

During the financial year under review, the Supervisory Board continually advised, monitored, and supervised the management of the Company. The Management Board informed the Supervisory Board regularly, without delay and comprehensively, both orally and in writing, upon all the issues important to the Bank. The Management Board reported on the Group's situation, business development, key financial indicators and market developments. In addition, detailed reports and explanations were given to the Supervisory Board regarding the current liquidity status and liquidity management measures taken, the prevailing risk situation, and on risk control and risk management measures taken within the Group. The Supervisory Board also received comprehensive reports on the development of the business segments, and on operative and strategic planning, and was involved in all important decisions. All material events were discussed and examined in detail; where a Supervisory Board resolution was required, the decision proposals were submitted to the Supervisory Board and a decision taken. In cases where resolutions needed to be passed in between scheduled Supervisory Board meetings, such resolutions were passed by way of circulation or via conference calls.

Furthermore, between the meetings of the Supervisory Board, the Chairman of the Management Board kept the Chairman of the Supervisory Board informed, on a continuous and regular basis, both orally and in writing, on all material developments of the Company. The Chairman of the Management Board maintained regular close contact with the Chairman of the Supervisory Board, in order to discuss key issues and important decisions personally.

Moreover, the Supervisory Board was informed, in detail, about the "Aareal 2020 – Adjust. Advance. Achieve." programme for the future, which was presented in February 2016. The Supervisory Board supports the related objectives set out by the Management Board. Given an unchanged basic strategic orientation, this development of the strategy aims to protect the Group's strong base in an increasingly demanding environment, and to unlock new revenue potential.

Activities of the Plenary Meeting of the Supervisory Board

Nine plenary meetings of the Supervisory Board were held during the year under review. During the meetings, the members of the Supervisory Board received reports and explanations from the members of the Management Board, and discussed these in detail. One of the focal working and reporting aspects during all scheduled meetings was the approach to be taken by the Bank towards the persistently challenging market environment.

In its discussions, the Supervisory Board also concerned itself with changes to the regulatory framework, in great detail.

Throughout the financial year, in the course of all meetings as well as during the periods between meetings, the Management Board informed the Supervisory Board about economic and market developments and their potential impact on Aareal Bank Group, in a timely, complete and comprehensible manner. This included detailed explanations of the appropriate measures taken in response to the challenges arising from general market developments, in particular the prevailing low interest rate environment.

During the plenary meetings of the Supervisory Board, the Management Board reported to the Supervisory Board regularly and comprehensively; these reports also covered the development of the Structured Property Financing and Consulting / Services segments, focusing on current economic developments. At regular intervals, the Supervisory Board was informed of the Bank's liquidity status and the related steps taken by the Bank's Treasury. In addition, the Supervisory Board was informed about the business development of the entire Aareal Bank Group. The Management Board also reported regularly on the quality of the property financing portfolio, against the background of general market trends and expected changes on the various property markets.

The focal points of the individual meetings are outlined below.

During its meetings in January and February, the Supervisory Board carried out the scheduled reviews of remuneration systems, including a detailed discussion of all related issues concerning the system and amount of remuneration. The Supervisory Board also discussed the establishment of a Chief Risk Officer, as a new Management Board position. As part of this task, based upon a proposal by the Executive and Nomination Committee, the Supervisory Board also discussed and determined the requirements profile for this role. The newly-established function of Chief Risk Officer was filled with the appointment of Ms Christiane Kunisch-Wolff to the Management Board of Aareal Bank. Throughout the appointment process, the Supervisory Board discussed, in great detail, which candidates meet this profile. With Ms Kunisch-Wolff, a renowned expert with relevant qualifications was appointed for this role. The Supervisory Board also debated the Bank's future dividend policy.

In the March meeting, the Supervisory Board concerned itself in detail with the financial statements and consolidated financial statements presented for the 2015 financial year, and with the auditors' report. The relevant facts were presented in the Supervisory Board report for the previous year. In addition, the proposal regarding the selection and subsequent appointment of the external auditor for the Annual General Meeting was discussed. This also included the scope and focal points of the audit for the 2016 financial year, as defined by the Supervisory Board. Other issues covered during the March meeting included the preparations for the Annual General Meeting in May 2016. This meeting also discussed the annual reports submitted by Internal Audit and by the Compliance Officer.

During its April meeting, the Supervisory Board resolved on the process for the appointment of Mr Christof Winkelmann to Aareal Bank's Management Board. Mr Winkelmann was appointed in consideration of his proven market and banking expertise, and his long track record of successful work for Aareal Bank, which make him especially suitable for the position of the Management Board member responsible for Sales units.

The May meeting commenced with a detailed review of the Annual General Meeting of Aareal Bank AG, which preceded the meeting. Furthermore, the Management Board presented its regular reporting on business developments, which the Supervisory Board discussed in great detail.

The meeting in July exclusively comprised an extensive presentation and discussion of Aareal Bank Group's strategy, during which the Supervisory Board intensely discussed strategic initiatives with the Management Board, passing the necessary resolutions.

Besides receiving regular reports, during its September meeting, the Supervisory Board discussed new rules imposed by an EU Regulation pursuant to which the Supervisory Board Audit Committee will have greater importance from the 2017 financial year onwards. In order to support the Supervisory Board in monitoring the audit of the financial statements – especially with regard to the independence of external auditors, and the services rendered by them – the Audit Committee will in future decide upon the approval of so-called non-audit services provided by the external auditors.

In the December meeting, the Management Board reported on the Group's corporate planning. The Management Board submitted and explained the corporate planning in detail to the Supervisory Board. Corporate governance issues were discussed as well. The requisite resolutions were passed and implemented. Furthermore, the Supervisory Board adopted the regular Declaration of Compliance, pursuant to section 161 of the German Public Limited Companies Act (Aktiengesetz – "AktG"), which was subsequently published on the Bank's website.

In accordance with sections 25c and d of the German Banking Act (Kreditwesengesetz – "KWG"), the results of the evaluations carried out in November and December 2016 have been discussed in detail by the Supervisory Board during its meeting in March 2017. The Supervisory Board will incorporate these findings into its work.

Strategy documents were regularly submitted to, and discussed by the Supervisory Board, in accordance with the Minimum Requirements for Risk Management in Banks (MaRisk). The Company's remuneration systems were also subjected to a scheduled review, with the reports submitted to the Supervisory Board. The Supervisory Board determined that the Company's remuneration systems are appropriate.

The Chairmen of Supervisory Board committees regularly gave account of the work in the committees to the plenary meeting, answering all related questions submitted by the plenary meeting in detail.

To the extent that any Supervisory Board decisions were taken by way of circulation, the related issues were discussed in detail at the subsequent Supervisory Board meeting, including a report by the Management Board on the implementation of such decisions taken previously.

As part of preparing Supervisory Board decisions, a routine examination is carried out as to whether there are any conflicts of interest. No potential conflicts of interest that would need to be considered in the context of decision-making processes were identified during the financial year under review. The members of the Supervisory Board have declared in writing that no conflicts of interest pursuant to section 5.5.2 of the Corporate Governance Code arose during the financial year under review.

In addition to its regular meetings, the Supervisory Board convened for a separate informational meeting, during which auditors Pricewaterhouse-Coopers provided very detailed information on current changes and deliberations in the regulatory and legal framework, as well as on the potential impact of such trends upon Aareal Bank.

Activities of Supervisory Board Committees

The Supervisory Board has established six committees in order to perform its supervisory duties in an efficient manner: the Executive and Nomination Committee, the Risk Committee, the Committee for Urgent Decisions (as a sub-committee of the Risk Committee), the Audit Committee, the Remuneration Control Committee, and the Technology and Innovation Committee.

The Executive and Nomination Committee of the Supervisory Board convened for four scheduled meetings, during which the committee prepared the plenary meetings of the Supervisory Board. During the financial year under review, the Executive and Nomination Committee concerned itself with the establishment of a Chief Risk Officer, as a new Management Board position. As part of this process, the Committee discussed the necessary questions regarding the job description, as well as candidates' required qualifications, in great detail. The appointment process for this position was carried out subsequently, and concluded with the appointment of Ms Kunisch-Wolff. Furthermore, the Committee carried out the appointment process for the position of Management Board member responsible for Sales units, and prepared the corresponding proposals for resolutions to be adopted by the plenary meeting, together with a recommendation to appoint Mr Winkelmann.

Furthermore, the Executive and Nomination Committee concerned itself with the efficiency of the Supervisory Board and its committees, as well as with corporate governance rules; within the scope of a regular dialogue with the Management Board, the Committee informed itself on the strategic development of Aareal Bank Group.

The Risk Committee held four meetings during the year under review. 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 regarding the Bank's investments in securities portfolios. The committee members discussed these reports and market views in detail; the committee also concerned itself with the banking and regulatory environment, and dealt with both loans requiring approval and transactions subject to reporting requirements on a regular basis. The committee discussed individual exposures of material importance to the Bank, which were presented and explained by the Management Board. In addition, reports on current developments and related market responses were provided to the committee. Also, detailed reports were given regarding the Bank's liquidity status and management as well as its funding. Risks from existing investments, as well as all additional material risks were also presented.

The committee regularly discussed reports on the Bank's risk situation, which were submitted and explained by the Management Board. Having discussed the contents with the Management Board, these were duly noted and approved by the members of the committee. Besides credit and country risks, the committee concerned itself with market risks, liquidity risks, and operational risks. The committee also concerned itself with Aareal Bank's risk-bearing capacity and capital ratios, as well as the Bank's cooperation with regulators, within the scope of the Single Supervisory Mechanism (SSM) under the auspices of the ECB. The committee also decided on any other transactions requiring the Supervisory Board's approval pursuant to the Company's Memorandum and Articles of Association or the internal rules of procedure.

The Committee for Urgent Decisions is a subcommittee of the Risk Committee. It approves loans subject to approval requirements by way of circulation. For this reason, it did not hold any meetings. Any decisions which were taken between meetings of the Risk Committee were presented again at the subsequent meeting, whereby the Management Board provided supplementary information on current implementation progress.

The Audit Committee held six meetings during the year under review. During its meeting in February 2016, the Audit Committee received and discussed the preliminary results for the 2015 financial year. During its March meeting, the committee received the external auditors' report on the 2015 financial year and discussed the results with the auditors in detail. The committee members discussed the contents of the audit reports provided; they formed their own judgement of the audit results on the basis of these reports, and by way of meetings held with the external auditors. In accordance with its duties under the Memorandum and Articles of Association, the Audit Committee also discussed the selection of external auditors and the focal aspects of the audit for 2016 during the same meeting.

During its meeting in May 2016, the Audit Committee considered the contents and further development of sustainability reporting for Aareal Bank Group. In addition, the committee discussed the initial audit for achieving limited assurance for this report, including an examination of selected qualitative and quantitative information in the Sustainability Report 2015 by PwC, the results of which were discussed in the presence of PwC representatives.

In accordance with the requirements of the German Corporate Governance Code, during its meetings in May, August and November 2016, the Audit Committee discussed with the Management Board the quarterly results to be published.

Proceedings at the meetings in August and November also included supplementary topics, such as amendments under the EU Audit Regulation and Directive, according to which external auditors are no longer permitted to provide certain non-audit services. With effect from 1 January 2017, permitted non-audit services to be rendered by the external auditors must be approved by the Audit Committee. Said regulation has extended the Audit Committee's oversight duties in the context of monitoring the Bank's procurement of services from the external audit firm elected by the Annual General Meeting. In order to fulfil these oversight duties in an efficient manner, the Audit Committee adopted a process for approving and monitoring non-audit services rendered by the external auditors during its November meeting. Furthermore, the committee was informed about the review of the Internal Control System, in accordance with legal requirements; it duly acknowledged the report, following discussion. In addition to a report on the audit progress, the Management Board presented and explained the updated Group planning to the committee during its December meeting. The committee also received reports submitted by Internal Audit, and the Compliance Report, requesting and receiving detailed explanations, and duly noting both reports.

During its six meetings, the Remuneration Control Committee discussed issues related to the Bank's remuneration systems and all related matters, fulfilling its original assignment. In addition to topics to be dealt with on a regular basis, the Remuneration Control Committee concerned itself with necessary adjustments of the remuneration systems due to amendments to the German Regulation on Remuneration in Financial Institutions ("Institutsvergütungsverordnung – InstVergV"). Moreover, the Remuneration Control Committee supported the Supervisory Board with all issues related to the remuneration of the Management Board. In particular, the committee provided support for determining the Management Board's targets for the current year, and for assessing target achievement by the Management Board, as a basis for determining variable remuneration for the members of the Management Board for the year 2016. As a rule, support was provided to the Supervisory Board by preparing the corresponding recommended resolutions.

The Technology and Innovation Committee convened for four meetings, during which the committee discussed market trends, technological developments and innovation trends in detail, especially with a view to clients of the Consulting / Services segment. Discussion topics included potential business opportunities arising from the growing digitalisation of business processes, and how Aareal Bank Group could turn such opportunities into benefits for clients. In this connection, the committee also discussed measures in detail which are required for an optimal design of change processes, and which create an innovation-friendly environment. Such topics also include considerations to further develop talent management measures. Another key aspect of regular discussions was how to support the Bank in realigning its banking systems, against the background of numerous new requirements in terms of accounting, regulation, and IT security.

Where members of the Supervisory Board were unable to attend a meeting, they had announced their absence in advance, giving reasons. Attendance of Supervisory Board members at meetings is shown in the table below.

Member of the Supervisory Board	Number of meetings attended / number of meetings (plenary and committee meetings)		
Marija Korsch	33	of	33
Prof. Dr Stephan Schüller	24	of	25
York-Detlef Bülow*	23	of	25
Thomas Hawel*	13	of	13
Dieter Kirsch*	18	of	19
Richard Peters	21	of	23
Dr Hans-Werner Rhein	17	of	17
Sylvia Seignette	13	of	13
Elisabeth T. Stheeman	16	of	17
Hans-Dietrich Voigtländer	25	of	25
Prof. Dr Hermann Wagner	19	of	19
Beate Wollmann*	9	of	9

* Employee representative

Financial Statements and Consolidated Financial Statements

The Supervisory Board instructed PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt/Main (from 1 March 2017: PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft), who were elected as auditors by the Annual General Meeting 2016, with the audit of the financial statements and the consolidated financial statements. The external auditors appointed submitted a statement regarding their independence to the Supervisory Board, who duly noted it. The Supervisory Board has no reason to doubt the accuracy of this statement of independence. Fulfilling their duties as commissioned by the Supervisory Board, PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft audited the financial statements prepared in accordance with the German Commercial Code (HGB) and the consolidated financial statements prepared in accordance with IFRSs, as well as the Management Report and the Group Management Report. Based on the results of their audit, PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft issued an unqualified audit opinion for the financial statements and consolidated financial statements.

All members of the Supervisory Board received the audit reports, including all annexes thereto, in good time before the meeting during which the financial statements and the consolidated financial statements were discussed. Having examined the documents provided, the Supervisory Board members formed their own judgement of audit results. The representatives of the external auditor participated in the meeting of the Supervisory Board, during which the financial statements and consolidated financial statements were discussed, and gave a detailed account of the results of their audit. The representatives of PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft were available to the Supervisory Board to answer further questions, and to provide additional information. All questions were answered to the full satisfaction of the Supervisory Board.

The financial statements and management report of Aareal Bank AG, prepared in accordance with the HGB, and the consolidated financial statements and the Group management report prepared in accordance with IFRSs, and the proposal of the Management Board regarding the appropriation of profit, and the audit reports, were all examined in detail. No objections were raised to the audit results. In its meeting on 23 March 2017, 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 and the Group Management Report prepared in accordance with IFRSs, and thus confirmed the financial statements of Aareal Bank AG. The Supervisory Board examined and discussed with the Management Board its proposal regarding the appropriation of profit. On the basis of the discussion, the Supervisory Board endorsed the proposal for the appropriation of profit submitted by the Management Board.

Special transactions

Aareal Bank Group was able to conclude material litigation concerning former Corealcredit Bank, with rulings in the Bank's favour. Even though the resulting non-recurring effect only had a relatively minor impact on the Bank's results after taxes, the conclusion of these proceedings was a positive outcome.

Personnel matters

At its meeting held on 19 February 2016, the Supervisory Board appointed Ms Christiane Kunisch-Wolff as a member of the Management Board of Aareal Bank, effective 15 March 2016. To date, Ms Kunisch-Wolff was a member of the Management Board of Westdeutsche ImmobilienBank AG, where her responsibilities included accounting and financial reporting as well as anti-money laundering and Compliance. The Supervisory Board is delighted to have won another Management Board member from within the Group, and wishes Ms Kunisch-Wolff every success for her mandate.

In its meeting on 20 April 2016, the Supervisory Board appointed Mr Christof Winkelmann as a member of the Management Board of Aareal Bank, effective 1 July 2016. Mr Winkelmann first worked for Aareal Bank from 2000 to 2006, being responsible for the Bank's hotel financing business. Having worked for another bank, he returned to Aareal Bank in 2008 as Managing Director, Special Property Finance. He has been responsible for the Bank's Special Property Finance business – covering financings for hotels, retail and logistics properties – ever since.

During the same meeting, the Supervisory Board adopted a new distribution of responsibilities amongst the members of the Management Board. Mr Winkelmann assumed responsibility for the Sales units in the Structured Property Financing segment, a position previously held by Ms Dagmar Knopek, with effect from 1 July 2016. Mr Winkelmann is thus particularly responsible for all of the segment's new business activities. Ms Knopek, who has been a member of the Management Board since 2013, assumed the function of Chief Credit Officer on the Management Board on the same date. In her new function, she is responsible for Credit Management (encompassing loan administration and management), Operations, and the Workout portfolio. These duties were previously within the portfolio of Hermann J. Merkens, the Chairman of the Management Board of Aareal Bank AG.

In conclusion, the Supervisory Board would like to thank the Management Board and all of the Group's employees for their strong commitment during the 2016 financial year, which was once again characterised by a challenging environment. That commitment – and strong motivation – from all employees of Aareal Bank Group made the Company's success possible.

Frankfurt, March 2017

For the Supervisory Board

Marija Korsch

Marija Korsch (Chairman)

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Glossary

Accrued interest
Interest on debt securities (such as bonds, notes or Pfandbriefe) which has accrued since the last coupon payment date. When buying such a security, the buyer must pay accrued interest to the seller.

Ad-hoc disclosure
Pursuant to section 15 of the German Securities Trading Act (WpHG), issuers of securities are obliged to publish any information that may have an impact on the price of these securities without delay. This obligation is discharged using so-called "ad-hoc" disclosures which may relate to the issuer's financial position and performance, or to its general business operations. The ad-hoc disclosure obligation applies in Germany as well as in other major financial centres; it is designed to prevent insider trading.

Advanced Approach
Under the "Advanced Approach", banks having sufficiently developed procedures for internal capital allocation (subject to strict requirements concerning methodology and disclosure) are allowed to use their internal credit quality ratings for a given borrower, to assess the credit risk exposure of their portfolios.

Amortised cost
The amount at which a financial asset or financial liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation of any premium or discount, and minus any reduction for impairment or non-collectability.

Asset-backed securities
A special form of securitising payment claims in tradable securities that are structured by aggregating certain financial assets.

Associated enterprise (associate)
Enterprise which is accounted for in the consolidated financial statements using the equity method (as opposed to full or partial consolidation), over whose business or financial policies an entity included in the consolidated financial statements exercises significant influence.

Available for sale (AfS)
This IFRS measurement category denotes financial assets which are available for sale by an enterprise, and which are not receivables, financial instruments held for trading (HfT) or held-to-maturity (HtM) financial instruments. AfS financial instruments are predominantly fixed-income securities which the enterprise cannot (or does not intend to) hold until maturity. They can also be equity instruments without a final maturity date.

Basel III
"Basel III" denotes the regulatory framework for banks, promulgated by the Basel Committee on Banking Supervision at the Bank for International Settlements (BIS) with the objective of stabilising the banking sector.

Bonds
Generic term for fixed-income securities or debt securities.

Capital markets
The markets for any kind of medium- to long-term funds – in a narrower sense, generic term for supply and demand in securities.

Cashflow-Hedge
Using a swap transaction to hedge the risk of future variable-rate interest payments from an underlying on-balance sheet transaction.

Collateral
Rights granted to the Bank by the borrower to facilitate enforcing the Bank's claims in case of default. Collateral may be provided in the form of personal collateral (e.g. a guarantee) and impersonal collateral (e.g. a land charge). In principle, collateral reduces expected losses sustained by the Bank in the event of default.

Commercial Mortgage Backed Securities (CMBS)
Bonds backed by loans collateralised by commercial and multi-family properties.

Consolidated statement of cash flows
Statement showing the cash flows an enterprise has generated and used during a financial year, from its operating, investment and financing activities, also showing cash and cash equivalents at the beginning and end of the financial year.

Corporate Governance
Corporate Governance denotes the legal and factual framework for the management and governance of enterprises. The recommendations of the German Corporate Governance Code provide transparency and are designed to strengthen confidence in good and responsible corporate governance. They predominantly serve to protect shareholders' interests.

Cost/income ratio (CIR)
Financial indicator expressing the ratio of expenses to income within a given reporting period.

$$\text{CIR} = \frac{\text{Administrative expenses}}{\begin{array}{c}\text{Net interest income + net commission income}\\ \text{+ net result on hedge accounting + net trading income/}\\ \text{expenses + results from non-trading assets}\\ \text{+ results from investments accounted for using the}\\ \text{equity method + net income from investment properties}\\ \text{+ net other operating income/expenses}\end{array}}$$

Counterparty credit risk
Counterparty credit risk can be further distinguished into credit risk, counterparty risk, issuer risk and country risk; it denotes the potential loss in value which may be incurred as a result of the default (or deterioration of credit quality) of borrowing clients, issuers of promissory note loans or securities, or of counterparties to money market, securities or derivatives transactions.

Covered bonds
"Covered" bonds is a generic term for debt securities covered by collateral. In Germany,

covered bonds are mainly issued in the form of "Pfandbriefe" pursuant to the German Pfandbrief Act (PfandBG), which provides a legal framework for collateralisation (assets eligible for Pfandbrief cover include mortgages and public-sector loans and aircraft financings).

Credit default swap (CDS)
Financial contract where the risk of a credit event specified in advance (such as insolvency, failure to pay, or deterioration of credit quality) is transferred from a protection buyer to a protection seller. The protection seller receives regular premium payments from the protection buyer in exchange for the assumption of credit risk, regardless of whether a credit event has actually occurred.

Debt security
Certificate whose issuer undertakes to repay the amount borrowed (plus current interest, or other form of performance) to the bearer.

Deferred taxes
Income taxes payable or receivable in the future, due to temporary differences between the carrying amounts of assets and liabilities in the IFRS statement of financial position and the tax accounts. At the time of recognition, deferred tax assets or liabilities do not yet constitute any actual claims on, or liabilities to the tax authorities.

Derivatives
Derivatives – which include all types of forwards, futures, options and swaps – are financial instruments whose value is derived from the price (and/or the price fluctuations) of an underlying instrument, such as equities, bonds or currencies.

Earnings per share
Financial indicator expressing the ratio of net income after non-controlling interest income to the average number of common shares outstanding.

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

EBIT margin

$$\text{EBIT margin} = \frac{\text{EBIT (operating profit before interest and taxes)}}{\text{Sales revenues}}$$

Effective interest method
Method for amortising the mark-up/markdown between cost and the nominal value (premium/discount), using the effective yield of a financial asset or liability.

Equity method
Method for measuring shareholdings in enterprises on whose business policy the reporting entity has significant influence ("associates"). When applying the equity method, the associate's pro-rata net income/loss is recognised in the carrying amount of the shareholding; any distributions are recognised via a corresponding pro-rata reduction in the carrying amount.

EURIBOR
European Interbank Offered Rate – the interest rate at which prime European banks offer euro deposits (with fixed terms of one week, and between one and twelve months) to one another.

Fair value
The fair value is the amount for which an asset can be exchanged (or a liability settled) between knowledgeable, willing parties in an arm's length transaction; this is often identical to the market price.

Fair value hedge
Using a swap to hedge the market risk of a balance sheet item with a fixed interest rate (e.g. a receivable or a security); this is measured at fair value.

Financial assets or liabilities at fair value through profit or loss (FVtPL)
Financial instruments assigned to this measurement category are carried at fair value, with the re-measurement recognised in income. A further differentiation is made within the category "Financial assets at fair value through profit or loss" into 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.

Financial instruments
Generic term for loans extended and other receivables, fixed-income securities, equities, shareholdings, liabilities, and derivatives.

Financial liabilities measured at amortised cost (LaC)
Financial liabilities not designated "at fair value through profit or loss". These items are re-measured at amortised cost. Premiums and discounts are amortised over their term using relevant effective interest rates.

FX
Abbreviation for foreign exchange, referring to the FX market or the FX asset class.

German Accounting Standards
Recommendations for the application of (German) standards for consolidated financial statements, issued by the German Accounting Standards Board (GASB), a committee of the Accounting Standards Committee of Germany.

Goodwill
An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.

Hedge accounting
Concept describing the recognition (or other form of accounting) of two or more financial instruments, which together form a hedging relationship. In this context, the relationship between these contracts is based in the equal and opposite specification of contractual elements giving rise to risks (usually financial risks). Due to these specifications, such agreements can be used to partially or fully offset and neutralise risks. In the context of hedge accounting, one of the contracts involved (specifically, the contract establishing the risk(s) concerned) is referred to as the "underlying transaction", and the other contract (the one entered into to hedge the risk(s) of the underlying transaction) as the "hedge transaction" or just "hedge".

Hedging
A strategy where a hedge is entered into in order to protect a position against the risk of unfavourable movements of prices or (interest) rates.

Held to maturity (HtM)
Financial assets with a fixed term as well as fixed or determinable payments acquired from a third party, where the reporting entity has the intention and the ability to hold such financial assets to maturity.

Impairment
An impairment occurs when the recoverable amount declines below the carrying amount. Impairment tests are required to be carried out for the purposes of determining allowance for credit losses.

International Accounting Standards (IASs)
Accounting standards issued by the International Accounting Standards Board (IASB), an international standard-setting body established by professional accountants' associations. The objective is to establish transparent, comparable international financial reporting standards.

International Financial Reporting Standards (IFRS/IFRSs)
IFRSs comprise International Accounting Standards (IASs) and interpretations issued by the Standing Interpretations Committee, as well as International Financial Reporting Standards (IFRSs) and related interpretations published by the International Accounting Standards Board (IASB).

LIBOR
London Interbank Offered Rate; the interest rate at which prime London banks offer deposits to one another.

Liquidity Coverage Ratio (LCR)
A Basel III indicator designed to assess liquidity risk.

Loan-to-value ratio
The ratio of loan amount to property value in the context of property loans.

MDAX
The MDAX® mid-cap index comprises the shares of 50 companies from traditional sectors listed in Deutsche Börse's Prime Standard segment that, in terms of exchange turnover and market capitalisation, rank immediately below the companies included in the DAX® blue-chip index. The index is calculated on the basis of price data from Xetra®, the electronic trading system of the Frankfurt Stock Exchange.

Medium-Term Notes (MTNs)
Debt issuance programme used to issue unsecured debt securities at different points in time; the volume, currency and term (one to ten years) of each issue can be customised to the issuer's prevailing funding needs.

Minimum Requirements for Risk Management (MaRisk)
The Minimum Requirements for Risk Management in Banks (MaRisk) are binding requirements for the structure of risk management in German banks, as promulgated by the German Federal Financial Supervisory Authority (BaFin). Setting out the specifics of section 25a of the German Banking Act (KWG), BaFin has consolidated the previously-applicable Minimum Requirements for the Trading Activities of Credit Institutions (MaH), Minimum Requirements for the Internal Audit Function of Credit Institutions (MaIR) and Minimum Requirements for the Credit Business of Credit Institutions (MaK), updating and supplementing them in the process.

Nominal interest rate
Return of a security defined by reference to its nominal amount.

North American Free Trade Agreement (NAFTA)
North American free-trade agreement entered into between Canada, the US, and Mexico.

Option
The right to buy or sell a specific asset.

Over the counter (OTC)
Financial markets term for off-exchange trading between market participants.

Present value
The present value of a future cash flow, determined by discounting all future cash flows (inflows and outflows) to today's date.

Profit-participation certificate
Securitised profit-participation rights which may be issued by enterprises (regardless of their legal form) and listed in official (exchange) trading. Subject to certain conditions, profit-participation certificates may be eligible for inclusion in liable capital.

Public-Sector Pfandbriefe
Debt securities issued by Pfandbrief issuers (Pfandbrief banks), which are collateralised by claims against the public sector.

Rating
Risk assessment regarding a borrower (internal rating) or credit quality assessment regarding an issuer and its debt securities by a specialist rating agency (external rating).

Repurchase transaction (repo transaction)
Short-term money-market transaction collateralised by securities; in a repo, the owner of securities sells them and simultaneously agrees to repurchase the securities at a later point in time, at an agreed price.

Residential Mortgage Backed Securities (RMBS)
Bonds backed by loans collateralised against residential property.

Return on equity (RoE)
Financial indicator expressing the ratio of net income (or pre-tax profit, for example) to average equity over the period. RoE expresses the return on the capital employed by the company (and its owners/shareholders).

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

$$\text{RoE after taxes} = \frac{\text{Operating profit ./. income taxes ./. non-controlling interest income ./. AT1 coupon (net)}}{\text{Average equity (IFRS) excluding non-controlling interests, other reserves, AT1 bond, and dividends}}$$

Revaluation surplus
The revaluation surplus is used to recognise changes in the market value of securities and available-for-sale assets (and their deferred tax effects) directly in equity.

Reverse repo transaction
A repo transaction where the buyer of securities simultaneously agrees to sell the securities at a later point in time, at an agreed price.

Segment reporting
Breakdown of aggregate consolidated figures across individual segments, by type of activity (business segment) or by geographical location (region). The segment reporting permits conclusions regarding developments in the various segments, and their individual contribution to consolidated net income.

Solvency
A bank's capitalisation – literally, its ability to pay.

Swap
Generic term for contracts to exchange cash flows, such as the exchange of fixed-rate and variable-rate cash flows in the same currency (interest rate swap), or the exchange of cash flows and/or nominal amounts in different currencies (cross-currency swap).

Unwinding
The increase in a written-down receivable's present value over time, due to the fact that the receivable is being discounted at its original effective interest rate.

Value-at-risk (VaR)
Method to quantify risks: it measures the maximum potential future loss which will not be exceeded within a defined period, and given a certain probability.

Volatility
Volatility denotes the scope and intensity of fluctuations in the price of securities or currencies. Volatility is often calculated via the standard deviation of historical price data, or implied via a pricing formula. The higher the volatility, the riskier the respective investment.

Financial Calendar

11 May 2017	Publication of results as at 31 March 2017
31 May 2017	Annual General Meeting – Kurhaus, Wiesbaden
10 August 2017	Publication of results as at 30 June 2017
14 November 2017	Publication of results as at 30 September 2017

Imprint
Contents:
Aareal Bank AG, Corporate Communications
Photographs:
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Wolfgang Schmidt (p. 35)
Layout/Design:
S/COMPANY · Die Markenagentur GmbH, Fulda, Germany
Conception/Design (Thinking ahead. Shaping the future.):
fischerAppelt AG, Hamburg/Frankfurt, Germany
Production:
Druckerei Chmielorz GmbH, Wiesbaden-Nordenstadt, Germany

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Print | ID 12360-1703-1005

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03/2017

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