QUALITY Ⓐ
made by AAREAL

2017

Aareal Bank AG – Annual Report 2017

Aareal Bank

Contents

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

Management Report

Fundamental Information about the Group

Business model

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

Aareal Bank Group's strategic business segments comprise commercial property finance as well as services, software products and digital solutions for the property sector and related industries.

Structured Property Financing

In the Structured Property Financing segment, Aareal Bank facilitates property investments for its domestic and international clients, and is active in this respect in Europe, North America and Asia. It stands out here especially for the direct and long-standing relationships it has established with its clients. Aareal Bank finances commercial property investments, especially for office buildings, hotels, retail, logistics and residential properties, with a focus on existing buildings. Its particular strength lies in its success in combining local market expertise and sector-specific know-how. This allows Aareal Bank to offer tailor-made financing concepts that meet the special requirements of its national and international clients. In particular, the Bank excels with its structuring expertise, as well as in portfolio and cross-border financings.

Aareal Bank manages its sales activities in the individual regions worldwide via a network of sales centres (hubs), some of which have been reorganised since November 2017. In addition to the locally-based experts, the distribution centres for sector specialists covering hotels, shopping centres and logistics properties, as well as those catering to the specific needs of investment fund clients, are located in Wiesbaden.

There are now two regional hubs in Europe: one hub combines sales activities for the euro zone, with a focus on the Benelux countries, France, Germany, Italy and Spain. An additional hub focuses on sales activities outside the euro zone, with a focus on Central and Eastern Europe, Northern Europe, and the UK. As before, the hubs have a network – comprising numerous branches in Brussels, Paris, Rome, London, Stockholm and Warsaw – at their disposal. Representative offices are located in Madrid and Moscow. The Istanbul representative office is allocated to the specialist hub, reflecting the fact that this location is only active in financing hotels and shopping centres.

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

Funding

Aareal Bank has a broad and solid refinancing base. It has established itself as an active issuer of Pfandbriefe, which account for a major share of its long-term funding. The AAA rating of the Pfandbriefe additionally confirms the quality of the cover assets pool. To cater to a broad investor base, Aareal Bank covers a wide range of other refinancing tools, including promissory notes and debt securities. 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

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

Aareon Group offers its customers consulting, software and services to optimise IT-supported business processes. With its Enterprise Resource Planning (ERP) systems distributed from 36 locations in Austria, Germany, France, the Netherlands, Norway, Sweden and the UK, Aareon generates stable, long-term business volume. In addition, Aareon develops a portfolio of digital solutions with its own research and development team and in cooperation with PropTech enterprises, offering these solutions internationally. "Aareon Smart World", the digital ecosystem, connects these solutions, networking property companies with customers, staff and business partners, as well as connecting technical devices in apartments and buildings. Aareon Group benefits from a transfer of cross-border know-how, leveraging the respective country-specific focal areas of digitalisation to expand its range of products and services. Aareon offers software solutions both in Germany and abroad that may be used in various types of operating environments: in-house services, hosting and Software as a Service (SaaS) from the exclusive Aareon Cloud.

In its Housing Industry division, Aareal Bank offers its customers process optimisation, electronic banking and asset management and markets its BK01 software which is the leading procedure in the German housing property industry for the automated settlement of mass payments. The procedure is integrated in licensed bookkeeping systems. Therefore, customers in Germany may process their payment transactions and account management from the administration software employed. In addition to the German property industry, the German energy sector forms a second major client group of the Bank's Housing Industry division for the services mentioned above. This enables the offer of further products, facilitating the cross-sector cooperation of client groups and realising synergies via end-to-end digital processes. In conjunction with payment transactions processed via Aareal Bank's systems, deposits are generated that contribute significantly to Aareal Bank Group's refinancing base.

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

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 1 ratio (CET 1 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 preservation of capital and the ability to distribute dividends are additional financial performance indicators applicable to Aareal Bank AG.

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

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

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

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

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

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

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

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

Economic Report

Macro-economic environment

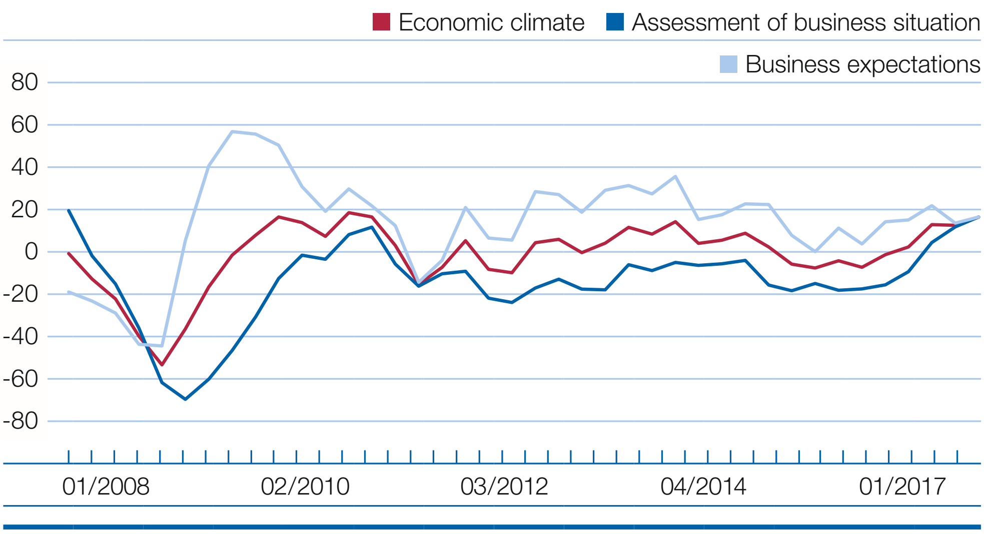
The developed economies reported robust and synchronised growth in 2017. A number of political uncertainties and natural disasters failed to dampen the positive mood. Further focus was on the central banks, some of whom began to, or at least signalled their intention to shift away from extremely expansionary monetary policies.

Economy

Global economic output grew steadily in 2017, and as a result, a synchronous rise was observed in the industrial nations. World trade rose significantly and the economic sentiment indicators reached high levels.

Growth in the euro zone was robust during all four quarters of the year under review, reflecting enhanced trade, greater investments and strong private consumption. Numerous political elections throughout Europe did not impact negatively on the economy. In Germany, the Institute for Economic Research's (ifo) business climate index reached a new record high in November, and this was reflected in strong economic growth. Growth in Germany was slightly above that of the euro zone as a whole in 2017. Economic output in France rose significantly compared with the previous year. From September onwards in Spain, the quest for independence by the autonomous province of Catalonia dominated events. Political and economic uncertainty resulted from the issues concerning independence, and remained unresolved at the end of the year. Growth in Spain was considerably less dynamic in the second half of the year – which meant that overall growth in 2017 remained slightly below the very high rate of the previous year. Growth in Italy was up markedly on the previous year, albeit below the euro zone average. Consolidation in the Italian banking sector continued during the second quarter, with the controlled resolution of two regional institutions. Prior to this development, Fitch Ratings had downgraded Italian government bonds from BBB+ to BBB.

ifo Business Climate World Economy



Source: ifo World Economic Survey (WES) IV/2017.

Growth in the non-euro zone EU nations was mixed. Economic growth in Sweden remained virtually unchanged from the previous year's high level, whilst the Danish economy grew in line with the previous year. In Poland, the economy grew strongly in 2017, driven by strong consumer spending.

The UK's exit from the EU, which was formally requested on 29 March 2017, continued to impact upon British politics and the economy, along with the early parliamentary elections on 8 June 2017. Several terrorist attacks added to the uncertainty. Contrary to the governing Conservative party’s hopes, the June election did not produce a strong mandate for the forthcoming Brexit negotiations with the EU. This increased the uncertainty surrounding the planned withdrawal from the EU, even though preliminary agreements were reached in negotiations at the end of 2017. Weak private consumer spending, slower construction activity and only a slight expansion in the service sector slowed economic growth during the course of the year. Moody’s responded to this by downgrading the UK’s credit rating from Aa1 to Aa2.

The Turkish economy grew strongly during the year under review, which was mainly due to the weak previous year as well as one-off effects. Economic output increased in Russia again after the decline of the previous year, but the recovery remained fragile.

Economic growth in the US in 2017 was markedly higher than the previous year; the underlying momentum was moderate yet robust, thus taking expansion into its eighth year – only the third such occurrence in history. Both hurricanes ”Harvey” and ”Irma” had little effect. Growth was sustained by higher investments and already very robust private consumption. The tax reform adopted on 20 December has not yet had any real impact. Growth in Canada increased significantly in 2017.

China’s growth in 2017 was slightly above that of the previous year, mainly due to increased world trade and government interventions. Due to high private debt and falling growth prospects, rating agency Moody’s downgraded China’s rating from A1 to A3 at the end of May, also changing the outlook from "stable" to "negative". However, government-backed measures helped stem the credit-financed boom in residential property slightly.

Unemployment rates declined markedly during the year under review, both in the euro zone and in the EU, to 7.6 % and 9.1 % respectively. Unemployment was also stable to slightly lower when looking at individual countries. In the UK, the rate of unemployment reached a very low level of 2.3 %, and in the US it declined even further, from its already very low level, to 4.4 %.

Annual rate of change in real gross domestic product (%)

%	2017 [1]	2016 [2]
Europe		
Euro zone	2.5	1.8
Austria	3.1	1.4
Belgium	1.7	1.5
Finland	3.0	1.9
France	1.9	1.1
Germany	2.5	1.9
Italy	1.5	1.1
Luxembourg	3.3	3.1
Netherlands	3.2	2.1
Portugal	2.7	1.5
Spain	3.1	3.3
Other European countries		
Czech Republic	4.6	2.5
Denmark	2.1	2.0
Poland	4.6	2.9
Russia	1.7	-0.2
Sweden	2.7	3.0
Switzerland	1.0	1.4
Turkey	7.0	3.2
United Kingdom	1.8	1.9
North America		
Canada	2.9	1.4
USA	2.3	1.5
Asia		
China	6.9	6.7
Japan	1.6	0.9
Singapore	3.5	2.0

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

Financial and capital markets, monetary policy and inflation

Geopolitical events and the realignment of central bank policy were the main focus of attention in financial and capital markets during 2017. This resulted in significant exchange rate fluctuations against the euro, especially versus the US dollar and pound sterling. Due to the overall stabilising effect of the consolidated economy, volatility remained low. A special feature of 2017 was the sharp rise in interest in digital cryptocurrencies over the course of the year, with rates increasing markedly as a result.

The European Central Bank (ECB) maintained its expansionary policy throughout 2017. However, as already announced in December 2016, it reduced the monthly purchase volume within the scope of its asset-buying programme by €20 billion, to € 60 billion from April 2017. In October, it announced that it was extending its asset-buying programme until September 2018, however, halving asset-buying volumes from January 2018 onwards. Sweden's Riksbank further expanded its monetary policy during the same period, increasing the planned government bond purchase volume by SEK 15 billion for the second half of the year. The Bank of England (BoE) raised its key interest rate by 25 basis points in November 2017, thus reversing its most recent cut – following Brexit – in 2016.

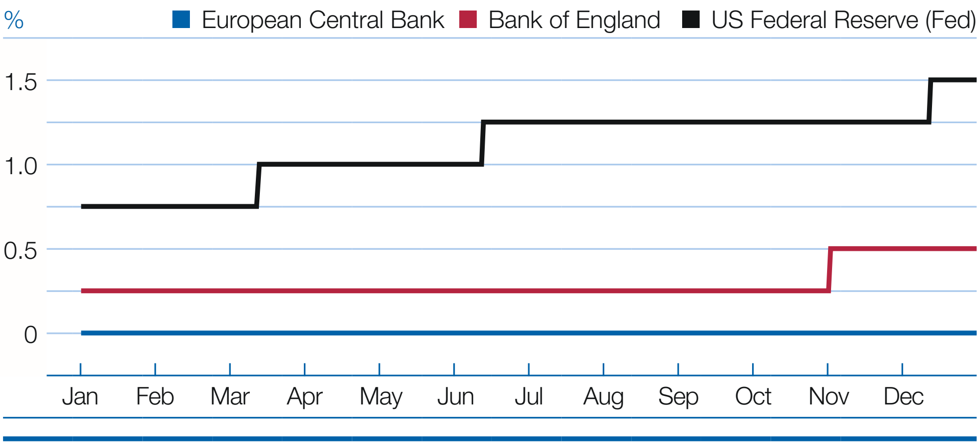
The US Federal Reserve (Fed) raised the target corridor for its key interest rate three times over the course of the year – most recently in December – by 25 basis points, respectively. Thus, at the end of the year, the Fed Funds corridor was between 1.25 % and 1.50 %. It also confirmed at the end of September that it will start to gradually reduce its balance sheet from October onwards, in small steps initially. The reduction is expected to pick up pace over time, according to a fixed schedule. The Fed is therefore the first of the globally important central banks to start reducing its balance sheet. However, it gave no indication of the extent of the reduction.

Long-term interest rates[1] showed no uniform trend in 2017 across the currencies that are important to Aareal Bank. US dollar rates rose slightly year-on-year, following some volatility during the course of 2017. Pound sterling rates fell slightly compared with the end of 2016. Long-term rates increased steadily in the euro area, and at the end of 2017 they were marginally higher than at the end of the previous year.

Short-term US dollar rates[2] showed a significant increase over the course of the year compared with the end of 2016. They remained almost unchanged in pound sterling until the third quarter, but rose marginally in line with the interest rate hike at the end of the year. In the euro area, they remained stable in slightly negative territory over the course of the year.

Yields on long-term government bonds showed a mixed trend. The decline in the US was continuous until the third quarter, with yield levels only slightly lower compared with year-end 2016. However, by the end of 2017 they had returned to the previous year's level. Within the euro zone, yields rose in the first quarter but then fell back in most markets during the course of the year. However, by the end of 2017 they had returned to the previous year's level on average. Yields in the UK had initially fallen, but at the end of the year they finished slightly higher than 2016.

Key rate developments in 2017[3]



Exchange rates in the currency areas that are relevant for Aareal Bank versus the euro were subject to stronger fluctuations, particularly from the second quarter onwards. By the end of the year, the euro had strengthened significantly against the US dollar and the Canadian dollar. Pound sterling lost some of its value against the euro during the course of the year.

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

Inflation increased markedly over the course of the year in many economies compared with 2016, reaching a preliminary high in many markets during the first half of the year. At 1.5 %, inflation in the euro zone remained below the ECB's target of just under 2 % in 2017 while it increased significantly over the course of the year in the UK, to reach 2.7 %. This was mainly due to the weaker pound sterling. The inflation rate in the US was at 2.1 % in the year under review. In China, inflation remained at 1.5 % in 2017, thus below the previous year's level.

The Pfandbrief market was once again heavily influenced in 2017 by the ECB, and by developments related to quantitative easing measures. Persistently low interest rates and narrow credit spreads on Pfandbriefe determined the ability to place Pfandbriefe in 2017, too. Notwithstanding the discernible decline in the volume of privately placed Pfandbrief issues, issuing activity of Pfandbrief transactions in benchmark format was only marginally lower than in the previous year. However, positive net issuance was seen again in 2017: by September, issuance had already exceeded maturities by close to € 5 billion.

Regulatory environment

The environment in which banks are operating continues to be defined by highly dynamic regulatory requirements, as well as by changes in banking supervision. This includes, in particular, implementation of the final draft of the Basel III framework into EU law, which was endorsed by the Basel Committee's Group of Governors and Heads of Supervision (GHOS) on 7 December 2017. In addition, the amendments to BAFin's Minimum Requirements for Risk Management (MaRisk) – including the new German Banking Supervisory Requirements for IT (BAIT), the EU Commission's proposals to revise supervisory regimes (CRR, CRD IV, BRRD and SRMR) as well as the EBA consultation paper "Guidelines on PD estimation, LGD estimation and the treatment of defaulted exposures" – will all lead to further regulatory changes.

The ECB's Supervisory Review and Evaluation Process (SREP) ensures a common approach on the supervisory review of banks, within the framework of Pillar 2. The SREP is built around a business model analysis, an assessment of governance, as well as of the capital and liquidity risks. The results of the individual areas are aggregated in a score value, from which the ECB derives supervisory measures on holding additional capital and/or additional liquidity requirements. Aareal Bank's Total SREP Capital Requirement (TSCR) has been set at 9.75 % for 2018, comprising the total capital ratio of 8 % for Pillar 1 and a (Pillar 2) capital requirement of 1.75 % from the ECB's Supervisory Review and Evaluation Process (SREP). In addition, the Bank is required to hold a (phased-in) capital conservation buffer of 1.875 %, plus a countercyclical buffer of 0.113 % forecast for the end of the year. Aareal Bank's pure SREP-CET1 requirement has been set at 8.24 % for 2018, comprising 4.5 % for Pillar 1, the above-mentioned Pillar 2 requirement of 1.75 % as well as the capital conservation buffer (1.875 %) and countercyclical buffer forecast for the end of the year (0.113 %) (also mentioned above). Additional liquidity requirements were not demanded of Aareal Bank.

Sector-specific and business developments

Structured Property Financing segment

The transaction volume represents the volume of existing buildings traded on a market and is often viewed as a benchmark or surrogate for the appeal of, and liquidity in, a given market. The development of transaction volumes in the commercial property market[1] was inconsistent across the different regions in 2017. Transaction activity in some European markets rose again over the previous year. In contrast, volumes in North America declined slightly, whilst remaining stable in Asia.

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.

[1] Office, retail, logistics and hotel property markets were analysed.

Financing of existing commercial property continued to be subject to considerable competitive pressure in many markets. While margins were under pressure in most European markets and the US in 2017, they remained on a higher level in the US when compared to Europe. Pricing levels on the US market are also influenced by the market for commercial mortgage-backed securities (CMBS). The volume of transactions in this segment remained on a low level in 2017.

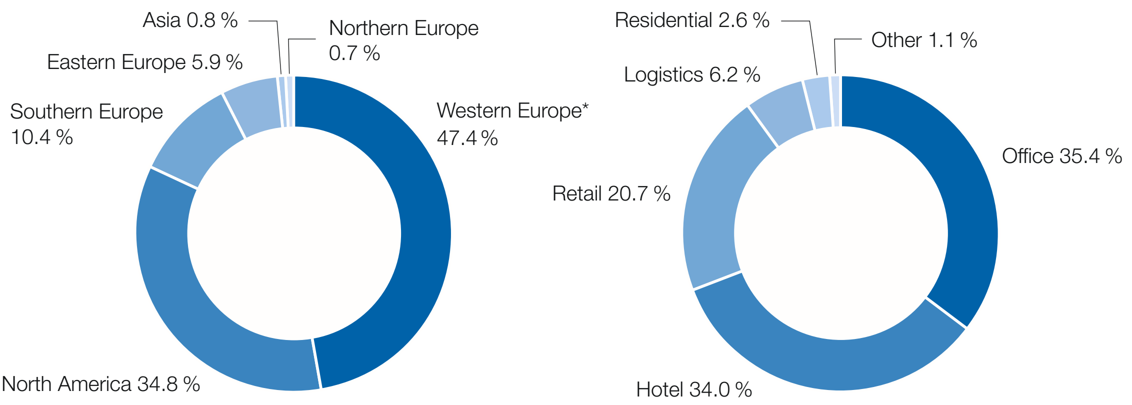
In a highly competitive business environment characterised by numerous uncertainty factors, Aareal Bank succeeded in generating € 8.8 billion of new business[1] in 2017. This figure was down slightly on the corresponding figure for the previous year (€ 9.2 billion). The original target was clearly exceeded thanks to high early renewals. With € 6.5 billion, the volume of newly-originated loans was up on the previous year's figure of € 5.8 billion.

At 64.4 % (2016: 73.3 %), Europe accounted for the largest share of new business in 2017, followed by North America with 34.8 % (2016: 24.6 %), and Asia with 0.8 % (2016: 2.1 %). This increase in the North American share over the previous year is in line with the targets of our "Aareal 2020" programme for the future.

With a share of 35.4 %, office properties accounted for the largest share in new business in terms of property type (2016: 45.4 %). This was followed by hotel property, with 34.0 % (2016: 20.7 %), ahead of retail property with 20.7% (2016: 22.7 %) and logistics property with 6.2 % (2016: 8.5 %). The share of residential property was 2.6% (2016: 2.1 %) while other property and financing amounted to 1.1 % (2016: 0.6 %).

New business 2017

by region | by type of property



* incl. Germany

Europe

The volume transacted in commercial property in Europe was stable in 2017, remaining on a high level overall. Transaction volumes increased slightly in Germany and the UK, and significantly in the Netherlands. In the UK, a few large transactions concluded with Asian investors led to an increase in the volume transacted. Volumes in France remained stable, thanks to a strong fourth quarter, whilst Italy, Poland and Spain saw slight decreases. Transaction volumes in Sweden were down significantly, however. European REIT structures and private investors were largely on the sell side, while investors from outside Europe were clearly on the buy side. Investment by institutional investors was balanced.

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

Compared to year-end 2016, yields[1] for newly-acquired, first-class commercial properties declined during the course of 2017 in many European economic centres; in part, this was due to the shortage of available top-quality properties. The underlying yield development trend applied to office, retail and logistics properties alike. Yields for UK offices declined slightly in some sub-markets, having risen slightly following the Brexit vote on 23 June 2016. By comparison, retail property yields increased slightly in the UK in 2017, compared to the previous year.

Rents for first-class office properties in the European economic centres mostly reported a slightly positive development in 2017, compared to the end of 2016. Retail and logistics properties were largely stable relative to the end of 2016. Only a few European economic centres witnessed declining rents in the premium segment, for example in a few retail locations in Germany, and office properties in some London locations.

The hotel markets in the European economic centres were largely positive during the year under review. Occupancy ratios rose in most markets, even markedly in some markets, such as Brussels, Milan and Paris. The indicator of average revenues per available room (which is important for hotel markets) also recorded an increase in most markets. Developments in Brussels and Paris should be highlighted: these markets recovered very well, after the burdens of terrorist attacks in recent years. In London, occupancy figures remained stable on a high level at the end of the year, and average revenues per available room picked up significantly.

Aareal Bank originated new business of € 5.6 billion (2016: € 6.7 billion) in Europe during the year under review. As in previous years, Western Europe accounted for the largest share, with € 4.2 billion (2016: € 4.8 billion). Southern Europe followed, with new business of € 0.9 billion (2016: € 1.1 billion), Eastern Europe with € 0.5 billion (2016: € 0.5 billion) and Northern Europe with minor volume (2016: € 0.3 billion).

North America

The volume transacted in commercial property in North America fell slightly compared with the previous year. Nonetheless, it could still be described as high, and the market considered very liquid overall. The declines were concentrated for the most part on office and retail properties, as well as on hotels. Institutional investors were mainly sellers, while private and cross-border investors were mainly net buyers. Still, cross-border investors were considerably less active than in the previous year. REIT structures had a balanced investment position.

The year 2017 was characterised by largely constant yield developments. On a national average, investment yields in the US hardly moved – compared to the year-end 2016 – for office and retail properties. Slight increases were seen in the metropolitan areas of California, for both office and retail properties.

Rents increased marginally on a national average in the US, compared to the final quarter of 2016, for the types of property mentioned. There were marginal differences in the regional centres. The growth in office property rents stagnated for example in Boston, New York, San Francisco and the metropolitan region of Washington. A slight increase was observed on the other hand in Chicago, Dallas and Los Angeles. The scenario was similar for retail properties.

Occupancy rates for hotels in the year under review remained stable in the US on a national average. Average revenue per available hotel room on the other hand climbed slightly. In Canada, occupancy rates rose slightly, whilst average revenue per available hotel room increased significantly.

Aareal Bank originated new business of € 3.1 billion in North America during the year under review (2016: € 2.3 billion). This business was originated in the US and Canada.

Asia

The volume transacted in commercial property during the year under review in the Asia-Pacific region was up slightly on the previous year’s figure. Volumes in China failed to match the high levels seen in the previous year, and overall volume was also slightly lower. The considerably lower activity of institutional investors, such as pension funds, insurance companies and sovereign wealth funds, was offset only partially by slightly higher activity amongst private investors.

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

Investment yields for newly-acquired, high-quality office property was stable in Beijing, whilst a slight decrease was evident in Shanghai. Retail property showed the reverse picture, with a slight decline in Beijing and stable development in Shanghai.

Rents for first-class office and retail properties in these two metropolitan areas were virtually unchanged from year-end 2016.

A slightly positive development of average revenues per available hotel room prevailed on the hotel markets of Beijing and Shanghai during the period under review. Occupancy ratios also rose slightly in the two metropolitan areas.

Aareal Bank Group originated € 0.1 billion in new business in Asia during the year under review (2016: € 0.2 billion).

Consulting / Services segment

Bank division Housing Industry

Business development in the German housing industry proved solid in 2017 as well. Largely constant rental income and long-term funding structures secure a solid foundation and facilitate entrepreneurial investments in conjunction with the very low interest rates. Investments made by the housing enterprises organised in the German Federation of German Housing and Real Estate Enterprises (Bundesverband deutscher Wohnungs- und Immobilienunternehmen – "GdW") increased to around € 16 billion during the year under review, and were therefore 17 % higher than in 2016. The upturn in investments is supported by an expansion of residential construction activity. With more than 28,000 apartments completed, the previous year's level was exceeded by 42 %, thus reaching the highest number of new buildings since the turn of the millennium. In December 2017, rents throughout Germany were some 4.7 % higher than in the previous year.

However, the market developed differently regionally: internal migration and immigration from abroad are responsible for a constantly diverging population development. While the demand for apartments is rising in the metropolitan regions and university cities, rural areas continue to lose inhabitants. The vacancy ratio based on the housing stock managed by GdW enterprises is stable, at 1.9 % in the former West German Federal states and at 8.2 % in the East German states.

The Bank's Housing Industry division further strengthened its market position in 2017, bringing in more business partners from the institutional housing industry and the commercial property sector – managing around 290,000 residential units between them – for the payments and deposit-taking businesses. Moreover, it intensified existing business relationships. We also continuously expanded our client base in the energy and waste disposal industries, especially through interface products (such as BK01 eConnect and BK01 immoconnect) facilitating cross-sector collaboration amongst our client groups. Examples include accounting documentation and invoicing of energy supplies.

At present, more than 3,700 business partners throughout Germany are using our process-optimising products and banking services. The high volume of deposits, averaging € 10 billion (2016:
€ 9.6 billion) in the year under review, is in line with the "Aareal 2020" programme for the future. Besides the increase in current account deposits, the share of rent deposits and reserves in accordance with the German Residential Property Act in particular also increased. Deposits averaged € 10.4 billion in the fourth quarter of 2017 (Q4 2016: € 10 billion). All in all, this reflects the strong trust that clients place in Aareal Bank.

Aareon

Aareon is the leading international consultancy and IT systems house for the property industry in Europe. It is pursuing a profitable growth strategy and continued to grow in the 2017 financial year. Key factors to its success are the expansion in digital solutions, strengthening of the ERP systems, and exploration of new markets associated with the property industry. The process of internal optimisation to enhance efficiency and profitability also continued.

Overall, Aareon's business developed on schedule in 2017. Strong performance increases in Germany and France offset weaker demand on the UK market and the delay in implementing projects in Sweden. Sales revenue rose from € 211 million to € 221 million, mainly on the back of acquisitions. Aareon matched the previous year's good consolidated operating profit of € 34 million in 2017, despite higher investments.

ERP systems, being the pivot of the Aareon Smart World digital ecosystem, are continuously being developed further: in 2017, the focus was on Wodis Sigma and Blue Eagle in Germany, as well as on Tobias AX in the Netherlands. Additionally, the Scandinavian ERP solution Incit Xpand was expanded with functionality for use in the commercial property sector, and the UK ERP solution QL was migrated to QL.web.

As expected, numerous additional customers opted for Wodis Sigma in Germany during the course of 2017, bringing the total number to 945. Among these new customers, there are still many previous GES customers who opted to change to Wodis Sigma within the framework of Aareon's migration campaign. As expected, the favoured version is the one that uses Wodis Sigma as a service from the exclusive Aareon Cloud. Aareon is still realising a large number of migration projects, all of which are developing on schedule. Systems for 109 customers were rolled out in 2017. Capacity utilisation in the Aareon consulting business thus remained high. The business volume of SAP® solutions and Blue Eagle developed as planned. Maintenance revenues in the Netherlands were increased through a large number of production roll-outs. Additional customers were acquired for the Tobias AX ERP solution. The acquisition of Kalshoven Groep B.V., effective 1 April 2017, also made a contribution to growth in the business with ERP products. Sustainable growth was also generated in France by increasing the maintenance business, especially through acquiring more customers for an extended range of maintenance services. Despite intensive competition, additional customers were won in the UK for QL.net. Furthermore, a major Swedish company has opted for Incit Xpand, including a digital customer portal. A big Norwegian customer rolled out Incit Xpand. All in all, however, growth in the ERP business fell short of expectations, owing to intense competition in the UK and the delay in implementing projects in Sweden.

The digital solutions of Aareon Smart World will be expanded throughout the Group, as part of the digital transformation process. On the one hand, this will be effected through Aareon’s own research and development team, and the associated transfer of knowledge throughout the Group – on the other hand, through cooperations with PropTech companies that have developed solutions providing added value to Aareon Smart World stakeholders. The digital solutions involved boosting the cross-border development of Aareon CRM in particular. Having been available in France for quite some time, the Aareon CRM app was rolled out in Germany in 2017 for a pilot customer. The app, which simplifies the customer relationship management between housing enterprises and tenants, will be systematically rolled out on the market.

Business volumes with digital solutions in Germany developed as planned, with the Mareon service portal, Aareon Archiv kompakt, Aareon CRM (tenant portal) and Aareon Immoblue Pro (management of tenant prospects) solutions being in particular demand. These offers benefit from migration activities involving ERP products. In Aareon's international business, sales revenues generated with digital solutions continued to grow, especially in France and the Netherlands. Aareon Nederland rolled out Mareon and a customer portal (for tenants and owners) for several customers. Customers in France signed agreements for the digital Aareon solutions, such as the digital customer relationship management system Aareon CRM. Several customers have rolled out digital solutions, predominantly for mobile property inspection purposes. The regulatory requirements for digital invoicing in France in particular also led to an increase in digital sales revenues. Moreover, initial customers for the digital platform were acquired, within the scope of the new Platform as a Service (PaaS) business model. With this digital development platform, Aareon offers its customers the possibility of developing their own digital solutions, building on pre-programmed components. In the UK, more customers have opted for the Aareon 360° solutions, and for the mobile solutions. Effective 1 December 2017, Aareon Nederland acquired 60% of the shares in FIRE B.V., Utrecht. Aareon Nederland thus offers its customers an integrated solution that allows both the valuation and financial management of properties. Facilitor, the facility management solution already established in the Netherlands, was prepared for the Swedish market and Aareon Sverige has already succeeded in acquiring its first customer for this.

The 100 % acquisition of Incit Nederland B.V. from Swedish Incit AB (now Aareon Sverige AB) with effect from 1 January 2017 – and the subsequent merger of this company with Aareon Nederland B.V. – brought together Aareon's activities in the Netherlands under one roof. Incit AB in Sweden and Incit AS in Norway have traded as Aareon Sverige AB and Aareon Norge AS, respectively, since October 2017.

Aareon also cooperates with PropTech companies, in order to expand the integrated offer of Aareon Smart World for its clients – for example, with KIWI.KI GmbH, which offers the keyless entry system KIWI. This was integrated via an interface in the Mareon service portal. Furthermore, Aareon entered into a cooperation agreement with, and invested in Immomio GmbH, which offers a web-based customer acquisition management solution and is expected to develop into a comprehensive service platform covering digital renting. In France, Aareon France and Intent Technologies agreed upon a partnership for Aareon Group. Integration of the Intent platform will support the increased connectivity of Aareon Smart World solutions with software offers provided by other suppliers to Aareon's customers.

Within the area of add-on products, Aareon was able to considerably extend its outsourcing business in Germany, in particular. Turnover at the BauSecura insurance business was slightly higher than the previous year's level. The increase in sales revenues, with add-on products in the international business, was mainly attributable to the full acquisition of the Dutch company SG2ALL B.V. with its outsourcing business in 2016.

Aareon is now targeting new markets, such as utilities and the commercial property market, and is currently developing a solution for utilities, housing enterprises and metering service providers, which will digitalise the processes involved in moving house. With regard to the commercial property market, Aareon Nederland B.V. acquired 100% of Kalshoven Groep B.V., Amsterdam, effective 1 April 2017. It strengthened its presence in this market segment in Germany with the acquisition of the mse companies as at 1 October 2017; this move also enables Aareon to explore the Austrian market.

Net Assets, Financial Position and Financial Performance

Financial performance

Aareal Bank AG closed the financial year 2017 – which was characterised by a demanding and challenging market environment, as in the previous year – with an operating profit (excluding loan loss provisions) of € 194.6 million (2016: € 256.0 million).

The aggregate of net interest income and net commission income amounted to € 440.1 million, down € 126.8 million compared to the previous year. Interest income from lending and money-market transactions fell by € 30.9 million year-on-year, whilst interest income from securities declined by € 14.5 million. Interest expenses increased by € 10.5 million. Current income of € 0.1 million during the year under review (2016: € 70.0 million) was attributable to investments. Net commission income of € 7.5 million was down € 1.0 million year-on-year.

Administrative expenses (including depreciation and amortisation of intangible assets and tangible fixed assets) of € 285.2 million were € 11.3 million lower than in the previous year, reflecting declines in personnel expenses as well as in other administrative expenses.

Net other operating income and expenses showed a marked improvement of € 54.1 million year-on-year, to € 39.7 million.

The balance of provisions for loan losses and the result from securities held as liquidity reserve amounts to € -274.4 million (2016: € -86.1 million). This figure includes expenditure for specific and general loan loss provisions, as well as allocations to general risk provisions in accordance with section 340f of the HGB. Securities held as liquidity reserve were revalued strictly at the lower of cost or market; the item also includes capital gains and losses realised on this portfolio.

The integration of the split-off banking operations of former Westdeutsche ImmobilienBank AG (WestImmo) and the merger of GEV GmbH into Aareal Bank AG yielded aggregate extraordinary income of € 83.7 million. Extraordinary expenses of € 19.0 million were incurred for personnel measures resulting from the optimisation of processes and structures, within the scope of the "Aareal 2020" programme for the future.

Net other income and expenses of € 141.1 million (2016: € 4.9 million) includes income from the reversal of reserves in accordance with section 340g of the HGB carried by WestImmo at the time of said split-off, the results and revaluation of subsidiaries, as well as the results from investment securities and non-income taxes.

Taking into account a net income tax claim of € 21.1 million (2016: net income tax liability of € 53.1 million) and € 2.5 million (2016: € 0.5 million) in profits carried forward, the Bank posted net retained profit of € 149.6 million (2016: € 122.2 million), which permitted Aareal Bank AG to achieve its targets of preserving capital, and its ability to distribute dividends. Likewise, the Bank largely fulfilled – or exceeded – its targets with regard to the following key financial indicators at Group level, in accordance with IFRSs, with net interest income of € 634 million, € 82 million in allowance for credit losses, net commission income of € 206 million and administrative expenses of € 511 million. Overall Aareal Bank generated operating profit of € 328 million, earnings per ordinary share of € 3.20, and RoE before taxes of 11.9 %.

Net assets

Aareal Bank AG's total assets as at 31 December 2017 amounted to € 39.6 billion, after € 40.3 billion as at 31 December 2016. The decline in total assets was predominantly due to lower term deposits.

Net assets are dominated by the property financing business and securities investments.

The book value of debt securities and other fixed-income securities amounted to € 7.8 billion as at 31 December 2017 (31 December 2016: € 7.6 billion). These securities holdings comprise three asset classes: public-sector borrowers, covered bonds and Pfandbriefe, and bank bonds.

Property financing portfolio

Portfolio structure

The volume of Aareal Bank AG's property financing portfolio stood at € 22.1 billion as at 31 December 2017, a decline of approximately 3% compared to the 2016 year-end figure of € 22.7 billion.

Aareal Bank AG's property financing portfolio comprises financings of office, residential and retail properties, as logistics properties, hotel properties and other financings; the portfolio is distributed across the regions of Europe, North America and Asia.

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

Financial position

Interbank and repo business

Generally, in addition to customer deposits, Aareal Bank AG 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 2017.

Customer deposits

As part of our business activities, we generate deposits from housing industry customers, and from institutional investors. As at 31 December 2017, housing industry deposits amounted to € 9.2 billion (31 December 2016: € 9.2 billion). Deposits from institutional investors amounted to € 3.8 billion million as at 31 December 2017 (31 December 2016: € 4.5 billion).

Funding and equity

Funding structure

Aareal Bank AG's funding remains very solid indeed, as evidenced by the high proportion of long-term refinancing. This encompasses registered and bearer Pfandbriefe, promissory note loans, medium-term notes, other bonds and subordinated issues. The latter include subordinated liabilities, profit-participation certificates, silent participations as well as regulatory Additional Tier 1 instruments.

The long-term refinancing portfolio totalled € 21.3 billion as at 31 December 2017 (31 December 2016: € 20.9 billion), comprising € 15.5 billion (2016: € 14.1 billion) in Mortgage Pfandbriefe and Public Sector Pfandbriefe, € 4.9 billion (2016: € 5.6 billion) in unsecured funding, € 0.6 billion (2016: € 0.9 billion) in subordinated funding, plus € 0.3 billion (2016: € 0.3 billion) in Additional Tier 1 capital.

The Liquidity Coverage Ratio (LCR) exceeded 150% on the reporting days of the period under review.

Refinancing activities
A total of € 1.7 billion in Mortgage Pfandbriefe plus senior unsecured issues in the amount of € 0.7 billion were very satisfactorily placed by Aareal Bank on the capital markets during the financial year 2017. In addition to the very successful issue of a € 500 million Mortgage Pfandbrief, the Bank also placed non-euro issues of £ 250 million and an additional USD 625 million issue on the capital markets. Of Aareal Bank's senior unsecured issues, a USD 250 million bond deserves particular mention: this bond was Aareal Bank's first syndicated senior unsecured bond denominated in US dollars.

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 AG's total equity, as disclosed in the balance sheet, amounted to € 1,971.9 million as at 31 December 2017 (31 December 2016: € 1,944.5 million).

Regulatory capital[1)]

	31 Dec 2017[2)]	31 Dec 2016
€ mn		
Common Equity Tier 1 (CET 1)	2,305	2,351
Tier 1 (T1)	2,600	2,896
Total capital (TC)	3,536	3,994
%		
Common Equity Tier 1 ratio (CET 1 ratio)	19.6	16.2
Tier 1 ratio (T1 ratio)	22.1	19.9
Total capital ratio (TC ratio)	30.0	27.5

[2)] After confirmation of Aareal Bank AG's 2017 financial statements; the inclusion of retained earnings transferred as part of Aareal Bank AG's liable equity capital as at 31 December 2017 is subject to approval by the Annual General Meeting.

Our employees

Employee data as at 31 December 2017

	31 Dec 2017	31 Dec 2016	Change
Number of employees of Aareal Bank AG	927	933	-0.6%
Years of service	14.5 years	13.9 years	0.6 years
Staff turnover rate	1.8%	1.1%	

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

Qualification and training programmes

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

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

The Group consistently pursued this strategy throughout the year under review. The Bank thus focused its activities on further developing skills in project management methodologies, in particular, the agile project management method. Aareon's activities focused on the SAP HANA application environment and online English language training.

Promoting the next generation

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

The Bank's "Junior Training Programmes" once again provided support for young people in terms of training in 2016, including trainees for office management (within training courses at the Chamber of Commerce and Industry), students in the fields of business administration, banking, and business information systems from the Baden-Württemberg Cooperative State University (Duale Hochschule Baden-Württemberg – DHBW), Mannheim, as well as business administration students from the University of Applied Sciences Mainz (Hochschule Mainz). Alongside the trainee programmes, Aareon also offers vocational training for specialist jobs in office management and IT application development and system integration. It also offers the dual courses of study "Business Information Systems/ Software Engineering" and "Business Information Systems/Application Management", in partnership with the DHBW Mannheim.

Remuneration system

In addition to the fixed remuneration that is paid in twelve monthly instalments, all employees receive a performance-related variable remuneration. Salaries are reviewed annually, to ensure that individual remuneration packages are appropriate. The objective is to offer a remuneration level that is both appropriate and attractive to all Group employees.

Work-life balance

Aareal Bank Group places great importance on supporting its employees to achieve compatibility of career and family. This is emphasised by a broad range of dedicated support services such as partnerships with childcare institutions or service providers for the provision of private childcare, holiday programmes for employees' children, the availability of parent-child workrooms, flexible working policies, part-time positions and the option of working remotely or alternating teleworking for all employees. Another component of improving the work-life balance of the employees consists of services that make it easier to combine working life with the care of those who require it. This includes, among other things, the offer of counselling and support in the event of illness as well as nursing care for close relatives (available throughout Germany) and the option of participating in various training courses for better compatibility of family, care and work .

Health

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

In order to protect and promote the health of its employees in a targeted manner, Aareal Bank Group offers a comprehensive range of health-promoting measures in the areas of information, prophylaxis, exercise and ergonomics, nutrition, mental health and relaxation that are always based on employees' current needs. In the year under review, these included speeches on various topics, workshops on topics such as nutrition, exercise and back health as well as ageing at work, stress prevention and management measures (attention training, resilience support programme, stress management seminars), health checks, preventive individual health consultations, skin screenings and flu vaccinations.

Risk Report

Aareal Bank AG is the parent company of Aareal Bank Group. Aareal Bank AG has entered into profit and loss transfer agreements, or control and profit and loss transfer agreements, with numerous Group entities. The economic risks of these entities are thus reflected in Aareal Bank AG's risk profile. Moreover, the funding of Aareal Bank Group is managed centrally by Aareal Bank AG. The parent company therefore monitors and manages the Group's risks, based on uniform, Group-wide policies. Against this background, the risk report provided below outlines the risk management system at Group level.

Aareal Bank Group Risk Management

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

Risk management – scope of application and areas of responsibility

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

Uniform methods and procedures are deployed to monitor material risks generally associated with banking business across all entities of Aareal Bank Group. 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. The adjacent diagram provides an overview of the responsibilities assigned to the respective organisational units.

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

<table>
<tr><th colspan="2">Type of risk</th><th>Risk management</th><th>Risk monitoring</th></tr>
<tr><td colspan="2">Market price risks</td><td>Treasury, Transaction Committee</td><td>Risk Controlling</td></tr>
<tr><td colspan="2">Liquidity risks</td><td>Treasury</td><td>Risk Controlling</td></tr>
<tr><td rowspan="4">Credit risks</td><td>Property Finance Single exposures</td><td>Business & Syndication Management, Credit Management</td><td>Risk Contolling, Credit Management</td></tr>
<tr><td>Property Finance Portfolio risks</td><td>Credit Management, Project & Credit Portfolio Management</td><td>Risk Controlling</td></tr>
<tr><td>Treasury business</td><td>Treasury</td><td>Risk Controlling</td></tr>
<tr><td>Country risks</td><td>Treasury, Credit Management</td><td>Risk Controlling</td></tr>
<tr><td colspan="2">Operational risks</td><td>Process owners</td><td>Risk Controlling</td></tr>
<tr><td colspan="2">Investment risks</td><td>Strategy Development</td><td>Risk Controlling, Finance & Controlling, Controlling bodies</td></tr>
</table>

Process-independent monitoring: Audit

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

The risk monitoring function (the "Second Line of Defence") regularly measures utilisation of risk limits, and reports on the risk situation. In this context, the Management Board is supported by the Risk Executive Committee (RiskExCo). The RiskExCo develops proposals for resolutions in line with delegated tasks, and promotes risk communications and a risk culture within the Bank.

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

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

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 material types of risk. Taken together, these represent the Group's risk strategy. These strategies are designed to ensure a professional and conscious management of risks. Accordingly, these strategies include general policies, to ensure a uniform understanding of risks across all parts of the Group. They also provide a cross-sectional, binding framework applicable to all divisions. The Bank has implemented adequate risk management and risk control processes to implement these strategies, and to safeguard the Bank's risk-bearing capacity.

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

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

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

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

Risk-bearing capacity and risk limits

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

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

In accordance with this approach, potential risk cover is determined using data derived from the income statement and from the statement of financial position; this derivation also forms the basis for determining regulatory capital. 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). Freely available funds increased significantly during the period under review. Firstly, this was due to portfolio planning; secondly, Aareal Bank further refined its procedures, defining Tier 1 (T1) capital (as defined by the CRR) at a level of 7.75 % of forecast risk-weighted assets (RWA) as a deductible, in accordance with regulatory requirements. Only free own funds exceeding this level are applied as potential risk cover, of which a further 10 % is deducted. This deduction is not applied to risk limits, but retained for risk types that cannot be quantified (for example, business or strategic risks). Migration or FX lending risks are no longer deducted as a buffer, but are now included as credit risk exposure.

Likewise, the Bank adopts a conservative stance with respect to setting risk limits. The aggregation of individual limits is based on the assumption that no risk-mitigating correlation effects exist amongst different types of risk. Taking into account the prior deduction of a minimum Tier 1 ratio of 7.75 % of RWA, 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 summarises the Group's overall risk-bearing capacity as at 31 December 2017.

€ mn	31 Dec 2017	31 Dec 2016
Own funds for risk cover potential	2,623	2,598
less 7.75 % (31 Dec 2016: 8 %) of RWA (Tier 1 capital (T1))	870	1,477
Freely available funds	**1,753**	**1,121**
Utilisation of freely available funds		
Credit risks	265	317
Market risks	145	207
Operational risks	86	106
Investment risks	21	24
Other risks [1)]	173	-
Total utilisation	**690**	**654**
Utilisation as a percentage of freely available funds	**39 %**	**58 %**

[1)] Other risks such as business or strategic risks

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

Stress testing

Stress testing, and the analysis of stress test results, form an additional focal aspect of our risk management system. This involves conducting stress tests for all material risks, using both historical parameters as well as hypothetical stress testing scenarios. To also be able to assess cross-relationships between the various types of risk, we have defined multi-factor stress scenarios, so-called “global” stress tests. For instance, the impact of the crisis affecting financial markets and the economy, which broke out in 2007, on individual types of risk and aggregate risk is analysed within the scope of a historical scenario. In the hypothetical scenario, current potential developments are derived from factors such as political developments, and are combined with significant macroeconomic deterioration. The stress testing methodology implemented also takes into account the impact of any risk concentrations. We compare the aggregate risk cover available in a stress situation with the results 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 organisational structure and procedures in the credit business.

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

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

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

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

Process requirements

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

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

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

Early risk detection procedures

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

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

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

Extensive IT resources are deployed to identify risk positions, and to monitor and measure risks. Overall, the existing set of tools and methods 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.

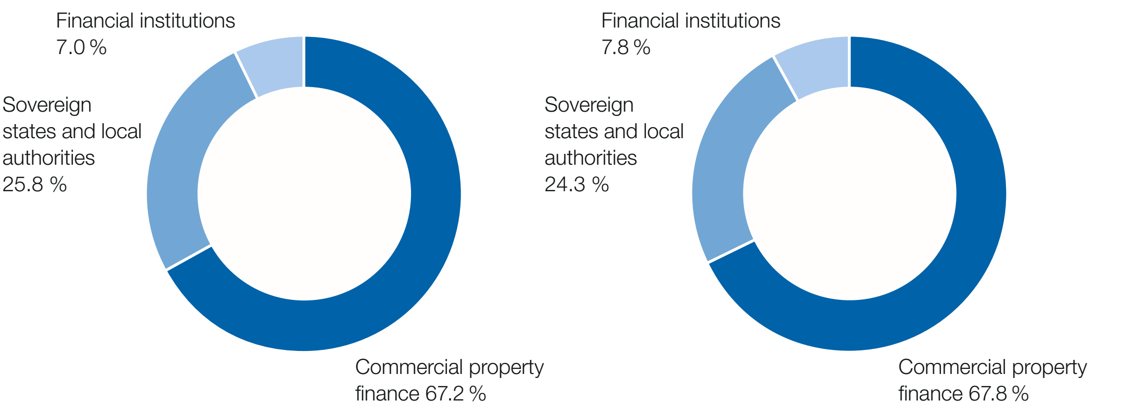
Risk classification procedures

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, and for annual validation, lies with two separate divisions outside the Sales units.

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

Breakdown of exposure by rating procedure

31 Dec 2017 | 31 Dec 2016 100 % = € 40.0 bn | 100 % = € 43.2 bn



Note that the exposure includes claims against the borrower plus off-balance sheet obligations. The following distributions of ratings and Expected Loss classes exclude exposures for which no rating has been concluded, or which are in default (as defined under the CRR). The rating procedures for financial institutions also apply to development and promotional banks. Such institutions accounted for 56 % of all rated financial institutions as at 31 December 2017.

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.

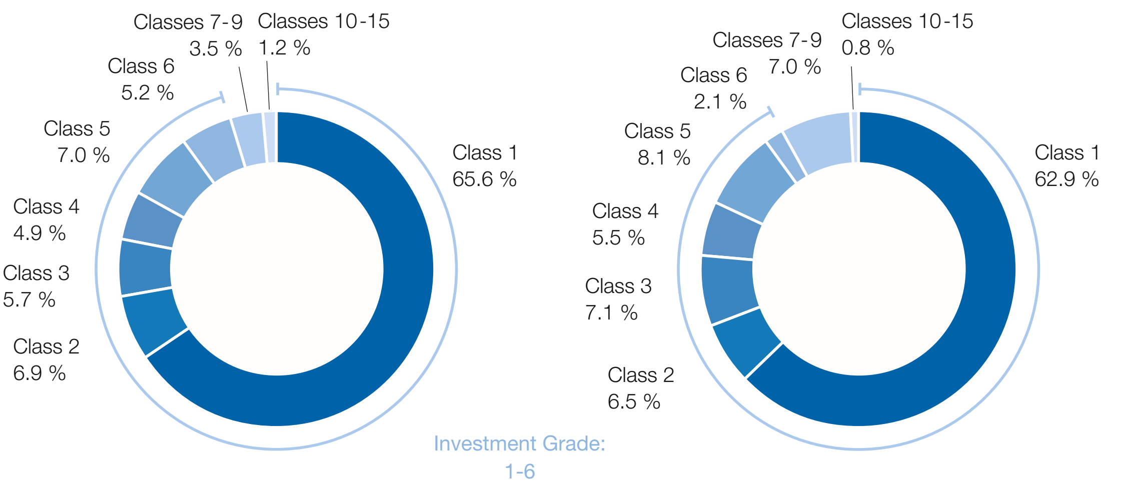
In a first step, the client's probability of default (PD) is determined using a rating procedure. The method used in this context comprises two main components, a property rating and a corporate rating.

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.

Large-sized commercial property finance

classified by internal expected loss classes — as at 31 Dec 2017 | as at 31 Dec 2016



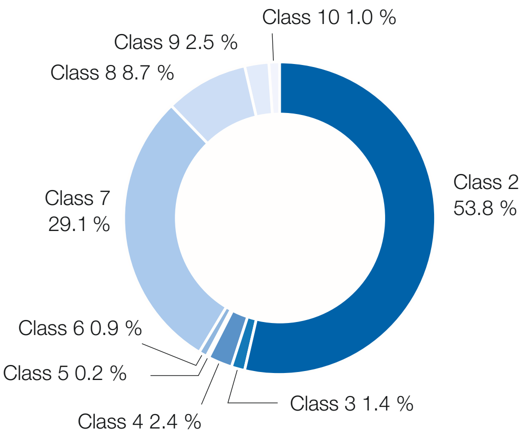
When evaluating collateral, haircuts are applied or recovery rates used, depending on the type of collateral involved and specific realisation factors. For financings of domestic properties, recovery rates are taken from a pool of data used across the Bank, whilst recovery rates for international properties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

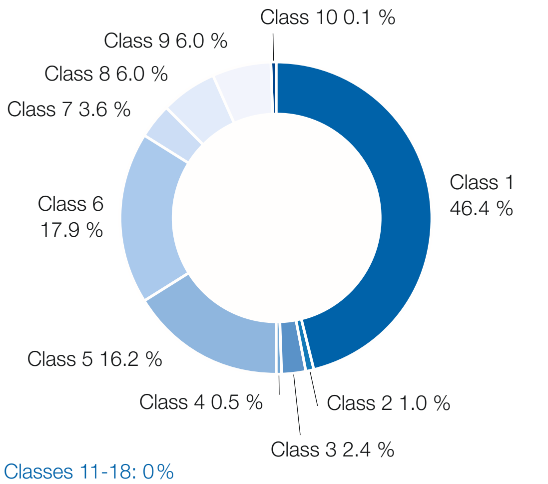
The expected loss (EL) in the event of default of an exposure is determined as the product of PD and LGD. As a risk parameter related to the financing, EL is used as an input factor for the tools used to manage the property financing business.

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

Financial institutions

by rating class — as at 31 Dec 2017 | as at 31 Dec 2016





Classes 1, 11-18: 0%

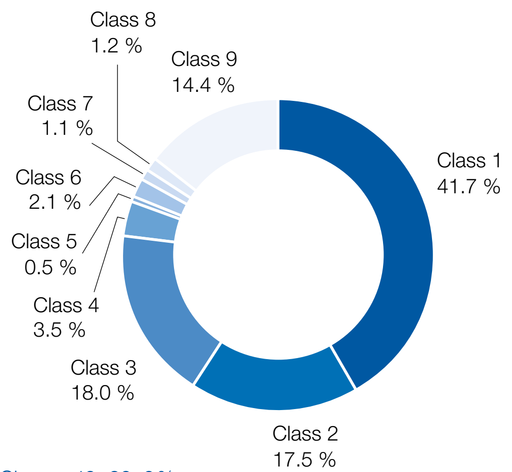
Classes 11-18: 0%

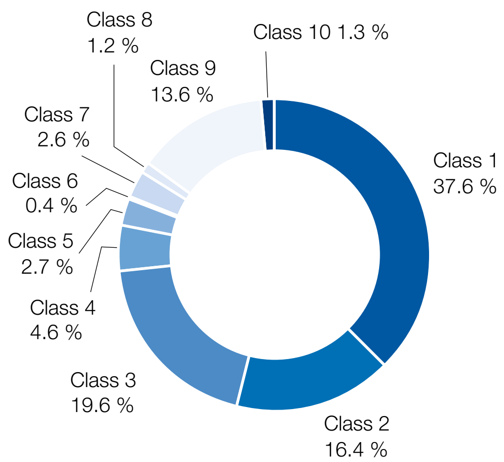
Sovereign states and local authorities
In addition, Aareal Bank Group employs internal rating methods for sovereign borrowers and regional governments, local and other public-sector entities. In this context, rating grades are assigned using clearly-defined risk factors, such as fiscal flexibility or 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 2017 | as at 31 Dec 2016





Classes 10-20: 0%

Classes 11-20: 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 & Controlling and Audit are responsible for tasks not directly related to processes.

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

The detailed assignment of responsibilities is outlined below.

Treasury is responsible for risk management and trading activities as defined by the Minimum Requirements for Risk Management ("MaRisk") 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.

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

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

Process requirements

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

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

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

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

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. The associated 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 Guidelines. 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.

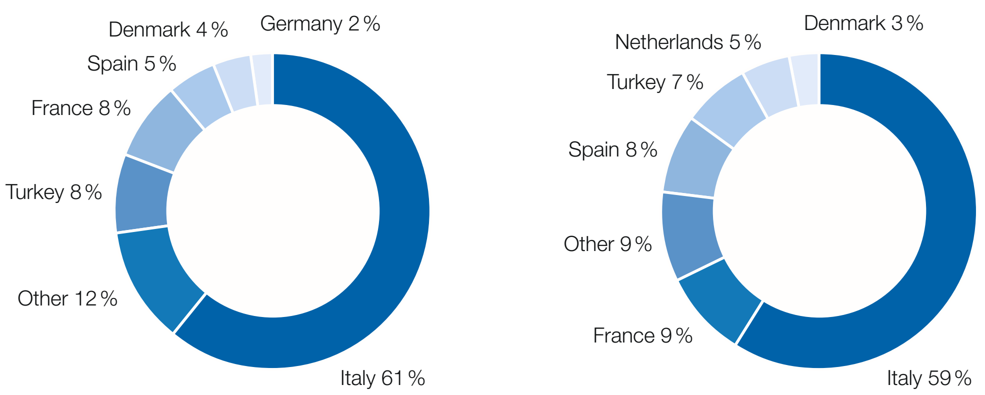
The Bank focuses in particular on the identification, monitoring and management of risk concentrations, where both quantitative and qualitative methods are being used. With regard to counterparty credit risk, these include for example, the regular analysis of our largest borrower units and the analysis 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, the monitoring of payment arrears, and the regular, individual analysis of the largest exposures.

Individually impaired property financings[1] (carrying amount)

by country (%) 31 Dec 2017: 100 % = € 1.2 bn | 31 Dec 2016: 100 % = € 1.4 bn



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

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 or issuers for whom the requisite limits are in place. Replacement and settlement risks are taken into account when determining counterparty/issuer limit usage. Persons holding position responsibility are informed about relevant limits and their current usage without delay.

All trades are immediately taken into account for the purposes of borrower-related limits. Compliance with limits is monitored in real time by Risk Controlling. Any limit breaches are documented, together with action taken in response. Where limit transgressions exceed an amount defined in line with risk considerations, these are escalated to the responsible members of senior management, using a standardised escalation process.

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.

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

Credit risk mitigation for trading activities

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

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

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

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

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

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

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

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

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

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

In principle, Aareal Bank pursues a 'buy and manage' strategy in managing its credit portfolio – with the primary objective of holding the majority of loans extended on its balance sheet until maturity; at the same time, targeted exit measures are deployed for actively managing the portfolio and the risks involved. Assets acquired upon the realisation of collateral are predominantly properties. The consideration received upon disposal is applied to repay the underlying financing. A rapid 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.

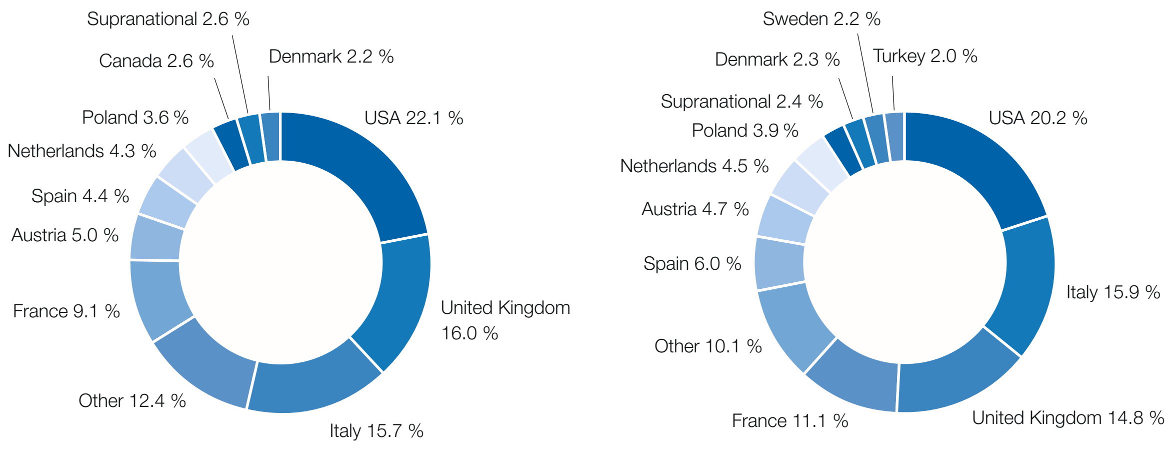
Country risk measurement and monitoring

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

Breakdown of country exposure in the international business

% 31 Dec 2017 | 31 Dec 2016



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 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.

When interpreting the VaR figures stated below, 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.

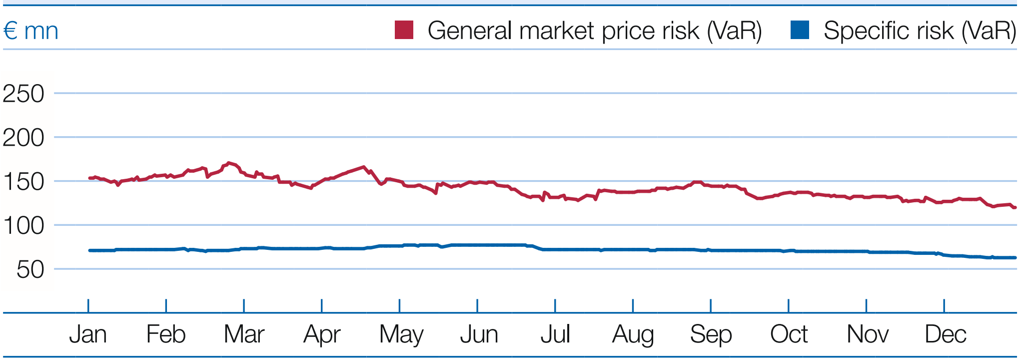
€ mn **Year-to-date (full previous year), 95%, 250-day holding period**	MAX	MIN	Mean	Limit
Aareal Bank Group – general market price risk	173.6(305.0)	119.6(161.1)	143.3(224.5)	- (-)
Group VaR (interest rates)	127.6(211.6)	71.6(103.0)	97.1(149.5)	- (-)
Group VaR (FX)	98.8(185.9)	68.9(102.2)	84.3(135.5)	- (-)
VaR (investment fund and equities)	4.8(5.8)	2.1(3.5)	3.8(4.6)	20.0(20.0)
Aggregate VaR in the trading book	0.0(0.0)	0.0(0.0)	0.0(0.0)	5.0(5.0)
Group VaR (specific risks)	79.8(85.9)	62.0(62.8)	73.0(73.3)	- (-)
Group funding risk	26.2(23.0)	3.0(17.2)	14.7(19.4)	- (-)
Aggregate VaR – Aareal Bank Group	204.6(311.5)	141.2(174.0)	175.6(237.5)	390.0(390.0)

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 **Year-to-date (full previous year), 95%, 1-day holding period**	MAX	MIN	Mean	Limit
Aareal Bank Group – general market price risk	11.0(19.3)	7.6(10.2)	9.1(14.2)	- (-)
Group VaR (interest rates)	8.1(13.4)	4.5(6.5)	6.1(9.5)	- (-)
Group VaR (FX)	6.3(11.8)	4.4(6.5)	5.3(8.6)	- (-)
VaR (investment fund and equities)	0.3(0.4)	0.1(0.2)	0.2(0.3)	1.3(1.3)
Aggregate VaR in the trading book	0.0(0.0)	0.0(0.0)	0.0(0.0)	0.3(0.3)
Group VaR (specific risks)	5.0(5.4)	3.9(4.0)	4.6(4.6)	- (-)
Group funding risk	1.7(1.5)	0.2(1.1)	0.9(1.2)	- (-)
Aggregate VaR – Aareal Bank Group	12.9(19.7)	8.9(11.0)	11.1(15.0)	24.7(24.7)

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.

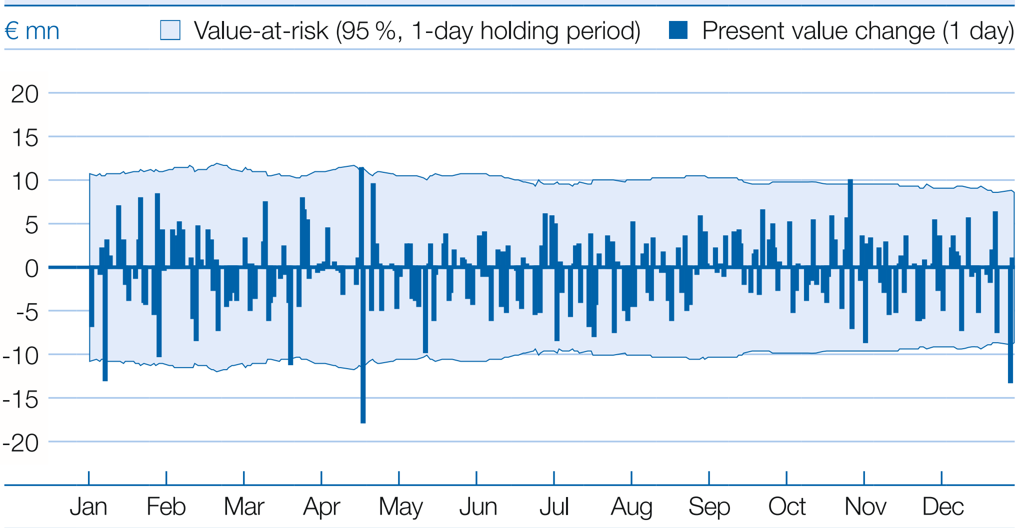
General market price risk and specific risk during 2017



Both general and specific market risk were relatively stable during the course of the year – overall, they declined.

Backtesting
The quality of forecasts made using this statistical model is checked through a weekly back-testing 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 2017



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 weekly and monthly stress test reporting.

The hypothetical scenario implied a present value loss of approximately 15 % of the stressed aggregate risk cover limit as at year-end 2017. 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

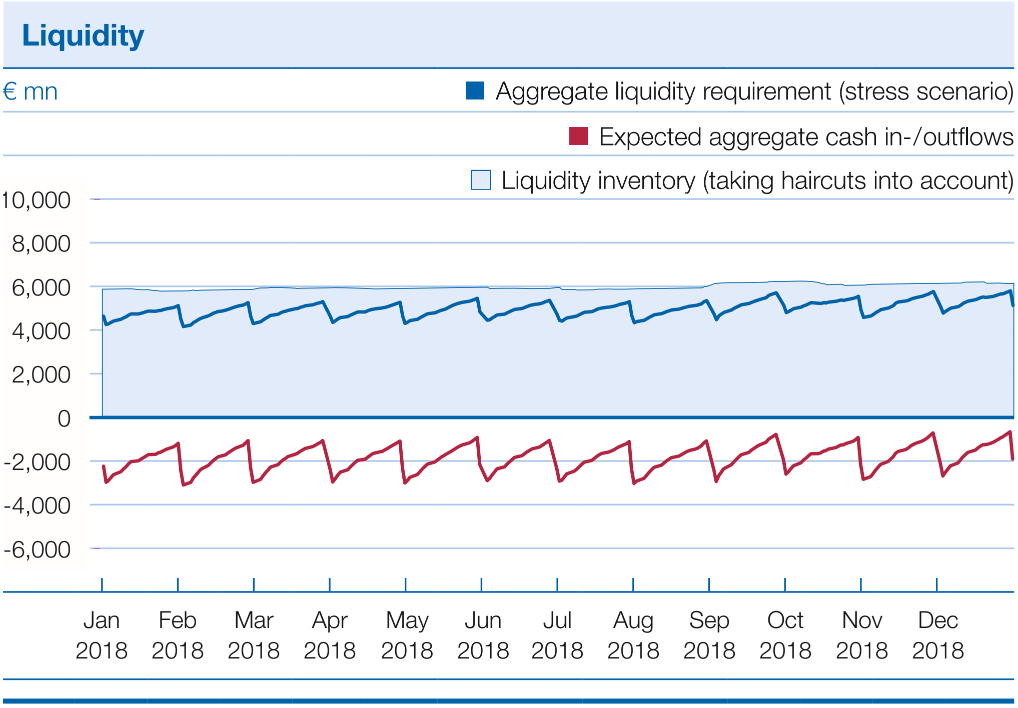
Definition
Liquidity risk in the narrower sense is defined as the risk that current or future payment obligations cannot be met in full or on time. Aareal Bank Group's liquidity risk management system is designed to ensure that the Bank has sufficient cash and cash equivalents to honour its payment obligations 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 following chart 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 2018. This presentation demonstrates that the liquidity stock will always exceed liquidity requirements, even under unfavourable conditions.

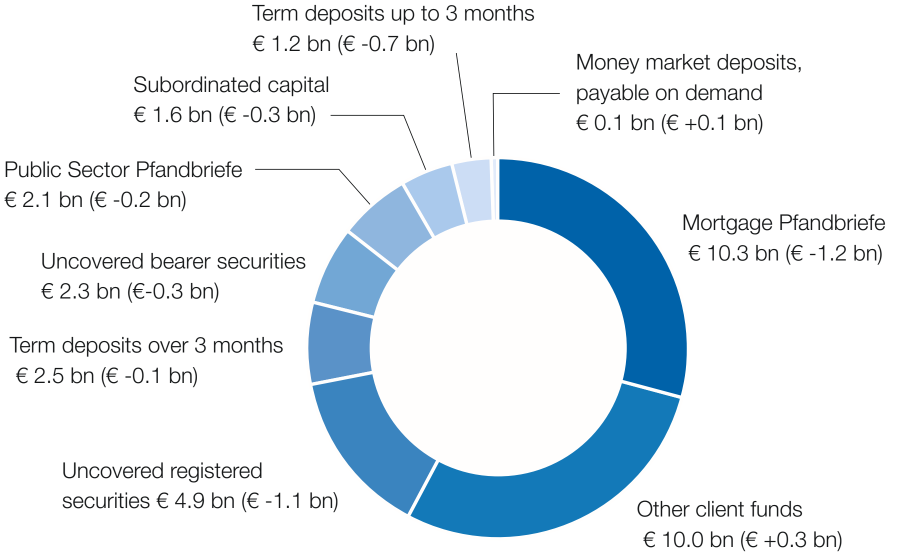


Further details are provided in the comments on the Bank's liquidity in the section on "Refinancing and Equity".

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.

Refinancing portfolio diversification by product

as at 31 Dec 2017 versus 31 Dec 2016 — Total volume (nominal): € 35.0 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 as well as historical scenarios and sensitivity analyses on the risk inventories. The results of the stress tests are reported regularly to the Management Board and serve as an indicator for potential developments within the operational risks that could jeopardise the continued existence of the Group.

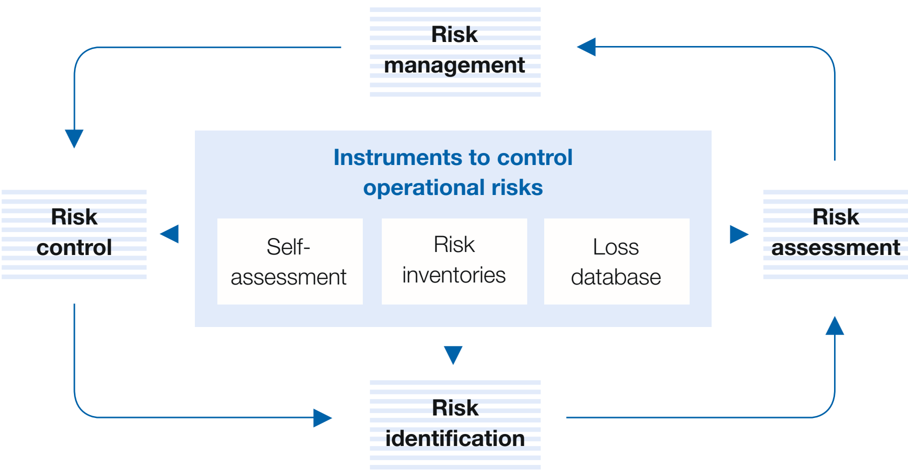
Aareal Bank's legal department deals with any litigation the Bank is involved in, as well as with any legal issues of fundamental importance – where necessary, using the support of external lawyers.

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

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

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

Management of operational risks



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

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

Investment risks

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.

Strategy Development, as well as Finance & Controlling and Risk Controlling, are responsible for measuring and monitoring investment risk exposure.

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

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. To protect and enhance the reputation of Aareal Bank Group, and to ensure the Group's uniform strategic position, the Group Communication Policy sets out procedures for (and the approach to be taken in) external media relations, internal communications, governmental affairs, financial reporting, as well as marketing, under the central responsibility of Corporate Communications.

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 AG 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. 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.

Primary responsibility for accounting and financial reporting lies with the Finance & Controlling division. Finance & Controlling manages the centralised processes for preparing Aareal Bank AG's annual and interim financial statements. Amongst other tasks, Finance & Controlling is responsible for preparing the financial statements (including the management report) in accordance with the German Commercial Code (German GAAP – "HGB"), and monthly reporting packages; the division is also responsible for developing accounting guidelines in accordance with the HGB, and IT guidelines.

The number of employees within Aareal Bank AG's Finance & Controlling division is adequate, as are their qualifications. Furthermore, they possess the necessary knowledge and experience relevant for their functions.

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

Internal Audit also has a process-independent monitoring function. It reports directly to the Management Board, and provides auditing and consulting services which are designed to optimise Aareal Bank AG'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 AG. 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 AG, various measures related to the Bank's organisational structures and procedures help to fulfil the monitoring duties within the framework of its Internal Control System.

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

Various guidelines exist for activities and processes. These guidelines are set out in the Written Set of Procedural Rules of Aareal Bank AG and are 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 Aareal Bank AG'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 accounting IT systems for material transactions, this has been integrated and documented in the manual process workflows.

Adherence of accounting to generally accepted accounting principles is ensured by both preventive and detective controls 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 AG 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 Bank's accounting-related IT systems were designed in such a way that both manual controls and automatic plausibility checks are performed for material technical and procedural system steps of the applications used. The controls in relation to processing within the IT systems are also integrated in the processes, as well as being independently performed. Process-integrated controls comprise, for example, the review of error and exception reports or the regular analysis of internal service quality. In contrast, IT reviews are conducted independently from processes, by Internal Audit.

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

Aareal Bank AG 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 Bank's organisational structure, to the business model, or new legal requirements.

Aareal Bank AG 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 and Opportunities

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

Macro-economic environment

Developments for the economy, as well as for financial and capital markets, are exposed to diverse risks and threats – which also have an impact on the commercial property markets. The economic forecast as at the end of December 2017 was characterised by significant uncertainty, such as geo-political risks, protectionist economic policies, and changing monetary policy.

The low interest rate environment – combined with expected low inflation – continues to be a risk factor in many markets, as it harbours risks for financial stability of a systemic dimension, should it persist for a longer period. Low interest rates can lead to a misallocation of investment capital, possibly resulting in asset-price bubbles. Moreover, market participants are encouraged to take on higher levels of risk. Sudden or excessive changes in interest rates may trigger a revaluation and changes in investor behaviour, potentially leading to a collapse in asset prices. Emerging economies in particular will have to face capital outflows, and may have to raise their own interest rates. Although financial market players are expecting interest rates to rise further in the US, the impact – in parallel with a decline in the Federal Reserve's balance sheet – is as yet unclear. Turmoil in the financial and capital markets may still hurt the global economy. A longer-lasting period of low interest rates complicates an exit from such an environment, heightening the risks for the financial and capital markets. In this context, traditional central bank policy may lose its impact. Low interest rates may also entice a scaling back of reform and consolidation efforts in various sectors.

In the US, we see increased political uncertainty, which might prevent or delay measures to stimulate growth. If this was to materialise, it could tip the economy into recession. Therefore, simultaneous corrections could occur on those financial and capital markets where expectations of such growth stimulus had led to currency or price increases.

A major risk factor in Europe is the impact of the UK’s exit from the EU (Brexit). We continue to see significant economic risks from this – both for the UK and for the EU. Differences about the EU's future orientation might cause further uncertainty; in this context, political uncertainty in Spain also needs to be mentioned. A separation of the Autonomous Community of Catalonia from the Kingdom of Spain might have negative economic consequences, which are as yet difficult to assess. The tense political situation in Turkey is a risk burdening the country's economy.

The sovereign debt crisis might still raise its head again in Europe: the problem of high levels of indebtedness continues to exist. Diverging monetary policy between the US and the euro zone, as well as political reorientation, could also heighten that risk.

In China, there is continued danger that the sharp increase in levels of private debt could lead to a pronounced market correction. Despite a slight easing of price pressure on the residential property market, the danger of a far-reaching market correction still exists.

Economy

Despite the numerous uncertainty factors and burdens, economic momentum – which already prevailed in 2017, driven by strong consumer spending and robust investment – is set to continue this year. The growth rate of real global economic output is expected to slightly exceed the levels seen during 2017. In this context, global trade is expected to grow further – which will especially benefit emerging market economies. Moderate inflation in the industrial countries is likely to provide additional support for purchasing power. Still, developments will differ across the regions. Moreover, risks and uncertainty factors, were they to materialise to a substantial extent, could mute the economic development, or even cause recessive tendencies in certain regions.

We anticipate growth in the euro zone in 2018 to be slightly weaker than in 2017. In line with our projections for the region as a whole, most of the euro zone countries relevant to Aareal Bank should show moderate to good economic development. In this connection, we must assume that growth rates in the Netherlands and in Spain will remain high, albeit short of the previous year's levels. We expect stable and robust growth in Germany and France. The Italian economy is likely to continue its recovery, with growth in line with the previous year.

In 2018, the economic development of the EU as a whole is anticipated to be similar to that of the euro zone countries. For the UK, we expect economic growth in line with last year's levels. Brexit will continue to be a burden. The Polish economy is expected to continue growing strongly, albeit at a slightly weaker rate than in the previous year. Economic growth in Denmark and Sweden is forecast to be markedly weaker than in 2017, but still at a good level.

The Turkish economy is expected to show a significantly lower growth rate than in the previous year. Due to the political situation, the outlook is clouded by a high degree of uncertainty. We expect the economy in Russia to grow at a comparable level than in the previous year.

In the US, economic growth is anticipated to be slightly more dynamic than the year before, thanks to strong exports and high levels of investment, alongside robust consumption. Whilst uncertainty remains concerning the direction of economic policy, the tax reform adopted in December 2017 is nonetheless likely to provide clearly positive impulses. In Canada, we anticipate robust, yet slightly lower growth in real economic output, compared to the previous year.

Following a year influenced by non-recurring effects in China, we expect the trend of slowing real GDP growth rates to continue. Factors influencing economic development in China are the targeted reduction of over-capacity in heavy industry and the transition to an overall lower investment ratio. We are still witnessing uncertainty with regard to the increase of macro-economic debt.

Against a background of a positive economic development, we expect most labour markets across the euro zone as well as in other European countries to register slowly decreasing or virtually stagnating unemployment rates for 2018. The US unemployment rate is also likely to decline slightly.

Financial and capital markets, monetary policy and inflation

The risks and uncertainty factors we have listed so far also apply to the financial and capital markets this year. Likewise, any of the aforementioned risks could, were they to materialise to a substantial extent, cause turbulence on the financial and capital markets. In the current environment, we assume volatility will remain moderate overall. We continue to expect that financial and capital markets will remain receptive towards securities issues and refinancings.

The ECB's decision – taken in the previous year – to expand its asset-buying programme, as well as further measures, underscored our expectation that the very expansive monetary policy pursued in the euro zone would remain intact. In this context, there is a possibility that the ECB will terminate its asset-buying programme in the autumn. In contrast, further interest rate hikes are expected in the US, whilst the Fed will likely continue the reduction of its balance sheet in 2018. Given the prospect of interest rate adjustments, as indicated by the Bank of England, the likelihood of an increase in UK key interest rates during 2018 has risen. Given the UK's exit from the EU and forecast economic developments, any change is expected to be moderate.

The continued normalisation of monetary policy in the US suggests that further gradual interest rate hikes are on the horizon for this year. Although this may place upside pressure on interest levels in the euro zone and other EU countries, European interest rate levels are expected to remain very low during the remainder of the year given the ECB's very loose monetary policy stance.

Euro zone inflation is expected to be roughly in line with the levels seen in 2017 – accordingly, we assume the euro zone inflation rate to remain clearly below 2 % for the full year 2018. The average inflation rate in the US for the full year is anticipated to be slightly higher than in the euro zone, but likely to remain at the previous year's level. In China, inflation is likely to return to a rate just over 2 %.

Regulatory environment

The trend towards a tighter regulatory framework in the banking business is set to persist during the coming years. For instance, the finalisation of the Basel III framework, adopted by the Basel Committee's Group of Governors and Heads of Supervision (GHOS), will bring about extensive changes to the approaches used for determining risk-weighted capital requirements (a concept known as "Basel IV"). Aareal Bank would already fulfil these future requirements, bearing in mind that these have as yet to be transposed into European law.

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). In addition, the Single Supervisory Mechanism (SSM) has developed expectations regarding the structure of ICAAP and ILAAP based on a multi-year plan. These expectations are set to be specified in more detail in 2018.

Furthermore, the Target Review of Internal Models within Pillar 1 has not yet been completed.

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. Moreover, EBA has published guidelines for PD and LGD estimates, and on the treatment of defaulted exposures, which must be implemented by the end of 2020.

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

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

Sector-specific and business developments

Structured Property Financing segment

During the year 2018, commercial property will continue to be a sought-after asset class in many markets. Global transaction volumes are therefore expected to remain high. Given the shortage of available first-class properties on offer, and rising total revenue requirements, investor interest in properties outside the top segment will likely increase compared to previous years. Investor demand is thus expected to continue to support performance this year. Nonetheless, commercial property markets are also exposed to major risks and threats. An excessively sharp interest rate hike – originating from the US – may have a negative effect on performance. Moreover, other uncertainty factors and risks in the macro-economic environment are also relevant for commercial property markets.

Several factors will impact the market value[1] of commercial property during the remainder of the year. Whilst the stable economy and the prevailing low interest rate environment will support property values, political uncertainty and a potentially significant interest rate increase can reduce values. Expansive monetary policy in numerous currency areas supports the upward trend in market values, which has now been intact for a very long time. Still, market cycles have not been invalidated. This means that cyclical downturns are possible as well.

[1] Assessments of individual sub-markets and properties may deviate from the general description of developments on commercial property markets outlined below.

We anticipate a largely stable development in the market values of commercial property in many markets this year.

We expect a stable development of market values in most European countries in 2018, including Italy, the Netherlands, Poland and Sweden. For Germany, France and Spain, we expect slightly positive growth. The situation in the UK is subject to uncertainty because of the Brexit vote. Market values could fall in some sub-markets, although we anticipate a stable development overall. Political unknowns in Turkey lead to uncertainty, which may have a negative impact on the market values of commercial property. We believe property values in Russia will stabilise in the current year due to the slight economic recovery.

In the US, backed by the relatively positive economic outlook, values are expected to show a slightly positive trend. Increasing interest rates pose certain risks for this development. We expect a stable performance in Canada.

In China, market values for commercial property are expected to remain stable.

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

We expect a slightly positive development overall in 2018 on the hotel markets of Europe's most significant economic centres. Looking at occupancy ratios, we see potential for further slight increases in numerous markets, including in Berlin and Paris. Likewise, we expect average revenues per available hotel room to further improve in most markets – in Paris and Madrid, for example. The difficult political situation in Turkey will continue to have negative implications for the hotel markets.

We believe a slight improvement on average in revenues per available room is likely in the US, with stable or slightly lower occupancy ratios. In Canada, we anticipate increases for both indicators – albeit short of the momentum seen in the previous year, which was driven by the 150th anniversary celebrations of the foundation of the Canadian Confederation.

In Asia, we anticipate occupancy ratios and average revenues per available room to remain stable throughout 2018 in the hotel markets of many metropolitan areas.

The intense competition in commercial property financing is also likely to persist in many markets during the current year, so that we assume that lenders will be willing to lower margins. We anticipate a virtually stable development in loan-to-value ratios across the various regions. Banks are expected to continue adhering to their preference for financing first-class properties in top locations. Investors' readiness to finance properties outside top locations will increase.

We have incorporated various market aspects and our "Aareal 2020" programme for the future, amongst other factors, in our assessment of anticipated new business volumes for the current year. For the Structured Property Financing segment, we are targeting new business of between € 7 billion and € 8 billion for the 2018 financial year, whereby the focus is set to remain on the high-margin US market. Aareal Bank Group's property financing portfolio should amount to between € 25 billion and € 28 billion at the end of 2018, subject to currency fluctuations. Within the framework of our "Aareal 2020" programme for the future, syndication is set to be one of the instruments for managing the portfolio, and managing risk. Syndication is a suitable tool here, 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

The German housing and commercial property industries are expected to continue showing solid development in 2018, on the back of stable rents and a high degree of stability in property values.

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

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

The stable development on the residential property market is expected to prevail in 2018. Regional differences are expected to further increase, as a consequence of migration driven by education and labour market factors. Due to the ongoing urbanisation trend, we expect demand for apartments to rise further, especially in economically strong conurbations. Property investors and potential sellers within the housing and commercial property industries should continue to be able to benefit from these market developments.

We see good opportunities during 2018 to acquire new clients and to intensify the business relationships with our existing client base. This also applies to utilities and the waste disposal industry. In addition, in line with our "Aareal 2020" programme for the future, we are investing into the expansion of the "Housing Industry Ecosystem", the cross-sector development of interface products, and the expansion to adjacent ecosystems. We will also examine cooperations with Fintech and Proptech companies.

We expect the volume of deposits taken to remain on a high level. The persistent low interest rate environment, which is relevant for the results from our deposit-taking business, will continue to burden segment results. However, the importance of this business goes way beyond the interest margin generated from the deposits, which is under pressure in the current market environment. This is because the deposits from the housing industry represent a strategically important additional source of funding for Aareal Bank.

Aareon

Aareon will continue in 2018 to pursue the growth strategy based on its strategy programme integrated in the "Aareal 2020" programme for the future. Both sales revenue and Aareon's contribution to consolidated operating profit are expected to rise significantly. Key success factors are the expansion of digital solutions within the Aareon Smart World portfolio, strengthening the ERP business, and growing activities targeting the commercial property markets in the Netherlands and in Germany. Furthermore, the structural organisation in the UK and Sweden are set to be optimised, with a view to more intensively exploiting the inherent potential regarding the existing customer base in these countries.

In Germany, Aareon anticipates higher sales revenues in the ERP business, especially from the acquisition of mse companies and the continued migration of GES customers to Wodis Sigma. Likewise, stronger demand is seen for digital solutions such as Immoblue Pro, Aareon CRM in conjunction with the tenant app, as well as for mobile services.

Sales revenue generated from ERP products in the international business will be slightly above the previous year's levels, whilst they are expected to remain unchanged year-on-year in France, the Netherlands and the UK. Incit Xpand, the solution for the Scandinavian markets, will be a growth driver. Following the acquisition of Kalshoven Groep, effective 1 April 2017, sales revenues are expected to increase in the Netherlands.

Sales revenues from digital solutions will also be significantly up year-on-year in the international business: in the UK, the CRM solution 360° Tenant Portal and a new release of the mobile solution are expected to generate additional demand. In the Netherlands, besides CRM solutions, growth is envisaged in the digital solutions Facilitor (for facility management), Trace & Treasury (for the management of assets), and ShareWorX (for case management). In France, the Building Relationship Management (BRM) and Supplier Relationship Management (SRM) solutions – newly-developed in 2017 – are expected to generate growth.

Based on the explanations outlined above, Aareon envisages a marked overall increase in sales revenue, as well as profits, for 2018. Aareon's contribution to consolidated operating profit is expected to amount to approximately € 40 million.

Business strategy

Aareal Bank Group’s strategy focuses on sustainable business success. With its Group-wide "Aareal 2020" programme for the future, the Bank is addressing the challenges of the future. In an environment characterised by technological change, altered client needs and fiercer competition, this programme allows us to secure our strong foundation while also leveraging new revenue potential. Aareal Bank developed an extensive strategic roadmap for the implementation of Aareal 2020, including various initiatives and projects for the further development of the Group. One of the top priorities is unlocking new revenue potential in both segments; another is to adapt structures and processes to its stakeholders' requirements in a digital world.

Company and Group targets

Key targets of Aareal Bank AG are the preservation of capital and the ability to distribute dividends. These are being taken into account for Group planning purposes, and are also set to be achieved in 2017. No single-entity planning is prepared for Aareal Bank AG. Accordingly, the following statements refer to Group planning in accordance with IFRSs.

We anticipate the challenging business environment to prevail during the current financial year – with continued low interest rates in Europe, and strong competitive and margin pressure on key target markets. Against this background, we will continue to adhere to our business policy with a strict focus on risks and returns. We will further accelerate our strategic development, within the framework of the "Aareal 2020" programme for the future, in order to safeguard the Group's long-term success – in a business environment that is set to remain highly challenging in the future.

We anticipate consolidated net interest income for the full year 2018 between € 570 million and € 610 million, including the net result from the derecognition of financial assets and liabilities not measured at fair value through profit or loss – which will be reported separately, in accordance with IFRS 9, in the future. Allowance for credit losses is expected in a range between € 50 million and € 80 million. Net commission income, whose importance for the Group is continuously rising due to the expansion of business activities in the Consulting / Services segment, is anticipated to rise further, to between € 215 million and € 235 million. Administrative expenses are expected to decline to between € 470 million and € 500 million.

Against this background, we expect consolidated operating profit for the current year to be in a range between € 260 million and € 300 million; this is in line with the previous year's figure, adjusted for the positive non-recurring effect related to Corealcredit. We envisage RoE before taxes of between 9.5 % and 11.0 % for the current financial year, with earnings per share between € 2.60 and € 3.00. We affirm our medium-term target RoE of around 12 % before taxes.

We will continue the reduction of non-strategic portfolios in the Structured Property Financing segment during 2018. At the same time, our core credit portfolio is planned to grow in line with respective market conditions: overall, subject to exchange rate fluctuations, the aggregate credit portfolio is expected to remain stable year-on-year, in a range between € 25 billion and € 28 billion. We are targeting new business between € 7 billion and € 8 billion for the current year, with a continued focus on the high-margin US market. In the Consulting/Services segment, we expect our IT subsidiary Aareon to provide a markedly higher contribution of approximately € 40 million to consolidated operating profit.

Subject to further regulatory changes, Aareal Bank considers a target CET1 ratio (post-finalisation of Basel III – so-called "Basel IV") of around 12.5 % to be appropriate. The Liquidity Coverage Ratio (LCR) is expected to be at least 150 %.

Corporate Governance Statement

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

The full Corporate Governance Statement pursuant to sections 289f of the HGB is publicly available on the Company's website (www.aareal-bank.com/en/about-us/corporate-governance/).

Non-Financial Report

The German Act implementing the CRS Directive has transposed the EU CSR Directive (2014/95/EU) into national law. With effect from 1 January 2017, Aareal Bank AG is obliged to report on material non-financial aspects (environmental, employee and social matters, respect for human rights and anti-corruption matters), to the extent necessary for an understanding of the Company's development, performance, position and impact of its activity.

The required disclosure is published not later than four months after the reporting date, within the scope of a separate non-financial report, in accordance with section 289b (3) of the HGB, on the Company's website (www.aareal-bank.com/en/responsibility/reporting-on-our-progress/).

Principles of remuneration of members of the Management Board and the Supervisory Board

The Supervisory Board determines the remuneration system, and the amount of remuneration for members of Aareal Bank AG's 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. It held eight meetings throughout the 2017 financial year. The Supervisory Board of Aareal Bank AG discussed remuneration issues at five meetings during the 2017 financial year.

The Supervisory Board defines – 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' target achievement and performance after the end of every financial year.

Members of the Management Board receive a fixed basic annual salary, a performance-related variable remuneration, as well as ancillary benefits. The Supervisory Board introduced a reduced entry-level remuneration for new members appointed to the Management Board. The majority of performance-related, variable remuneration is determined on the basis of a multiple-year assessment basis.

The amount of performance-related remuneration for Management Board members depends upon the individual Board member's performance, the performance of the division the respective member is responsible for, as well as the overall performance of Aareal Bank Group. The targets which are related to Aareal Bank Group's overall performance include annual targets and multiple-year targets. The measurement of the multiple-year target is undertaken retrospectively over a time period of three years. Annual and multiple-year targets are weighted using a ratio of 45 % (annual target) to 55 % (multiple-year target); within the annual target, individual, divisional, and Bank targets are weighted equally.

For each financial year, the Supervisory Board sets a target level for the Common Equity Tier 1 ratio (CET1 ratio) as the measurement threshold in order to secure adherence of the regulatory capital adequacy and a suitable liquidity measure (Liquidity Coverage Ratio – LCR). No variable remuneration will be determined for any financial year where any of these two targets has not been achieved.

All targets for Management Board members 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. 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). Any negative deviations from targets will reduce performance-related remuneration. 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 Supervisory Board is entitled to increase or decrease the overall target achievement level by up to 20 %, applying reasonable discretion, in the event of any material, specified external or internal non-recurring effects, provided that the upper limit of 150 % for overall target achievement must not be exceeded. 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 in 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, the initial value for variable remuneration – as determined according to the principles set out above – is awarded at the end of the financial year, according to the following principles:

20 % of the variable remuneration is 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 cash – pro rata temporis – over a defined retention 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 performance-related remuneration that is deferred initially as a cash deferral or a share deferral, the Supervisory Board makes a decision regarding the granting of one third of the amount, as well as the associated interest, in the three years following the determination of the performance-related remuneration (retention period). Starting with performance-related remuneration for the 2018 financial year, the retention period will be extended to five years. 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 virtual shares, subject to a two-year (starting with variable remuneration for the 2018 financial year: one-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 the division he/she is responsible for, as well as any weakness in the performance of Aareal Bank Group (ex-post risk adjustment). A negative individual performance contribution is deemed to be present, for example, in the event of breaches of the Code of Conduct and/or of Compliance guidelines, conduct that damages the Bank's reputation, or in the event of other misconduct which would justify a termination for good cause. Ex-post risk adjustment also involves a retrospective review as to whether the performance contributions assumed at the time of determining the initial value of performance-related remuneration are proven to be sustainable (backtesting). The Supervisory Board decides upon any adjustments to variable remuneration, according to its own best judgment, based on a recommendation by the Remuneration Control Committee. If any retained performance-related remuneration components are not awarded, or only in part, the remaining sum is forfeited, i.e. it is not carried forward into subsequent years. Moreover, 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.

Starting with variable remuneration for the 2018 financial year, agreements with Management Board members must ensure that any variable remuneration already disbursed may be reclaimed in certain cases of negative performance contribution (a “clawback”). Aareal Bank has already reached corresponding agreements with members of the Management Board, which will initially apply to variable remuneration for the 2018 financial year.

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 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 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 by the Management Board in Accordance with Section 289 (1) of the German Commercial Code (Handelsgesetzbuch – "HGB")

Composition of subscribed capital

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

Restrictions affecting voting rights or the transfer of shares

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

Shareholdings exceeding 10 % of voting rights

Details regarding any shareholdings exceeding 10 % of voting rights are provided in the Notes to the 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 31 May 2017 resolved to authorise the Management Board to increase, on one or more occasions, the Company’s share capital, subject to the approval of the Supervisory Board, by up to a maximum total amount of € 89,785,830 by issuance of new shares for contribution in cash or in kind; the Management Board is also authorised, within defined limits, to disapply pre-emptive rights, given the fulfilment of certain conditions. This authorisation will expire on 30 May 2022. When exercising this authorisation, the Management Board will restrict the exclusion of shareholders' pre-emptive rights to a total of 20 % of the Company's share capital – including treasury shares and any shares issued during the term of this authorisation, under the authorisation under agenda item no. 6 of the Annual General Meeting held on 21 May 2014. The authorised capital has not been utilised to date.

Conditional capital

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

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

Authorisation to purchase or use treasury shares

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

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

Subject to the approval of the Supervisory Board, the shares acquired under this or an earlier authorisation may be sold outside stock exchanges and without an offer to all shareholders, thereby excluding shareholders’ pre-emptive rights, provided that the shares sold do not exceed the threshold value of 10 % of the Company’s share capital and that the issue price is not significantly lower than the stock exchange price, or if the sale of such shares is made against contribution in kind, or if the shares are given to the holders of conversion or option rights, even if they had been issued by subsidiaries. The treasury shares may also be given to the holders of conversion or option rights in lieu of new shares from a contingent capital increase. The shares can also be withdrawn, without 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. In addition, any acquisition of shares shall count towards the 10 % threshold for the authorisation for the acquisition of treasury shares. Where treasury shares are acquired using equity derivatives, the shareholders' right to enter into any option transactions with the Company is excluded in analogous application of section 186 (3) sentence 4 of the AktG.

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

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

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

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

Annual Financial Statements

Income Statement of Aareal Bank AG
for the period from 1 January to 31 December 2017

€ mn			2017		2016
Expenses					
Interest expenses			**724.7**		714.2
including positive interest from lending and money-market transactions -7.5 (2016: -2.8)					
Commission expenses			**26.5**		16.8
General administrative expenses					
a) Staff expenses					
aa) Wages and salaries	110.5			121.9	
ab) Social security contributions, pensions and other employee benefits	23.9	134.4		16.2	
including for pensions 11.3 (2016: 3.7)					
b) Other administrative expenses		146.5	**280.9**	154.4	292.5
Amortisation, depreciation and write-downs of intangible and tangible fixed assets			**4.3**		4.0
Other operating expenses			**17.2**		40.5
Write-downs and valuation allowances of loans and advances and specific securities, as well as additions to loan loss provisions			**274.4**		86.1
Expenses for assumption of losses			**19.0**		87.5
Extraordinary expenses			**19.0**		-
Income taxes			**-21.1**		53.1
Other taxes not reported under other operating expenses			**1.0**		0.1
Net income			**147.1**		121.7
Total expenses			**1,493.0**		**1,416.5**
Net income			**147.1**		121.7
Profit carried forward from the previous year			**2.5**		0.5
Net retained profit			**149.6**		**122.2**

€ mn			2017		2016
Income					
Interest income from					
a) Lending and money market transactions	915.5			946.4	
including negative interest from lending and money-market transactions -11.9 (2016: -13.2)					
b) Fixed-income securities and debt register claims	241.7		**1,157.2**	256.2	1,202.6
Current income from					
a) Equities and other non-fixed-income securities	-			-	
b) Participating interests	0.1			-	
c) Interests in affiliated companies	-		**0.1**	70.0	70.0
Income from profit pools, profit transfer agreements or partial profit transfer agreements			**36.6**		14.1
Commission income			**34.0**		25.3
Income from write-ups on equity investments, interests in affiliated companies, and securities held as fixed assets			**1.3**		78.4
Other operating income			**56.9**		26.1
Income from amounts released from the fund for general banking risks			**123.2**		-
Extraordinary income			**83.7**		-
Total income			**1,493.0**		**1,416.5**

Balance Sheet of Aareal Bank AG as at 31 December 2017

€ mn			2017		2016
Assets					
Cash funds					
a) Cash on hand		0.0		0.0	
b) Balances with central banks		2,080.6	**2,080.6**	1,785.5	1,785.5
including: with Deutsche Bundesbank 2,076.8 (2016: 1,778.8)					
Loans and advances to banks					
a) Loans secured by charges on real property		5.6		6.2	
b) Loans to local authorities		57.3		15.0	
c) Other loans and advances		866.9	**929.8**	2,418.5	2,439.7
including: payable on demand 564.5 (2016: 1,355.5)					
collateralised by pledged securities - (2016: -)					
Loans and advances to customers					
a) Loans secured by charges on real property		21,631.4		21,520.3	
b) Loans to local authorities		1,500.7		1,107.6	
c) Other loans and advances		3,459.1	**26,591.2**	3,368.6	25,996.5
including: collateralised by pledged securities - (2016: -)					
Debt and other fixed-income securities					
a) Money market instruments		-		-	
b) Bonds and notes					
ba) Public-sector issuers	6,768.9			6,223.5	
including: with Deutsche Bundesbank 6,485.8 (2016: 5,900.8)					
bb) Other issuers	564.9	7,333.8		868.1	
including: with Deutsche Bundesbank 564.9 (2016: 868.1)					
c) Own bonds		463.7	**7,797.5**	504.2	7,595.8
Nominal amount: 462.0 (2016: 502.0)					
Equities and other non-fixed-income securities			**101.2**		101.3
Participating interests			**7.1**		0.6
including: interests in banks - (2016: -)					
interests in financial services providers - (2016: -)					
Interests in affiliated companies			**997.0**		1,385.0
including: interests in banks 9.4 (2016: 9.1)					
interests in financial services providers - (2016: -)					
Trust assets			**19.5**		23.4
including: trustee loans 17.9 (2016: 21.9)					
Intangible assets					
a) Internally generated industrial property rights and similar rights and assets		-		-	
b) Purchased concessions, industrial property rights and similar rights and assets, as well as licences in such rights and assets		2.3		2.7	
c) Goodwill		-		-	
d) Advance payments made		-	**2.3**	-	2.7
Tangible fixed assets			**14.5**		14.9
Other assets			**573.6**		446.9
Prepaid expenses					
a) From new issues and lending		180.8		175.2	
b) Other		48.8	**229.6**	64.2	239.4
Deferred tax assets			**279.8**		255.8
Total assets			**39,623.7**		**40,287.5**

€ mn			2017		2016
Equity and liabilities					
Liabilities to banks					
a) Outstanding registered mortgage Pfandbriefe		551.7		392.9	
b) Outstanding registered public sector Pfandbriefe		58.4		25.4	
c) Other liabilities		1,416.9	**2,027.0**	1,316.3	1,734.6
including: payable on demand 997.3 (2016: 799.9)					
Liabilities to customers					
a) Outstanding registered mortgage Pfandbriefe		4,636.1		2,841.5	
b) Outstanding registered public sector Pfandbriefe		2,008.3		1,984.3	
c) Savings deposits		-		-	
d) Other liabilities		18,828.2	**25,472.6**	19,728.0	24,553.8
including: payable on demand 7,954.7 (2016: 7,300.1)					
Certificated liabilities					
a) Bonds issued					
aa) Mortgage bonds	5,695.0			6,088.8	
ab) Public sector Pfandbriefe	45.0			45.0	
ac) Other debt securities	2,390.0	8,130.0		2,685.3	
b) Other certificated liabilities		-	**8,130.0**	-	8,819.1
including: money market instruments - (2016: -)					
Trust liabilities			**19.5**		23.4
including: trustee loans 17.9 (2016: 21.9)					
Other liabilities			**67.3**		927.0
Deferred income					
a) From new issues and lending		79.0		83.5	
b) Other		51.9	**130.9**	52.4	135.9
Deferred tax liabilities			**2.8**		23.8
Provisions					
a) Provisions for pensions and similar obligations		169.5		164.5	
b) Tax provisions		14.3		23.7	
c) Other provisions		121.4	**305.2**	129.6	317.8
Subordinated liabilities			**1,001.8**		1,275.8
including: maturing within two years 80.5 (2016: 43.5)					
Profit-participation certificates			**11.7**		48.8
including: maturing within two years 11.0 (2016: 46.0)					
Additional Tier 1 capital instruments			**315.4**		315.4
Fund for general banking risks			**167.6**		167.6
Equity					
a) Subscribed capital		179.6		179.6	
Contributions by silent partners		190.2		190.2	
b) Capital reserve		727.8		727.8	
c) Retained earnings					
ca) Legal reserve	4.5			4.5	
cb) Reserve for shares in a parent or majority investor	-			-	
cc) Statutory reserves	-			-	
cd) Other retained earnings	720.2	724.7		720.2	
d) Net retained profit		149.6	**1,971.9**	122.2	1,944.5
Total equity and liabilities			**39,623.7**		**40,287.5**

€ mn		2017		2016
Contingent liabilities				
a) Contingent liabilities from discounted forwarded bills	-		-	
b) Liabilities from guarantees and indemnity agreements	73.2		64.3	
c) Liability from the pledging of collateral for third-party liabilities	-	**73.2**	-	64.3
Other commitments				
a) Repurchase obligations from securities repurchase agreements	-		-	
b) Placement and underwriting obligations	-		-	
c) Irrevocable loan commitments	1,663.8	**1,663.8**	4,786.3	4,786.3

Notes

Basis of Accounting

Aareal Bank AG is a public limited company incorporated under German law, with its registered office in Wiesbaden, Germany, and the parent company of the Aareal Bank Group. It also prepares the consolidated financial statements majority of consolidated companies within the Group.

Aareal Bank AG prepared the present financial statements for the financial year ended on 31 December 2017 in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – "HGB"), the supplementary regulations of the German Public Limited Companies Act (Aktiengesetz – "AktG"), the German Accounting Directive for Banks and Financial Services Providers (Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute – "RechKredV") and the German Pfandbrief Act (Pfandbriefgesetz – "PfandBG"), as applicable at the reporting date. The reporting currency is the euro (€).

The financial statements were released for publication by the Management Board on 1 March 2018, and have been deposited with the Register of Companies at the Wiesbaden District Court (Amtsgericht, HRB 13 184). They are also available from Aareal Bank AG in Wiesbaden, Germany.
The consolidated financial statements are available from Aareal Bank AG in Wiesbaden, Germany.

Accounting and Valuation Principles

Cash funds

Cash funds include cash on hand and balances with central banks. Cash funds are accounted for at the notional amount.

Loans and advances

Loans and advances to banks and customers are carried at amortised cost, including deferred interest. Premiums and discounts are shown under deferred items, in accordance with section 340e (2) of the HGB. Credit risks are accounted for by setting aside provisions in the amount of the expected loss, using prudent estimates. In the year under review, this methodology was developed further for both specific and portfolio-based valuation allowances, since more detailed information was available. The proceeds from realisation are no longer determined on the basis of the most likely amount, but on the basis of the expected value of various possible scenarios. The portfolio-based 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) and probability of default (PD). With regard to exposures that were subject to a significant increase in default risk since the grant date, lifetime expected losses are recorded rather than the 12-month expected loss. The changes led to an effect of € 23.6 million recorded in the income statement item "Write-downs and valuation allowances of loans and advances and specific securities, as well as additions to loan loss provisions".

Securities

Bonds and other fixed-income securities, as well as equities and other non-fixed income securities, are measured strictly at the lower of cost or market value, as prescribed for current assets (strenges Niederstwertprinzip). Aareal Bank AG's current assets presently are composed exclusively of securities of the liquidity reserve. Bonds and other fixed-income securities that are intended to be held permanently, are carried at the lower of cost or market value; the carrying amount needs to be written down to the lower market value only if the impairment is permanent (gemildertes Niederstwertprinzip). Where the reasons for the write-down no longer apply, write-ups are made in accordance with section 253 (5) of the HGB.

Participating interests, interests in affiliated companies, intangible assets and tangible assets

Participating interests and interests in affiliated companies are stated at cost. Tangible assets and purchased intangible assets are stated at cost less depreciation/amortisation. Write-downs are required in the event of impairments in value deemed to be other than temporary.

Office furniture and equipment items are depreciated using the straight-line method, applying the following depreciation periods:

	Depreciation period
IT equipment	3 to 5 years
Other office furniture and equipment	5 to 13 years
Vehicle fleet	6 years
Tenant’s improvements	10 years

Intangible assets comprise purchased software, which is amortised over a useful life of three to five years. The option to capitalise internally generated intangible assets pursuant to section 248 (2) of the HGB was not exercised.

Where the reasons for the write-down no longer apply, write-ups are recognised for participating interests, interests in affiliated companies, intangible assets and tangible assets in accordance with section 253 (5) of the HGB. To the extent that land and buildings were acquired to salvage loans, and have been in the possession of the Bank for more than five years, these are reported under tangible fixed assets. Additions of low-value commercial goods ("geringwertige Wirtschaftsgüter") of not more than € 150 are fully written off in the year of acquisition, and accounted for as disposals. In addition, Aareal Bank AG made use of the simplification rule pursuant to section 6 (2a) of the German Income Tax Act (Einkommensteuergesetz – "EStG").

The option to disclose a net amount, pursuant to section 340c (2) of the HGB has been exercised.

Trust assets and trust liabilities

These balance sheet items include assets and liabilities that the Bank holds on its own behalf, but for the account of third parties. These items are measured at amortised cost.

Other assets

Other assets are reported at nominal amount. In case of reduced recoverability, impairment losses down to the expected value are recorded pursuant to section 253 (4) of the HGB.

Deferred taxes

If there are differences between the book value of assets, liabilities, deferred income and prepaid expenses and their related tax bases which are expected to be reversed in later financial years, any resulting net tax burden is recognised as a deferred tax liability and any resulting net tax benefit is recognised as a deferred tax asset, in accordance with section 274 of the HGB. Tax loss carry-forwards are taken into account in the calculation of deferred tax assets, based on the level of the potential losses to be offset within the next five years. Deferred taxes are measured using the company- and country-specific tax rates expected to apply at the time of the realisation of temporary differences and the offsetting of loss carryforwards. The Bank discloses deferred taxes on a gross basis, in accordance with section 274 (1) sentence 3 of the HGB.

Liabilities

Liabilities are shown on the balance sheet at the settlement amount. The difference between the settlement amount and the lower initial book value of liabilities is recognised under deferred items, and amortised over the term of the liability.

Provisions

Provisions are recognised in the amount of the required settlement amount, as determined based on prudent commercial judgement. Pursuant to section 253 (2) sentence 1 of the HGB, provisions with a remaining term of more than one year have to be discounted using the average market interest rate applicable for their remaining term; the average market interest rate for provisions for retirement benefit obligations is based on the rates of the past ten years, whilst that for other provisions is based on the rates of the past seven years.

Provisions for pensions and similar obligations are determined based on actuarial principles. Provisions for pensions are recognised at the settlement amount taking into account future wage, salary and pension trends and applying the average market interest rate applicable for an assumed remaining term of 15 years as disclosed by Deutsche Bundesbank, except where the applicable remaining term of the respective pension plan is shorter. In accordance with section 240 (2) of the HGB, pension obligations are generally determined based on inventory records established as at the balance sheet date. Pursuant to section 241 (3) of the HGB, the relevant group of eligible persons may also be recorded as at a date within the last three months prior to, or within the first two months after the balance sheet date, provided that the pension obligations may be measured properly as at the balance sheet date. This is ensured by using forecast interest rates. Reference is made to the Notes to the balance sheet. Provisions for taxes and other provisions have been set aside for existing legal or constructive obligations in the settlement amount, as required by prudent commercial judgement.

Currency translation

Currency translation complies with the principles set out in sections 256a and 340h of the HGB.

Assets and liabilities denominated in foreign currency or forward foreign exchange transactions are classified as specific cover and are measured at the middle spot rate (ECB reference middle rate) on the balance sheet date. Income and expenses from currency translations are recognised through profit or loss under other operating income and expenses.

The Bank decomposes foreign exchange forward transactions which are used to hedge interest-bearing balance sheet items into an agreed spot base and the swap rate, recognising a deferred asset or liability equivalent to the net aggregate difference between the spot base and the same currency’s exchange rates prevailing on the reporting date. Forward premiums or discounts are amortised in net interest income over the term of the transaction.

Trading portfolio

The Bank held no financial instruments for trading as at the balance sheet date.

Hedging relationships

The Bank establishes hedging relationships within the meaning of section 254 of the HGB. Accordingly, fixed-income securities of the liquidity reserve in the amount of € 3,909.0 million (2016: € 4,247.9 million) are hedged against changes in value attributable to interest rate risk, on the basis of so-called "micro hedges". In this context, the underlying transaction and the hedge generally are acquired within the framework of so-called "asset swap packages", i.e. they are so-called "perfect hedges" where all value-affecting factors between the hedged portion of the underlying transaction substantially correspond to the hedging portion of the hedge. The prospective effectiveness of the hedging relationship, which refers to the period until the security's final maturity, is proven, based on the so-called "Critical Terms Match Method". Regression and correlation coefficients are used as criteria to measure retrospective effectiveness.

This is presented in the financial statements using the so-called "Net Hedge Presentation Method" (Einfrierungsmethode). Under this method, the cumulative change in the value of the underlying transaction is determined on the basis of the hedged risk, and compared to the changes in the value of the hedge. The hedged risk amounts to € 355.2 million (2016: € 518.0 million) and corresponds to the cumulative increase of the fair value of assets since inception of the hedging relationship. This net increase is not shown in the income statement on a net basis, after including hedge transactions. Any previously existing ineffectiveness based on the hedged risk is reflected in a provision for hedging relationships. The changes in value attributable to the hedged risk are reflected on a portfolio basis, in the form of a write-down on the security concerned.

The Bank continues to establish hedging relationships between repurchased own bonds in a nominal amount of € 463.7 million (2016: € 504.2 million) and the corresponding securitised liabilities.

Fair value measurement of interest rate instruments of the banking book

In addition, the Bank uses derivative financial instruments of the banking book (non-trading book), above all interest rate swaps, for the purpose of controlling interest rate risk (interest spread risk) as part of the overall management of the Bank. In accordance with HGB, these instruments represent "pending transactions" which are not recognised in the balance sheet. They form a "hedging relationship", together with the recognised interest-bearing assets and liabilities of the banking book. In accordance with IDW RS BFA 3, this hedging relationship has to be reviewed as to whether losses are anticipated, taking into account expected expenses required for funding, risk management and administration in relation to managing the banking book. Currently, the Bank has two equally suitable methods available to determine provisions for anticipated losses: the P&L based approach referring to certain time periods, and the (static) present value method. The Bank uses the present value method. Under this method, a provision has to be recognised when the book value of the banking book exceeds the present value of the banking book, i.e. if there are net unrealised losses in the banking book. The present value is derived from the cash flows of the financial instruments included in the banking book, discounted to the balance sheet date. Potential future risk costs are considered by adjusting the applicable interest rate used for the discounting of cash flows. The administrative expenses relating to the banking book are derived from cost accounting and deducted on a lump-sum basis. No provision for anticipated losses had been recognised as at the balance sheet date, since the present value of the banking book is higher than the book value as at 31 December 2017.

Derivatives

Derivative financial instruments are considered pending transactions, and are therefore generally not recorded in the balance sheet.

Exchange-traded derivatives are measured at their quoted market price. The market price of over-the-counter (OTC) derivatives is determined using standard valuation models commonly accepted in the financial industry, such as the present value technique and option pricing models. The fair value of foreign exchange forwards is generally based on current forward exchange rates.

Acquired as well as issued structured products are generally accounted for as groups of uniform assets and liabilities in accordance with IDW RS HFA 22.

Interest income and expense

Negative interest from financial assets and positive interest from financial liabilities are disclosed separately under interest income and expenses as a ‘thereof’ position. These assets and liabilities are deposits as well as money market and securities repurchase transactions.

Acquisition of the split-off banking operations of the former Westdeutsche ImmobilienBank AG

In the course of the 2017 financial year, the split-off banking operations of former Westdeutsche ImmobilienBank AG were merged into Aareal Bank AG, with effect from 2 January 2017. The income statement includes the income and expenses of the split-off banking operations of former Westdeutsche ImmobilienBank AG as from 2 January 2017. The previous year's figures do not include income and expenses or assets and liabilities from former Westdeutsche ImmobilienBank AG’s banking operations; therefore, the respective financial statements and indicators for the financial position and financial performance of Aareal Bank AG for the financial years 2016 and 2017 are comparable only to a limited degree.

The assets and liabilities of the split-off banking operations of the former Westdeutsche ImmobilienBank AG were recognised at cost within the meaning of section 253 (1) of the HGB, determined using the book values reported in the closing balance sheet of the transferring legal entity in accordance with section 24 of the German Transformation Act (Umwandlungsgesetz – "UmwG"). The profit resulting from the difference between the book value of the absorbed shares and the book value of the acquired net assets (€76.9 million) is recognised as extraordinary income. In addition, the fund for general banking risks of the former Westdeutsche ImmobilienBank AG in the amount of € 123.2 million was released.

The assumption of the split-off banking operations resulted in an increase of total assets of Aareal Bank AG as at the split-off date by approx. € 5.4 billion. The major effects from the assumption of the split-off banking operations were an increase in loans and advances to customers and banks (€ 4.0 billion and € 0.3 billion, respectively) as well as the balance of debt and other fixed-income securities (€ 1.0 billion). On the equity and liabilities side of the balance sheet, liabilities to banks and customers increased (by € 1.1 billion and € 3.5 billion, respectively), while certificated liabilities were up by € 0.2 billion.

After the split-off of the banking operations, Westdeutsche ImmobilienBank AG has been operating under the name “Westdeutsche Immobilien Servicing AG”. The main business activity is the provision of credit services for Aareal Bank Group. Its banking licence has lapsed.

Previously, GEV GmbH was merged into Aareal Bank AG using the established book values within the meaning of section 24 of the UmwG. This mainly involved acquiring shares in the former Westdeutsche ImmobilienBank AG (€ 337.0 million), resulting in a merger gain of € 6.8 million which is reported under extraordinary income.

Notes to the Income Statement

Income by geographical segment

The aggregate of (i) interest income, (ii) current income on equities and other non-fixed income securities, and on participating interests and interests in affiliated companies, (iii) commission income and (iv) other operating income is broken down by the following regions, in accordance with section 34 of the RechKredV.

€ mn	2017	2016
Germany	514.6	469.8
Europe / America / Asia	733.6	854.2
Total	**1,248.2**	**1,324.0**

Administration and intermediation services rendered to third parties

Administration and intermediation services rendered to third parties concerned the administration and intermediation of loans and trust assets.

Other operating income and expenses

Other operating income totals € 56.9 million (2016: € 26.1 million), and comprises gains from currency translation in the amount of € 4.6 million (2016: losses of € 16.2 million) as well as income from the reversal of provisions in the amount of € 22.4 million (2016: € 13.7 million).

Other operating expenses total € 17.2 million (2016: € 40.5 million), and include expenses for subsidiaries in the amount of € 6.8 million (2016: € 1.1 million). In addition, the item includes expenses in the amount of € 8.1 million (2016: € 8.7 million) from unwinding of discounts, after offsetting with income from plan assets used for pension obligations pursuant to section 246 (2) sentence 2 of the HGB.

Extraordinary income and expenses

In connection with the split-off of the banking operations of Westdeutsche ImmobilienBank AG to Aareal Bank AG, extraordinary income is reported in the amount of € 76.9 million. There was also a gain of € 6.8 million arising from the merger of a subsidiary with Aareal Bank AG which is reported under extraordinary income.

Extraordinary expenses include € 19.0 million in expenses from the optimisation of processes and structures within the scope of the "Aareal 2020" programme for the future.

In the previous year, there was no extraordinary income or expenses.

Net income taxes

The net income tax position amounts to an income of € 21.1 million (2016: expense of € 53.1 million), of which expenses of € 21.8 million (2016: € 1.8 million) included in current taxes were payable in Germany: this figure comprises € 9.1 million (2016: € 19.1 million) in corporation tax and solidarity surcharge and € 14.1 million (2016: € 19.6 million) in trade tax payable for the current year, as well as € 1.4 million in tax income for previous years. The net income tax position also includes € 37.3 million (2016: € 14.2 million) in income from the increase of German deferred tax assets as well as € 5.6 million (2016: € 37.1 million) in income from the Bank's foreign branch offices.

The tax reconciliation is used to determine why the tax expense (current taxes and deferred taxes) reported in the income statement differs from the expense calculated using the expected tax rate. The expected tax rate of 31.7 % (2016: 31.7 %), including a weighted trade tax rate of assessment of 453 %, comprises trade taxes (15.9 %), corporation taxes (15.0 %) and the solidarity surcharge (0.825 %; 5.5 % of corporation tax).

€ mn	31 Dec 2017	31 Dec 2016
Income before income taxes	126.0	174.8
Expected income tax expenses; tax rate: 31.7 % (2016: 31.7 %)	39.9	55.4
Reconciliation		
Different foreign tax burden	12.3	-4.1
Tax attributable to tax-exempt income	-85.2	-44.6
Tax attributable to non-deductible expenses	15.6	22.8
Remeasurement of deferred taxes	0.0	24.5
Prior-period actual taxes	-3.6	2.8
Effect of changes in tax rates	0.0	-2.0
Other tax effects	-0.2	-1.7
Reported income tax expenses	-21.1	53.1
Effective tax rate (%)	-16.8	30.4

Prohibition of distribution

A total amount of € 283.3 million (2016: € 235.0 million) in profits is subject to a prohibition of distribution, pursuant to section 268 (8) of the HGB, of which € 277.0 million (2016: € 232.0 million) is attributable to the balance resulting from recognised deferred tax assets and recognised deferred tax liabilities. A prohibition of distribution applies to a net amount of € 6.3 million (2016: € 3.0 million) (after fair-value netting of assets), pursuant to section 246 (2) sentence 2 of the HGB.

In addition, a prohibition of distribution applies to an amount of € 34.6 million (2016: € 27.8 million) pursuant to section 253 (6) sentence 1 of the HGB regarding the difference between (a) the amount to be recognised for provisions for pensions according to the average market interest rate of the previous ten business years and (b) the amount to be recognised for provisions for pensions according to the average market interest rate of the previous seven business years.

The prohibition of distribution totalled € 317.9 million (2016: € 262.8 million) during the year under review pursuant to HGB regulations.

Notes to the Balance Sheet

Securities negotiable at a stock exchange

The following table is a breakdown of securities negotiable at a stock exchange included in the balance sheet line items, including accrued interest.

€ mn	Listed 31 Dec 2017	Unlisted 31 Dec 2017	Listed 31 Dec 2016	Unlisted 31 Dec 2016
Debt securities and other fixed-income securities	7,797.5	0.0	7,595.8	0.0
Equities and other non-fixed-income securities	0.0	0.0	0.0	0.0
Participating interests	-	-	-	-
Interests in affiliated companies	0.0	304.9	0.0	290.9

Hedging relationships as defined by section 254 of the HGB have been created with respect to negotiable securities in an aggregate amount of € 4,372.7 million (2016: € 4,752.1 million).

Bonds and notes of € 7,797.5 million (2016: € 7,595.8 million) (including accrued interest) reported under debt and other fixed-income securities include € 328.8 million (2016: € 368.4 million) in securities which are not eligible as collateral with Deutsche Bundesbank. Of that amount, € 111.9 million (2016: € 113.5 million) relate to sovereign foreign-currency bonds, which are eligible for securities lending.

The total amount of securities negotiable at a stock exchange reported in the balance sheet item “Interests in affiliated companies“ consists of interests in Aareon AG, Aareal Beteiligungen AG, Aareal First Financial Solutions AG, Westdeutsche Immobilien Servicing AG, SoftS IT Solutions AG and Deutsche Bau- und Grundstücks-Aktiengesellschaft.

Investment fund units

The following table is an analysis of investment fund assets, where more than 10 % of the fund units are held.

€ mn	Book value 31 Dec 2017	Market value 31 Dec 2017	Book value 31 Dec 2016	Market value 31 Dec 2016
DBB INKA	101.2	101.2	101.3	101.3
Aareal Altersvorsorge BV 97	48.9	48.9	43.1	43.1
Total	**150.1**	**150.1**	**144.4**	**144.4**

DBB INKA is an investment fund as defined under German law (Sondervermögen) which invests in assets permitted under the German Investment Act (Investmentgesetz – "InvG"), observing the principle of risk diversification.

Aareal Altersvorsorge BV 97 is an investment fund as defined under German law (Sondervermögen), which invests in assets permitted under the fund’s investment policy, observing the principle of risk diversification. This investment fund is protected from access by all creditors, and is only intended to settle liabilities from retirement benefit obligations vis-à-vis employees.

The value of investment fund units as defined by sections 168 and 278 of the German Capital Investment Act (Kapitalanlagegesetzbuch – "KAGB") was € 150.1 million (2016: € 144.4 million). During the financial year under review, no distributions were made under the fund.

Subordinated assets

The following items comprise subordinated assets in the amount shown:

€ mn	31 Dec 2017	31 Dec 2016
Loans and advances to banks	-	-
Loans and advances to customers	-	5.4
Debt and other fixed-income securities	-	-
Equities and other non-fixed-income securities	-	-
Other assets	-	-

Movements in fixed assets

The changes in fixed assets are presented in the fixed assets development schedule shown below.

The values shown for debt and other fixed-income securities include additions and disposals, as well as changes in inventory due to the amortisation of premiums and discounts (excluding accrued interest).

					Tangible fixed assets	
€ mn	Debt and other fixed-income securities	Participating interests	Interests in affiliated companies	Intangible assets	Office furniture and equipment	Land and buildings
Cost						
As at 1 Jan 2017	**2,817.9**	**1.7**	**1,411.0**	**40.2**	**41.7**	**0.1**
Additions						
Merger/split	0.0	0.0	12.1	0.0	0.0	0.0
Additions	375.9	6.5	311.7	0.7	2.9	0.0
Disposals	473.4	0.0	710.9	0.0	5.7	0.0
Changes in inventory/ transfers	0.0	0.0	0.0	0.0	0.0	0.0
As at 31 Dec 2017	**2,720.4**	**8.2**	**1,023.9**	**40.9**	**38.9**	**0.1**
Depreciation, amortisation and write-downs						
As at 1 Jan 2017	**0.0**	**1.1**	**25.9**	**37.5**	**26.9**	**0.0**
Additions[1)]						
Merger/split	0.0	0.0	0.0	0.0	0.0	0.0
Depreciation and amortisation	0.0	0.0	0.0	1.1	3.2	0.0
Write-downs	0.0	0.0	1.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	5.6	0.0
Transfers	0.0	0.0	0.0	0.0	0.0	0.0
Write-ups	0.0	0.0	0.0	0.0	0.0	0.0
As at 31 Dec 2017	**0.0**	**1.1**	**26.9**	**38.6**	**24.5**	**0.0**
Book value as at 31 Dec 2017	**2,720.4**	**7.1**	**997.0**	**2.3**	**14.4**	**0.1**
Book value as at 31 Dec 2016	**2,817.9**	**0.6**	**1,385.1**	**2.7**	**14.8**	**0.1**

[1)] This item includes cumulative historical depreciation recognised in the event of acquiring fixed assets in the case of transformations in accordance with section 24 of the German Transformation Act (Umwandlungsgesetz – "UmwG"), applying unchanged carrying amounts.

The assets of the split-off banking operations of former Westdeutsche ImmobilienBank AG are recognised at cost within the meaning of section 253 (1) of the HGB, determined using the book values reported in the closing balance sheet of the transferring legal entity in accordance with section 24 of the UmwG. The same applies to the assets of Aareal Finanz und IT Beteiligungen GmbH in connection with the merger into Aareal Bank AG. The original cost and any accumulated depreciation, amortisation and write-downs of the transferring legal entity are shown separately in the statement of fixed assets as an addition to historical cost and an addition to accumulated depreciation, amortisation and write-downs.

As at 31 December 2017, the securities held as fixed assets include bonds of North American financial institutions as well as securities issued by Eastern European and South-West European debtors. The following performance was recognised:

€ mn	Book value 31 Dec 2017	Market value 31 Dec 2017	Book value 31 Dec 2016	Market value 31 Dec 2016
Bank bonds	72.1	76.8	97.2	106.6
Covered bonds	113.9	115.5	325.9	333.9
Public-sector issuers	2,534.4	3,108.5	2,394.8	3,044.5
Total	**2,720.4**	**3,300.8**	**2,817.9**	**3,485.0**

Securities with a nominal amount of € 2,659.8 million (2016: € 2,755.7 million) were not measured at the lower of cost or market. For some of the securities issued by public-sector entities, the book value in the amount of €62.3 million (2016: € 256.8 million) is higher than the market value of € 61.9 million (2016: € 248.5 million). The measurement at the lower of cost or market as at 31 December 2017 did not result in impairments of a permanent nature.

The option to aggregate non-trading assets, pursuant to section 34 (3) of the RechKredV, has been exercised.

The Bank has rented the majority of business land and buildings used for its business operations from one of its subsidiaries.

Notes on affiliated companies and enterprises with a participatory interest

	Affiliated companies 2017		Enterprises with a participatory interest 2017		Affiliated companies 2016		Enterprises with a participatory interest 2016	
€ mn	Certificated	Not certificated	Certificated	Not certificated	Certificated	Not certificated	Certificated	Not certificated
Loans and advances to banks	-	-	-	-	-	753.2	-	-
Loans and advances to customers	-	3,265.6	-	74.8	-	3,208.8	-	-
Debt and other fixed-income securities	-	-	-	-	-	-	-	-
Liabilities to banks	-	-	-	-	-	188.2	-	-
Liabilities to customers	-	971.7	-	-	-	768.5	-	-
Certificated liabilities	-	-	-	-	208.0	-	-	-
Subordinated liabilities	-	-	-	-	-	250.0	-	-

Transactions with related parties are carried out on an arm's length basis. Our relationships to related parties are detailed in the section "Loans to executive bodies of Aareal Bank AG" as well as in the Remuneration Report.

Trust business

€ mn	31 Dec 2017	31 Dec 2016
Trust assets		
Loans and advances to banks	0.0	0.0
Loans and advances to customers	18.0	21.9
Equities and other non-fixed-income securities	1.5	1.5
Total trust assets	**19.5**	**23.4**
Trust liabilities		
Liabilities to banks	1.2	2.6
Liabilities to customers	18.3	20.8
Total trust liabilities	**19.5**	**23.4**

Other assets

Other assets include, in particular, receivables from the asset item recognised from currency translation (€ 486.6 million), tax receivables (€ 15.7 million), and receivables from profit distributions or profit assumptions (€ 33.9 million). In addition, other assets include receivables in the amount of € 13.7 million from the collateralisation of irrevocable payment obligations to the German Federal Agency for Financial Market Stabilisation (Finanzmarktstabilisierungsanstalt – "FMSA") resulting from the bank levy, and to the deposit guarantee scheme of German banks.

In the previous year, other assets included, in particular, receivables from the asset item recognised from currency translation (€ 297.8 million), tax receivables (€ 51.4 million), receivables from profit distributions or profit assumptions (totalling € 84.1 million). In addition, other assets in the previous year included receivables in the amount of € 8.2 million from the collateralisation of irrevocable payment obligations to the German Federal Agency for Financial Market Stabilisation (Finanzmarktstabilisierungsanstalt – "FMSA") resulting from the bank levy, and to the deposit guarantee scheme of German banks.

Prepaid expenses and deferred income

Prepaid expenses and deferred income primarily include upfront payments as well as any premiums and discounts on registered bonds, claims under promissory note loans, issued bonds and other loans as well as fee portions with interest-paying characteristics, which have been amortised over the relevant terms.

Prepaid expenses in the amount of € 229.6 million (2016: € 239.4 million) primarily include € 13.8 million (2016: € 5.4 million) in premiums on originated loans, in accordance with section 340e (2) sentence 3 of the HGB and € 167.0 million (2016: € 169.8 million) in discounts on bonds issued and borrowings pursuant to section 250 (3) of the HGB. The item also includes € 40.2 million (2016: € 51.0 million) from upfront payments/option premiums in connection with derivatives.

€ 130.9 million (2016: € 135.9 million) of deferred income refers to upfront payments/option premiums in connection with derivatives (€ 51.7 million; 2016: € 52.2 million), while € 4.8 million (2016: € 9.5 million) refers to discounts on originated loans, in accordance with section 340e (2) sentence 2 of the HGB, and to fee portions with interest-paying characteristics in the amount of € 66.8 million (2016: € 65.6 million).

Deferred taxes

As at 31 December 2017, € 279.8 million (2016: € 255.8 million) in deferred tax assets and € 2.8 million (2016: € 23.8 million) in deferred tax liabilities were reported. Deferred taxes are recorded in the amount of the assumed tax burden or relief in coming financial years, and are measured using the company- and country-specific tax rates expected to apply at the time of the realisation of temporary differences and the offsetting of loss carryforwards.

For Germany, we generally used a corporate income tax rate (including solidarity surcharge) of 15.8 %, and a municipal trade tax rate depending on the multiplier set by the relevant local authorities. This results in an overall tax rate of 31.7 % for Germany (2016: 31.7 %).

Deferred tax assets were largely recognised for valuation differences for loans and advances to customers compared to their tax base, provisions for impending losses from executory contracts, as required under German commercial law, prepaid expenses for collected loan fees as well as on provisions for pensions. Deferred tax assets in the amount of € 0.6 million (2016: € 1.6 million) were recognised for loss carryforwards, relating exclusively to foreign permanent establishments of Aareal Bank AG.

Deferred tax liabilities were primarily recognised for valuation differences for participations compared to their tax base.

Current tax assets and current tax liabilities developed as follows during the financial year 2017:

€ mn	31 Dec 2017	31 Dec 2016	Change in the year under review
Deferred tax assets	279.8	255.8	24.0
Deferred tax liabilities	2.8	23.8	-21.0

Other liabilities

Other liabilities included, in particular, € 15.0 million in trade payables and € 3.2 million in liabilities from profit entitlements from silent participations. In addition, other liabilities included € 10.7 million in liabilities recognised from currency translation, € 5.2 million in liabilities from profit and loss transfer agreements and € 3.7 million in tax liabilities.

In the previous year, other liabilities mainly comprised € 4.7 million in trade payables and € 3.4 million in liabilities as a result of profit entitlements from silent participations. In addition, other liabilities included € 769.6 million in liabilities recognised from currency translation, € 87.5 million in liabilities from profit and loss transfer agreements and € 5.6 million in tax liabilities.

Provisions for pensions and similar obligations

The values determined in the actuarial pension report are based on the following methods and assumptions. In this context, the collection of personnel data and the determination of the forecast interest rate were made as at 1 October 2017 (cut-off date), not as at the balance sheet date:

	31 Dec 2017	31 Dec 2016
Actuarial method applied:	Projected unit credit method	Projected unit credit method
Fundamental assumptions for calculation:		
Discount rate in %	3.68	4.00
Reference period for discount rate	10 years	10 years
Fluctuation (%)	approx. 3.00	approx. 3.00
Expected wage and salary increases in %	2.00	2.00
Adjustments of current pension payments (%)	1.00 or 1.75	1.00 or 2.00
Mortality tables used	"Richttafeln 2005G" mortality tables by Prof Dr Klaus Heubeck	"Richttafeln 2005G" mortality tables by Prof Dr Klaus Heubeck

The effect from the changes in the discount rate as at the end of the financial year compared to the discount rate as at the beginning of the financial year is recognised in staff expenses.

The fair value changes of the plan assets are shown together with the current income from plan assets under other operating income and expenses.

Assets which are held exclusively for the purpose of fulfilling pension obligations are netted against provisions for pensions, within the framework of a Contractual Trust Agreement (CTA) where the trustee is acting on behalf of both parties (in the capacity of an administrative trustee and security trustee).

€ mn	31 Dec 2017	31 Dec 2016
Pension obligation	244.9	233.1
Fair value of plan assets	75.4	68.6
Cost of plan assets	69.1	65.6
Provisions for pensions and similar obligations	**169.5**	**164.5**

The plan assets comprise the following items, all of which are exclusively reserved to meet Aareal Bank AG's pension obligations vis-à-vis its active and retired employees in Germany.

Fund units are recognised at fair value, resulting from the exchange prices and market values of the assets, while reinsurance cover is recorded at capitalised value (Aktivwert).

€ mn	31 Dec 2017	31 Dec 2016
Fund units	48.9	43.1
Bonds	-	-
Reinsurance cover	26.5	25.5
Fair value of plan assets	**75.4**	**68.6**

The following table shows the income and expenses in relation to pension obligations and the associated plan assets that were offset and recognised in the income statement of the reporting year.

€ mn	31 Dec 2017	31 Dec 2016
Interest cost on pension obligations	8.8	8.7
Income from plan assets	1.9	1.5
Net interest expense	**6.9**	**7.2**

Subordinated liabilities

Outstanding subordinated liabilities of Tier 2 capital are not subject to any prerequisites for the conversion into equity capital or into another type of debt.

Subordinated funds raised do not provide for any early repayment obligation for Aareal Bank AG. In the event of liquidation or insolvency, claims on interest and principal from these liabilities are subordinated to the claims of all other creditors of Aareal Bank AG, which are not themselves subordinated. This also applies to those subordinated funds raised that are not specified in detail.

Interest expenses for all subordinated liabilities during 2017 totalled € 46.6 million (2016: € 63.0 million), including an amount of € 25.6 million (2016: € 15.4 million) for accrued interest payments not yet due.

The subordinated equity made available by Aareal Bank Capital Funding LLC in the amount of € 250.0 million (2016: € 250.0 million) was terminated and fully repaid as at 31 December 2017.

Profit-participation certificates

As at the balance sheet date, profit-participation certificates issued comprise the following certificates issued by Aareal Bank AG.

The profit-participation certificates recognised on the balance sheet are eligible as own funds pursuant to Article 63 in conjunction with Article 484 et seq. of the Capital Requirements Regulation (CRR) in the amount of € 0.6 million (2016: € 4.1 million).

	Nominal amount (€ mn)	Issue currency	Interest rate (% p.a.)	Maturity
Registered profit-participation certificates:				
	5.0	EUR	7.22	2002 - 2017
	5.0	EUR	7.22	2002 - 2017
	10.0	EUR	5.95	2004 - 2017
	10.0	EUR	5.95	2004 - 2017
	5.0	EUR	5.38	2004 - 2017
Maturity in the year under review	**35.0**			
	5.0	EUR	6.31	2003 - 2018
	5.0	EUR	5.83	2005 - 2018
	1.0	EUR	5.83	2005 - 2018
Position as at 31 Dec 2017	**11.0**			

Pursuant to the terms and conditions of issue, holders of profit-participation certificates have a claim on interest payments which takes precedence over the profit entitlements of shareholders. Where a distribution during the term of the profit-participation certificates would cause a net loss, said interest claim would be reduced, 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), after the Annual General Meeting passes resolutions regarding the relevant financial year. The profit-participation certificates evidence creditors' rights; they do not grant any share in the liquidation proceeds.

There were three (2016: eight) profit-participation certificates as at the balance sheet date.

€ 1.7 million (2016: € 2.8 million) in interest expenses were incurred in the financial year 2017 with respect to profit-participation certificates issued.

Additional Tier 1 capital instruments

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.

Interest expenses for debt securities during 2016 totalled € 22.9 million (2016: € 22.9 million), including an amount of € 15.4 million (2016: € 15.4 million) for accrued interest payments not yet due.

Purchase of 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 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. Shares may be acquired via the stock exchange or by means of a public offer to buy, directed at all shareholders, and at purchase prices stipulated in the authorisation and based on the prevailing market price of the Company's shares. This authorisation may be exercised, in full or in part, on one or more occasions.

The shares acquired in accordance with this or an earlier authorisation may be sold, subject to Supervisory Board approval, outside the stock exchange and without an offer directed at all shareholders, subject to the exclusion of shareholders' pre-emptive rights, when the shares sold do not exceed 10 % of the share capital and the issue price is not significantly below the prevailing stock exchange price or in the event of a sale against contributions in kind, or when the shares sold are used to service rights from convertible bonds or bonds with warrants. This also applies to shares issued by subsidiaries. The treasury shares may also be given to the holders of conversion or option rights in lieu of new shares from a contingent capital increase. The shares can also be withdrawn, without such a withdrawal or its implementation requiring a further resolution by the General Meeting.

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

Development of shareholders' equity reported on the balance sheet

			Retained earnings			
€ mn	Subscribed capital	Capital reserves	Legal reserve	Other retained earnings	Net retained profit	Equity
As at 1 Jan 2017	**369.8**	**727.8**	**4.5**	**720.2**	**122.2**	**1,944.5**
Capital increase	**-**	**-**	**-**	-	-	**-**
(of which: contributions by silent partners)	190.2	-	-	-	-	190.2
Transfer from net retained profit 2016	-	-	-	-	-	-
Dividends distributed in 2017	-	-	-	0.0	-119.7	-119.7
Transfer from net income 2017	-	-	-	-	147.1	147.1
As at 31 Dec 2017	**369.8**	**727.8**	**4.5**	**720.2**	**149.6**	**1,971.9**
(of which: contributions by silent partners)	190.2	-	-	-	-	190.2

Subscribed capital amounts to € 179.6 million (2016: € 179.6 million) and is divided into 59,857,221 (2016: 59,857,221) bearer shares with a proportionate share in the nominal share capital of € 3.00 per share.

The Bank 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 can only be determined at Group level. As a result, regulatory details no longer need to be disclosed at a single-entity level in this context.

Authorised capital

Aareal Bank has authorised capital pursuant to the resolution by the Annual General Meeting held on 31 May 2017. The Annual General Meeting authorised the Management Board to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 89,785,830 (Authorised Capital 2017) by issuance of new bearer shares for contribution in cash or in kind, subject to the approval of the Supervisory Board; this authority will expire on 30 May 2022. In the event of a capital increase against cash contributions, the shareholders shall be granted a subscription right, unless the Management Board exercises its authority to exclude shareholder's pre-emptive subscription rights. The Management Board may exclude shareholders' subscription rights, subject to approval by the Supervisory Board and the conditions set out below:

a) In the event of a capital increase against cash contributions, provided that the issue price of the new shares is not significantly below the prevailing stock exchange price of the Company's listed shares at the time of the final determination of the issue price. However, this authorisation shall be subject to the proviso that the aggregate value of shares sold to the exclusion of shareholders' subscription rights, in accordance with section 186 (3) sentence 4 of the AktG, shall not exceed 10 % of the issued share capital at the time said authorisation comes into effect or – if lower – at the time it is exercised. Any shares that were issued or sold during the term and prior to the exercising of said authorisation, in direct or analogous application of section 186 (3) sentence 4 of the AktG, shall count towards the above threshold of 10 % of the issued share capital. Said ten-per-cent threshold shall also include shares the issuance of which is required under the terms of debt securities with embedded conversion or option rights on shares issued pursuant to section 186 (3) sentence 4 of the AktG (excluding shareholders' subscription rights), which were (or may be) issued during the validity of this authorisation;

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

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

d) for an amount of up to € 4,000,000, to offer employees (of the Company or its affiliated companies) shares for subscription.

e) in the event of a capital increase against contributions in kind for the purpose of acquiring companies, divisions of companies or interests in companies or other assets.

The above authorisation for the exclusion of shareholders' subscription rights in the case of capital increases against contributions in cash or in kind is limited to a total of 20 % of share capital; this limit may be exceeded neither at the time said authorisation comes into effect, nor at the time it is exercised. The above-mentioned 20 % threshold shall furthermore treasury shares which are sold to the exclusion of shareholders' subscription rights as well as such shares which are issued to service debt securities, provided that the debt securities were issued to the exclusion of shareholders' subscription rights during the validity of this authorisation due to the authorisation under agenda item 6 of the Annual General Meeting on 21 May 2014. When a new authorisation for the exclusion of shareholders' subscription rights is resolved after the reduction and said new authorisation comes into effect, the upper limit, reduced in accordance with the above-mentioned requirements, shall be increased again to the amount permitted by the new authorisation, with a maximum total of 20 % of the share capital in accordance with the above-mentioned requirements.

The authorised capital has not yet 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 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. The issue of profit-participation rights may also be effected by domestic or foreign companies in which the Company either directly or indirectly holds a majority interest. In this case, the Company, subject to Supervisory Board approval, may guarantee such issues as well as issue shares on its own to fulfil the conversion rights. Subject to the approval of the Supervisory Board, the Management Board may exclude shareholders' pre-emptive rights in relation to the profit-participation rights in certain cases.

The purpose of the authorisation passed by the Annual General Meeting on 21 May 2014 is to create Tier 1 capital that is eligible for regulatory purposes; it also provides for the issue of profit-participation rights with conversion obligations. It is in accordance with the various structuring alternatives for Additional Tier 1 capital instruments, pursuant to the Capital Requirements Regulation[1]. 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.

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.

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.

Contingent liabilities and other commitments

The Bank has off-balance contingent liabilities and irrevocable loan commitments. During the term of these obligations, the Bank regularly reviews whether any losses can be expected from the utilisation of such contingent liabilities. This assessment is primarily made due to the credit risk analysis. Any losses that can be expected according to this analysis are recognised in the balance sheet as provisions, and are no longer disclosed as contingent liabilities or other liabilities.

Contingent liabilities result from guarantees and indemnity agreements, of which € 24.1 million (2016: € 18.3 million) are granted to domestic borrowers and € 49.1 million (2016: € 46.0 million) to foreign borrowers.

[1] Regulation 575/2013/EU

Liabilities did not have to be recognised for obligations from indemnity agreements vis-à-vis third parties and other obligations, which were entered into in favour of affiliated companies, as the underlying liabilities are likely to be fulfilled by the affiliated companies. Therefore, we do not expect any utilisation in this regard.

Irrevocable loan commitments are made up of credit and loan commitments, of which € 58.8 million (2016: € 2,994.3 million) are granted to domestic borrowers and € 1,605.0 million (2016: € 1,792.0 million) to foreign borrowers.

Unrecognised transactions and other obligations

Aareal Bank AG is the lessee mainly of operating leases. Rental and lease contracts relate to the buildings of the Bank's head office in Wiesbaden used for the Bank's operations, and of the foreign branch offices and representative offices as well as to the vehicle fleet and certain operating and office equipment. In all cases, the contracts are so-called operating leases which are not recognised in the financial statements of the Bank. The key benefit of such contracts is a lower amount of capital lock-up compared to an acquisition, and the elimination of realisation risk. At the moment, there are no indications that risks may result from the lease term.

Disclosures on repurchase agreements and derivatives are presented in the following section of the Notes.

The financial amounts subject to legal disputes are within the mid two-digit million range. Based on a legal analysis, successful outcome of these disputes is more likely than not, and therefore, no liabilities are recognised in the financial statements.

There are fully cash-collateralised and irrevocable payment obligations from the bank levy and the deposit guarantee scheme of German banks. Cash collateral is reported under other assets.

Maturity groupings

€ mn	31 Dec 2017	31 Dec 2016
Loans and advances to banks	**929.8**	**2,439.7**
With a residual term of		
Payable on demand	564.5	1,355.5
Up to 3 months	5.0	334.7
Between 3 months and 1 year	94.0	446.0
Between 1 year and 5 years	0.9	13.7
More than five years	13.7	13.6
Pro rata interest	251.7	276.2
Loans and advances to customers	**26,591.2**	**25,996.5**
With a residual term of		
Payable on demand	388.3	322.7
Up to 3 months	577.0	901.5
Between 3 months and 1 year	2,780.9	2,013.2
Between 1 year and 5 years	14,729.6	16,403.6
More than five years	8,013.3	6,246.6
Indefinite maturity	-	-
Pro rata interest	102.1	108.9
Debt and other fixed-income securities maturing in the following year (nominal amount)	**914.6**	**859.1**
Liabilities to other banks	**2,027.0**	**1,734.6**
With a residual term of		
Payable on demand	997.3	799.9
Up to 3 months	19.4	61.4
Between 3 months and 1 year	178.6	59.2
Between 1 year and 5 years	290.5	277.5
More than five years	360.5	336.5
Pro rata interest	180.7	200.1
Liabilities to customers		
Savings deposits with an agreed notice period of more than three months	**0.0**	**0.0**
With a residual term of		
Up to 3 months	0.0	0.0
Between 3 months and 1 year	0.0	0.0
Between 1 year and 5 years	0.0	0.0
Pro rata interest	0.0	0.0
Other liabilities to customers	**25,472.6**	**24,553.8**
With a residual term of		
Payable on demand	7,954.7	7,300.1
Up to 3 months	3,748.1	4,348.0
Between 3 months and 1 year	3,221.8	3,669.0
Between 1 year and 5 years	4,382.0	3,402.6
More than five years	5,941.6	5,633.9
Pro rata interest	224.4	200.2
Bonds issued maturing in the following year (nominal amount)	**2,112.5**	**2,515.6**
Other certificated liabilities	**0.0**	**0.0**

Shareholdings

The following disclosures are made pursuant to section 285 (11) of the HGB:

No.	Company name	Registered office	Shareholding	Equity	Results
No.			%	€ mn	€ mn
1	1st Touch Ltd	Southampton	100.0	GBP 2.7 million	GBP -0.5 million [2]
2	Aareal Bank Asia Limited	Singapore	100.0	SGD 16.9 million	SGD -0.5 million [1]
3	Aareal Beteiligungen AG	Frankfurt	100.0	227.8	0.0 [3]
4	Aareal Capital Corporation	Wilmington	100.0	252.4 mn USD	33.0 mn USD [1]
5	Aareal Estate AG	Wiesbaden	100.0	2.5	0.0 [3]
6	Aareal First Financial Solutions AG	Mainz	100.0	3.2	0.0 [3]
7	Aareal Gesellschaft für Beteiligungen und Grundbesitz Erste mbH & Co. KG	Wiesbaden	94.9	2.5	0.1 [1]
8	Aareal Holding Realty LP	Wilmington	99.8	205.6 mn USD	-0.5 mn USD [5]
9	Aareal Immobilien Beteiligungen GmbH	Wiesbaden	100.0	456.8	0.0 [3]
10	Aareal Valuation GmbH	Wiesbaden	100.0	0.5	0.0 [3]
11	Aareon AG	Mainz	100.0	112.0	17.2
12	Aareon Deutschland GmbH	Mainz	100.0	33.9	0.0 [3]
13	Aareon France S.A.S.	Meudon-la-Forêt	100.0	8.4	2.4 [2]
14	Aareon Immobilien Projekt GmbH	Dortmund	100.0	0.7	0.0 [3]
15	Aareon International Solutions GmbH	Mainz	100.0	0.0	0.0
16	Aareon Nederland B.V.	Emmen	100.0	23.7	1.9 [2]
17	Aareon Norge AS	Oslo	100.0	NOK 0.3 million	NOK -2.3 million [2]
18	Aareon Sverige AB	Mölndal	100.0	SEK 33.7 million	SEK 10.4 million [2]
19	Aareon UK Ltd.	Coventry	100.0	GBP 4.7 million	GBP 0.9 million [2]
20	Anfield Portfolio GmbH & Co. KG	Mainz	100.0	0.0	0.0
21	Anfield Verwaltungs GmbH	Mainz	100.0	0.0	0.0
22	BauContact Immobilien GmbH	Wiesbaden	100.0	5.1	0.5
23	BauGrund Immobilien-Management GmbH	Bonn	100.0	0.5	0.0 [3]
24	BauGrund Solida Immobilien GmbH	Frankfurt	100.0	0.1	0.0
25	BauGrund TVG GmbH	Munich	100.0	0.1	0.0 [1]
26	BauSecura Versicherungsmakler GmbH	Hamburg	51.0	3.4	3.3 [1]
27	BVG - Grundstücks- und Verwertungs-gesellschaft mit beschränkter Haftung	Frankfurt	100.0	217.3	0.0 [3]
28	Capital Funding GmbH & Co. KG	Frankfurt	100.0	0.0	0.0 [4]
29	Deutsche Bau- und Grundstücks-Aktiengesellschaft	Berlin	100.0	1.5	0.1 [1]
30	Deutsche Structured Finance GmbH	Wiesbaden	100.0	6.0	-0.2 [1]
31	DSF Flugzeugportfolio GmbH	Wiesbaden	100.0	0.0	0.0 [3]
32	DSF PP Justizzentrum Thüringen GmbH & Co. KG	Frankfurt	48.4	0.4	0.0 [2]
33	Esplanade Realty LP	Wilmington	100.0	27.0 mn USD	1.7 mn USD [5]
34	Facilitor B.V.	Enschede	100.0	0.4	0.7 [2]
35	FIRE B.V.	Utrecht	60.0	0.1	0.0 [2]
36	GEV Besitzgesellschaft mbH	Wiesbaden	100.0	30.0	0.0 [3]
37	GEV Beteiligungsgesellschaft mbH	Wiesbaden	100.0	0.1	0.0
38	GVN-Grundstücks- und Vermögensverwaltungs-gesellschaft mit beschränkter Haftung	Frankfurt	100.0	0.5	0.0 [3]

[1] Preliminary figures as at 31 December 2017; [2] Equity and results as at 31 December 2016;

[3] Profit transfer agreement/control and profit transfer agreement;

[4] 10 % of voting rights, diverging from the equity interest held; [5] Disclosures in accordance with IFRSs; [6] n/a = no data

No.	Company name	Registered office	Shareholding	Equity	Conclusion
.			%	€ mn	€ mn
39	IV Beteiligungsgesellschaft für Immobilieninvestitionen mbH	Wiesbaden	100.0	2.4	0.1 1)
40	Izalco Spain S.L.	Madrid	100.0	9.2	-1.0 1)
41	Jomo S.p.r.l.	Brussels	100.0	44.0	0.0 1)
42	Kalshoven Automation B.V.	Amsterdam	100.0	3.0	0.4 2)
43	Konsortium BauGrund/TREUREAL	Bonn	50.0	0.0	-0.1 1)
44	La Sessola Holding GmbH	Wiesbaden	100.0	86.6	0.0 1)
45	La Sessola S.r.l.	Rome	100.0	116.3	-5.8 1)
46	La Sessola Service S.r.l.	Rome	100.0	3.3	0.1 1)
47	Manager Realty LLC	Wilmington	100.0	0.0 mn USD	0.0 mn USD 5)
48	Mercadea S.r.l.	Rome	100.0	7.2	0.2 1)
49	Mirante S.r.l.	Rome	100.0	10.3	-0.9 1)
50	Mount Street Group Limited	London	20.0	n/a	n/a 6)
51	Mount Street US Group LLP	Wilmington	20.0	n/a	n/a 6)
52	mse Augsburg GmbH	Augsburg	100.0	0.3	0.0 2)
53	mse Immobiliensoftware GmbH	Hamburg	100.0	0.7	0.3 2)
54	mse RELion GmbH	Augsburg	100.0	0.1	0.0 2)
55	Northpark Realty LP	Wilmington	100.0	92.3 mn USD	6.0 mn USD 5)
56	Participation Achte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 3)
57	Participation Elfte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 3)
58	Participation Neunte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 3)
59	Participation Zehnte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 3)
60	phi-Consulting GmbH	Bochum	100.0	2.0	0.6
61	Real Verwaltungsgesellschaft mbH	Schönefeld	100.0	29.2	1.5 1)
62	Rive Defénse S.A.S.	Paris	50.0	-116.0	-10.9 2)
63	Sedum Grundstücksverwaltungsgesellschaft mbH & Co. Vermietungs KG	Wiesbaden	94.9	-4.2	-1.7 1)
64	SG2ALL B.V.	Huizen	100.0	0.6	0.2 2)
65	SoftS IT Solutions AG	Wiesbaden	100.0	0.5	-0.5 1)
66	Square DMS B.V.	Grathem	100.0	1.0	0.6 2)
67	Terrain-Aktiengesellschaft Herzogpark	Wiesbaden	100.0	4.7	0.0 3)
68	Terrain Beteiligungen GmbH	Wiesbaden	94.0	54.8	4.5 1)
69	Westdeutsche Immobilien Servicing AG	Mainz	100.0	50.1	0.0 3)
70	Westhafen Haus GmbH & Co. Projektentwicklungs KG	Frankfurt	25.0	-0.2	0.0 2)
71	Westhafen-Gelände Frankfurt am Main GbR	Frankfurt	33.3	0.0	0.0 2)
72	WP Galleria Realty LP	Wilmington	100.0	94.5 mn USD	4.4 mn USD 5)

1) Preliminary figures as at 31 December 2017; 2) Equity and results as at 31 December 2016;

3) Profit transfer agreement / control and profit transfer agreement;

4) 10 % of voting rights, diverging from the equity interest held; 5) Disclosures in accordance with IFRSs; 6) n/a = no data

Assets pledged as collateral

Assets in the amount stated were pledged for the following liabilities:

€ mn	31 Dec 2017	31 Dec 2016
Liabilities to banks	703.0	1,498.3
Liabilities to customers	0.0	0.0
Total	**703.0**	**1,498.3**

Other assets include the cash-collateralised and irrevocable payment obligation to the FMSA resulting from the bank levy, for which € 12.0 million (2016: € 7.4 million) in cash collateral has been pledged.

Repurchase agreements

As at 31 December 2017, no bonds were used as part of repurchase agreements (2016: € –).

Assets and liabilities in foreign currencies

The aggregate equivalent amount of assets denominated in foreign currencies was € 12,705.4 million (2016: € 12,590.8 million) at the balance sheet date, whilst liabilities totalled € 2,255.4 million (2016: € 2,324.5 million). Foreign currency balances are partly offset by equivalent foreign exchange forwards and currency swaps.

Forward transactions

The following forward transactions had been entered into as at 31 December 2017:

- **Transactions based on interest rates:**
  caps, floors, swaptions, interest rate swaps
- **Transactions based on exchange rates:**
  forward foreign exchange transactions, cross-currency interest rate swaps
- **Other transactions:**
  other forward transactions

Interest-rate based transactions and cross-currency interest rate swaps are primarily used to hedge against interest rate and exchange rate fluctuations. Forward foreign exchange transactions are almost exclusively used for refinancing purposes.

Remaining terms and future cash flows of derivatives are broken down in the following table:

31 December 2017

€ mn	Up to 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total as at 31 Dec 2017
Interest rate instruments					
Interest rate swaps					
Cash inflows	161.4	429.5	1,359.5	417.4	2,367.8
Cash outflows	143.9	279.6	980.7	357.8	1,762.0
Forward rate agreements					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Swaptions					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Caps, floors					
Cash inflows	-	0.3	4.8	0.9	6.1
Cash outflows	0.0	0.3	4.8	0.9	6.1
Currency-related instruments					
Spot and forward foreign exchange transactions					
Cash inflows	2,869.4	341.3	-	-	3,210.7
Cash outflows	2,843.4	336.9	-	-	3,180.3
Cross-currency swaps					
Cash inflows	186.0	1,923.0	5,132.6	1,147.6	8,389.3
Cash outflows	230.6	2,032.4	4,967.0	1,067.7	8,297.8
Other transactions					
Options, futures					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Other derivative transactions					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Total cash inflows	**3,216.8**	**2,694.1**	**6,496.9**	**1,565.9**	**13,973.9**
Total cash outflows	**3,217.9**	**2,649.2**	**5,952.5**	**1,426.4**	**13,246.2**

31 December 2016

€ mn	Up to 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total as at 31 Dec 2016
Interest rate instruments					
Interest rate swaps					
Cash inflows	174.5	460.2	1,423.1	545.0	2,602.8
Cash outflows	167.0	318.7	1,045.8	437.0	1,968.5
Forward rate agreements					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Swaptions					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Caps, floors					
Cash inflows	-	0.9	4.8	1.3	7.0
Cash outflows	0.0	0.9	4.8	1.3	7.0
Currency-related instruments					
Spot and forward foreign exchange transactions					
Cash inflows	2,523.9	261.4	-	-	2,785.3
Cash outflows	2,583.1	261.2	-	-	2,844.3
Cross-currency swaps					
Cash inflows	45.9	1,598.4	5,851.4	1,042.8	8,538.5
Cash outflows	67.1	1,913.5	6,344.0	1,003.7	9,328.3
Other transactions					
Options, futures					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Other derivative transactions					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Total cash inflows	**2,744.3**	**2,320.9**	**7,279.3**	**1,589.1**	**13,933.6**
Total cash outflows	**2,817.2**	**2,494.3**	**7,394.6**	**1,442.0**	**14,148.1**

The following overview shows positive and negative market values, aggregated by product level (without taking collateral or netting agreements into account):

Unless a quoted market price is available, derivatives are measured using generally accepted methods on the basis of current market parameters (yield curves, volatility factors, etc.). Methods used include standard methods and models such as discounted cash flow analyses and option pricing models. Structured products are measured after they have been split into their individual components. Fair values, including accrued interest, are given for derivative financial instruments not recognised at fair value as at 31 December 2017.

€ mn	Nominal amount 31 Dec 2017	Market value as at 31 Dec 2017 positive	Market value as at 31 Dec 2017 Negative	Market value as at 31 Dec 2016 Positive	Market value as at 31 Dec 2016 Negative
Interest rate instruments					
OTC products					
Interest rate swaps	37,876.6	1,627.0	1,496.1	2,143.2	2,166.1
Swaptions	22	-	-	-	-
Caps, floors	4,622.3	6.0	6.0	6.9	6.9
Total interest rate instruments	**42,520.9**	**1,633.0**	**1,502.1**	**2,150.1**	**2,173.0**
Currency-related instruments					
OTC products					
Spot and forward foreign exchange transactions	3,196.2	36.5	2.5	7.2	64.2
Cross-currency swaps	8,386.2	583.3	198.2	314.0	749.4
Total currency-related instruments	**11,582.4**	**619.8**	**200.7**	**321.2**	**813.6**
Other transactions					
OTC products					
Other derivative transactions	-	-	-	-	-
Total other transactions	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Total	**54,103.3**	**2,252.8**	**1,702.8**	**2,471.3**	**2,986.6**

The year-on-year increase in market values of hedging derivatives carried as liabilities is attributable to exchange rate developments, in addition to the changes in interest rates. Currency hedges are largely used to hedge foreign exchange risk in the lending business.

Derivatives have been entered into with the following counterparties:

€ mn	Market value as at 31 Dec 2017 Positive	Market value as at 31 Dec 2017 Negative	Market value as at 31 Dec 2016 Positive	Market value as at 31 Dec 2016 Negative
OECD public-sector authorities	-	-	-	-
OECD banks	2,087.1	1,692.5	2,265.2	2,972.2
Non-OECD banks	-	-	-	-
Companies and private individuals	165.7	10.3	206.1	14.4
Total	**2,252.8**	**1,702.8**	**2,471.3**	**2,986.6**

Remuneration Report

The remuneration report for the 2017 financial year contains detailed information on the remuneration of Aareal Bank AG Management Board members, together with the Bank's 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 2017 in accordance with section 16 (1) of the German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – "InstitutsVergV"), and Article 450 of Regulation (EU) No. 575/2013 (the Capital Requirements Regulation or "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. Quantitative disclosures on the remuneration of Management Board members, employees as well as senior executives required pursuant to Article 450 (2) of the CRR will be disclosed on Aareal Bank AG's homepage by the end of June.

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 first outlines the remuneration system for the members of Aareal Bank AG's Management Board.

Remuneration system for the Management Board

Responsibilities and procedures of Aareal Bank AG regarding remuneration policies

The Supervisory Board determines the remuneration system, and the amount of remuneration for members of Aareal Bank AG's 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. It held eight meetings throughout the 2017 financial year. The Supervisory Board of Aareal Bank AG discussed remuneration issues at five meetings during the 2017 financial year.

The Supervisory Board defines – 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' target achievement and performance after the end of every financial year.

Success criteria and parameters

Members of the Management Board receive a fixed basic annual salary, a performance-related variable remuneration, as well as ancillary benefits. In 2016, the Supervisory Board introduced a reduced entry-level remuneration for new members appointed to the Management Board. The majority of performance-related, variable remuneration is determined on the basis of a multiple-year assessment basis.

Performance-related remuneration

Remuneration parameters
The amount of performance-related remuneration for Management Board members depends upon the individual Board member's performance, the performance of the division the respective member is responsible for, as well as the overall performance of Aareal Bank Group. The targets which are related to Aareal Bank Group's overall performance include annual targets and multiple-year targets. The measurement of the multiple-year target is undertaken retrospectively over a time period of three years. Annual and multiple-year targets are weighted using a ratio of 45 % (annual target) to 55 % (multiple-year target); within the annual target, individual, divisional, and Bank targets are weighted equally.

For each financial year, the Supervisory Board sets a target level for the Common Equity Tier 1 ratio (CET1 ratio) as the measurement threshold in order to secure adherence of the regulatory capital adequacy and a suitable liquidity measure (Liquidity Coverage Ratio – LCR). No variable remuneration will be determined for any financial year where any of these two targets has not been achieved.

All targets for Management Board members 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. 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). Any negative deviations from targets will reduce performance-related remuneration. 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 Supervisory Board is entitled to increase or decrease the overall target achievement level by up to 20 %, applying reasonable discretion, in the event of any material, specified external or internal non-recurring effects, provided that the upper limit of 150 % for overall target achievement must not be exceeded. 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 in accordance with 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, the initial value for variable remuneration – as determined according to the principles set out above – is awarded at the end of the financial year, according to the following principles:

- 20 % of the variable remuneration is disbursed as a cash bonus after the Supervisory Board has determined the overall target achievement level.
- A further 20 % of the variable remuneration is awarded as a share bonus subject to a holding period (and forms part of the share-based bonus plan), in the form of virtual shares, also after the Supervisory Board has determined the overall target achievement level.
- 30 % of the variable remuneration is retained (cash deferral), and disbursed in cash – pro rata temporis – over a defined retention 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 performance-related remuneration that is deferred initially as a cash deferral or a share deferral, the Supervisory Board makes a decision regarding the granting of one third of the amount, as well as the associated interest, in the three years following the determination of the performance-related remuneration (retention period). Starting with performance-related remuneration for the 2018 financial year, the retention period will be extended to five years. 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 virtual shares, subject to a two-year (starting with variable remuneration for the 2018 financial year: one-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 the division he/she is responsible for, as well as any weakness in the performance of Aareal Bank Group (ex-post risk adjustment). A negative individual performance contribution is deemed to be present, for example, in the event of breaches of the Code of Conduct and/or of Compliance guidelines, conduct that damages the Bank's reputation, or in the event of other misconduct which would justify a termination for good cause. Ex-post risk adjustment also involves a retrospective review as to whether the performance contributions assumed at the time of determining the initial value of performance-related remuneration are proven to be sustainable (backtesting). The Supervisory Board decides upon any adjustments to variable remuneration, according to its own best judgment, based on a recommendation by the Remuneration Control Committee. If any retained performance-related remuneration components are not awarded, or only in part, the remaining sum is forfeited, i.e. it is not carried forward into subsequent years. Moreover, 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.

Starting with variable remuneration for the 2018 financial year, agreements with Management Board members must ensure that any variable remuneration already disbursed may be reclaimed in certain cases (a “clawback”). Aareal Bank has already reached corresponding agreements with members of the Management Board, which will initially apply to variable remuneration for the 2018 financial year.

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

The portion of the variable remuneration which is subject to the share bonus plan 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 (starting with variable remuneration for the 2018 financial year: the first financial year) following the financial year for which the virtual shares were granted (“holding period”). The conversion will be effected using the weighted average price calculated on the basis of the five (Xetra®) exchange trading days following the publication of the preliminary 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).

Share Deferral Plan

The portion of the variable remuneration subject to the Share Deferral Plan 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. In the three years (starting with variable remuneration for the 2018 financial year: five years) following the credit (retention period), the Supervisory Board decides whether in each case one third (starting with variable remuneration for the 2018 financial year: one fifth) of the share deferral should be converted.

The question as to whether a third of the virtual shares is converted and, if so, in which amount, is based on the principles set out above (refer to the 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 (starting with variable remuneration for the 2018 financial year: one year). 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 into a cash payment must not exceed 300% of the share deferral (30 % of the initial value of 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).

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

Remuneration granted	Hermann J. Merkens – Chairman of the Management Board			
	2016	2017	2017 (min) [1)]	2017 (max)[2)]
€				
Fixed remuneration	1,300,000	1,300,000	1,300,000	1,300,000
Ancillary benefits	38,511	39,557	39,557	39,557
Total	**1,338,511**	**1,339,557**	**1,339,557**	**1,339,557**
Variable remuneration based on a single-year assessment	280,000	280,000	-	420,000
Variable remuneration based on a multiple-year assessment				
Cash deferral 2016 (March 2020)	420,000	420,000	-	630,000
Share bonus 2016 (March 2020)	280,000	280,000	-	420,000
Share deferral 2016 (March 2022)	420,000	420,000	-	630,000
Cash deferral 2015 (March 2019)	-	-	-	-
Share bonus 2015 (March 2019)	-	-	-	-
Share deferral 2015 (March 2021)	-	-	-	-
Total	**1,400,000**	**1,400,000**	**-**	**2,100,000**
Benefit expense	1,032,350	726,347	726,347	726,347
Total remuneration	**3,770,861**	**3,465,904**	**2,065,904**	**4,165,904**

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

Remuneration granted	**Dagmar Knopek**			
	2016	**2017**	**2017 (min) [1]**	**2017 (max)[2]**
€				
Fixed remuneration	880,000	880,000	880,000	880,000
Ancillary benefits	41,449	32,605	32,605	32,605
Total	**921,449**	**912,605**	**912,605**	**912,605**
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	240,000	-	360,000
Share bonus 2016 (March 2020)	160,000	160,000	-	240,000
Share deferral 2016 (March 2022)	240,000	240,000	-	360,000
Cash deferral 2015 (March 2019)	-	-	-	-
Share bonus 2015 (March 2019)	-	-	-	-
Share deferral 2015 (March 2021)	-	-	-	-
Total	**800,000**	**800,000**	**-**	**1,200,000**
Benefit expense	526,355	399,791	399,791	399,791
Total remuneration	**2,247,804**	**2,112,396**	**1,312,396**	**2,512,396**

Remuneration granted	**Christiane Kunisch-Wolff[3]**			
	2016	**2017**	**2017 (min) [1]**	**2017 (max)[2]**
€				
Fixed remuneration	561,244	704,000	704,000	704,000
Ancillary benefits	27,595	27,922	27,922	27,922
Total	**588,839**	**731,922**	**731,922**	**731,922**
Variable remuneration based on a single-year assessment	102,120	128,000	-	192,000
Variable remuneration based on a multiple-year assessment				
Cash deferral 2016 (March 2020)	153,180	192,000	-	288,000
Share bonus 2016 (March 2020)	102,120	128,000	-	192,000
Share deferral 2016 (March 2022)	153,180	192,000	-	288,000
Cash deferral 2015 (March 2019)	-	-	-	-
Share bonus 2015 (March 2019)	-	-	-	-
Share deferral 2015 (March 2021)	-	-	-	-
Total	**510,601**	**640,000**	**-**	**960,000**
Benefit expense	51,707	697,851	697,851	697,851
Total remuneration	**1,151,147**	**2,069,773**	**1,429,773**	**2,389,773**

[1] Minimum amount of the remuneration component granted in the year under review.
[2] Maximum amount of the remuneration component granted in the year under review.
[3] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.

Remuneration granted	Thomas Ortmanns			
	2016	2017	2017 (min) [1)]	2017 (max)[2)]
€				
Fixed remuneration	880,000	880,000	880,000	880,000
Ancillary benefits	35,945	55,260	55,260	55,260
Total	**915,945**	**935,260**	**935,260**	**935,260**
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	240,000	-	360,000
Share bonus 2016 (March 2020)	160,000	160,000	-	240,000
Share deferral 2016 (March 2022)	240,000	240,000	-	360,000
Cash deferral 2015 (March 2019)	-	-	-	-
Share bonus 2015 (March 2019)	-	-	-	-
Share deferral 2015 (March 2021)	-	-	-	-
Total	**800,000**	**800,000**	**-**	**1,200,000**
Benefit expense	725,906	544,137	544,137	544,137
Total remuneration	**2,441,851**	**2,279,397**	**1,479,397**	**2,679,397**

Remuneration granted	Christof Winkelmann[3)]			
	2016	2017	2017 (min) [1)]	2017 (max)[2)]
€				
Fixed remuneration	352,000	704,000	704,000	704,000
Ancillary benefits	12,125	24,062	24,062	24,062
Total	**364,125**	**728,062**	**728,062**	**728,062**
Variable remuneration based on a single-year assessment	64,000	128,000	-	192,000
Variable remuneration based on a multiple-year assessment				
Cash deferral 2016 (March 2020)	96,000	192,000	-	288,000
Share bonus 2016 (March 2020)	64,000	128,000	-	192,000
Share deferral 2016 (March 2022)	96,000	192,000	-	288,000
Cash deferral 2015 (March 2019)	-	-	-	-
Share bonus 2015 (March 2019)	-	-	-	-
Share deferral 2015 (March 2021)	-	-	-	-
Total	**320,000**	**640,000**	**-**	**960,000**
Benefit expense	66,747	663,349	663,349	663,349
Total remuneration	**750,872**	**2,031,411**	**1,391,411**	**2,351,411**

[1] Minimum amount of the remuneration component granted in the year under review.
[2] Maximum amount of the remuneration component granted in the year under review.
[3] 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**	
	2017	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
€								
Fixed remuneration	1,300,000	1,300,000	880,000	880,000	704,000	561,244	880,000	880,000
Ancillary benefits	39,557	38,511	32,605	41,449	27,922	27,595	55,260	35,945
Total	**1,339,557**	**1,338,511**	**912,605**	**921,449**	**731,922**	**588,839**	**935,260**	**915,945**
Variable remuneration based on a single-year assessment	377,720	299,544	212,320	212,640	135,309	-	213,600	211,360
Variable remuneration based on a multiple-year assessment	-	-	-	-	-	-	-	-
Cash deferral 2013 (April 2017)	112,727	-	65,757	-	-	-	112,727	-
Cash deferral 2014 (April 2017)	103,030	-	102,785	-	-	-	102,215	-
Cash deferral 2015 (April 2017)	150,686	-	106,969	-	-	-	106,325	-
Share bonus 2013 (April 2017)	239,867	-	139,922	-	-	-	239,867	-
Share deferral 2011 (April 2017)	-	-	-	-	-	-	-	-
Share deferral 2012 (April 2017)	222,358	-	-	-	-	-	222,358	-
Share deferral 2013 (April 2017)	121,816	-	71,060	-	-	-	121,816	-
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
Dividends	101,276	73,961	63,848	38,522	7,595	-	82,271	68,575
Total	**1,429,480**	**1,187,440**	**762,661**	**417,772**	**142,904**	**-**	**1,201,179**	**1,093,063**
Benefit expense	726,347	1,032,350	399,791	526,355	697,851	51,707	544,137	725,906
Total remuneration	**3,495,384**	**3,558,301**	**2,075,057**	**1,865,576**	**1,572,677**	**640,546**	**2,680,576**	**2,734,914**

[1] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.

Remuneration paid	Christof Winkelmann[1)]		Dr Wolf Schumacher[2)]		Dirk Große Wördemann[3)]	
	2017	2016	2017	2016	2017	2016
€						
Fixed remuneration	704,000	352,000	-	-	-	-
Ancillary benefits	24,062	12,125	-	90	-	-
Total	**728,062**	**364,125**	**-**	**90**	**-**	**-**
Variable remuneration based on a single-year assessment	85,120	-	-	275,940	-	-
Variable remuneration based on a multiple-year assessment	-	-	-	-	-	-
Cash deferral 2013 (April 2017)	-	-	190,184	-	-	-
Cash deferral 2014 (April 2017)	-	-	179,875	-	-	-
Cash deferral 2015 (April 2017)	-	-	138,812	-	-	-
Share bonus 2013 (April 2017)	-	-	404,684	-	-	-
Share deferral 2011 (April 2017)	-	-	-	-	238,390	-
Share deferral 2012 (April 2017)	-	-	375,143	-	180,523	-
Share deferral 2013 (April 2017)	-	-	205,519	-	-	-
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
Dividends	4,778	-	111,251	111,776	10,369	27,954
Total	**89,898**	**-**	**1,605,468**	**1,766,914**	**429,282**	**694,895**
Benefit expense	663,349	66,747	-	-	-	-
Total remuneration	**1,481,309**	**430,872**	**1,605,468**	**1,767,004**	**429,282**	**694,895**

[1] Christof Winkelmann was appointed to the Management Board on 1 July 2016.
[2] Dr Wolf Schumacher resigned with effect from 30 September 2015.
[3] Dirk Große Wördemann resigned with effect from 31 May 2013.

In accordance with German commercial law, 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 remu-neration	Variable remuneration					Ancillary benefits	Total remuneration
			Cash component		Share-based component		Total		
			Cash bonus	Cash deferral[3]	Share bonus	Share deferral[3]			
€									
Hermann J. Merkens	2017	1,300,000	343,994	515,991	343,994	515,991	1,719,970	39,557	**3,059,527**
	2016	1,300,000	377,720	566,580	377,720	566,580	1,888,600	38,511	**3,227,111**
Dagmar Knopek	2017	880,000	196,568	294,852	196,568	294,852	982,840	32,605	**1,895,445**
	2016	880,000	212,320	318,480	212,320	318,480	1,061,600	41,449	**1,983,049**
Christiane Kunisch-Wolff[1)]	2017	704,000	157,254	235,882	157,254	235,882	786,272	27,922	**1,518,194**
	2016	561,244	135,309	202,964	135,309	202,964	676,546	27,595	**1,265,385**
Thomas Ortmanns	2017	880,000	194,168	291,252	194,168	291,252	970,840	55,260	**1,906,100**
	2016	880,000	213,600	320,400	213,600	320,400	1,068,000	35,945	**1,983,945**
Christof Winkelmann[2)]	2017	704,000	159,174	238,762	159,174	238,762	795,872	24,062	**1,523,934**
	2016	352,000	85,120	127,680	85,120	127,680	425,600	12,125	**789,725**
Total	**2017**	**4,468,000**	**1,051,158**	**1,576,739**	**1,051,158**	**1,576,739**	**5,255,794**	**179,406**	**9,903,200**
	2016	**3,973,244**	**1,024,069**	**1,536,104**	**1,024,069**	**1,536,104**	**5,120,346**	**155,625**	**9,249,215**

[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.

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 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 2017/2016:

		Share-based remuneration	
	Year	Value (€)	Quantity (number)[1)]
Hermann J. Merkens	2017	859,985	22,793
	2016	944,300	26,503
Dagmar Knopek	2017	491,420	13,025
	2016	530,800	14,898
Christiane Kunisch-Wolff [2)]	2017	393,136	10,420
	2016	338,273	9,494
Thomas Ortmanns	2017	485,420	12,866
	2016	534,000	14,987
Christof Winkelmann [3)]	2017	397,936	10,547
	2016	212,800	5,972

[1] The stated number of virtual shares granted for 2017 is a preliminary figure, based on the price of Aareal Bank AG's share on 31 December 2017 (€37.73). The final conversion rate may only be determined after publication of preliminary results for 2017.The stated number of virtual shares granted for 2016 differs slightly from the previous year's figure since the former was calculated using a final conversion rate of € 35.63.
[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.

Ancillary benefits

Aareal Bank AG provides a company car to Management Board members, which may also be used for private purposes.

Management Board members are covered by the group accident insurance in case of death or invalidity.

In addition, Aareal Bank AG bears the costs incurred for certain security expenses.

Pensions, 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 [on or] 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.

	2017			2016		
	Pension claims p.a.[1)]	Balance of pension obligations as at 31 Dec 2017	Increase of pension obligations in 2017	Pension claims p.a.[1)]	Balance of pension obligations as at 31 Dec 2016	Increase of pension obligations in 2016
€ 000's						
Hermann J. Merkens	285	4,096	821	265	3,275	244
Dagmar Knopek	113	1,532	386	125	1,146	307
Christiane Kunisch-Wolff[2)]	116	487	454	-	33	33
Thomas Ortmanns	267	4,043	677	254	3,366	190
Christof Winkelmann[3)]	113	408	372	-	36	36
Total	**894**	**10,566**	**2,710**	**644**	**7,856**	**810**

[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.

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 costs incurred in the 2017 financial year in connection with the pension claims of members of the Management Board totalled € 3.1 million (2016: € -0.9 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 € 3.6 million in the year under review (2016: € -0.5 million). The total amount of pension obligations was € 36.4 million (2016: € 32.8 million). Of that amount, € 25.8 million related to former members of the Management Board and their surviving dependants (2016: € 24.9 million). Payments to former Management Board members of Aareal Bank AG and their surviving dependants totalled € 0.8 million (2016: € 0.9 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.

Remuneration system for senior executives and employees

Risk takers (senior executives and employees 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.

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 2017, 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 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. Variable remuneration is the sum of (i) a component related to Group performance, (ii) a component related to the performance of the organisational unit, and (iii) a component related to individual performance. The weighting of individual components differs for the various staff groups (depending on the level of seniority), with the respective weight applied for the purpose of determining variable remuneration:

- component related to Group performance (between 25 % and 35 %);
- component related to the performance of the organisational unit (between 15 % and 25 %);
- individual component (between 40 % and 60 %).

The first component is based on the overall performance of the Aareal Bank Group; the second component is related to the performance of the respective organisational unit, and the third component is related to each employee's individual performance.

Target achievement for the component related to Group performance is determined by multiplying the two individual target achievement parameters for operating profit before taxes (OPbT) and risk-weighted assets (RWA); the target achievement level is capped at 150 %. If one or both of the target achievements are zero (OPbT or RWA), target achievement for the Group component will also be zero. Target values for the OPbT and RWA parameters are agreed upon between the Management Board and the Supervisory Board, on the basis of the medium-term planning. Caps are determined when setting target values for these two parameters: target achievement for OPbT is capped at 150 % if the upper threshold is exceeded. RWA target achievement is capped at 125 % if the upper threshold is exceeded. If target achievement falls below the respective lower threshold, a zero per cent figure will be used for the component related to Group performance.

The performance of the organisational unit for divisions allocated to Sales and of the Treasury division is measured using the Structured Property Financing segment result (OPbT and RWA). The performance of the Housing Industry division is measured by reference to the segment result (PBbT) of the Consulting/Services Segment. For organisational units within corporate services divisions or Credit Management, as well as for Operations (together, the Corporate Centre), performance of the respective organisational unit is measured by reference to the cost target for that unit.

The component related to Group performance as well as the target achievement level of the organisational unit are measured together, and are capped at a maximum target achievement level of 150 %.

The component related to individual performance is measured in terms of personal performance; it is determined on the basis of the performance appraisal, and the degree to which the respective manager has achieved individual targets agreed upon. Where the component related to individual performance is measured with a zero rating, this will set the entire variable remuneration component to zero. The individual component across all risk takers is capped at 125 % in aggregate.

The Management Board may reduce the variable remuneration or, if appropriate, determine it to be zero, if by publication of the annual report for the year under review, the own funds of Aareal Bank AG do not meet the requirements under section 10 (1) or (3), or under section 45b (1) of the KWG, or if its funds are not invested in compliance with the requirements of section 11 (1) of the KWG, or if the development of Aareal Bank AG's assets and liabilities, profitability or financial position justifies the assumption that it will not be able to meet these requirements on a sustainable basis.

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 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.

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 InstitutsVergV in connection with art. 450 of the CRR) as well as the review of the risk taker analysis.

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

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

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

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	2017	265,000	33,000	298,000
Chairman	2016	265,000	33,000	298,000
Prof. Dr Stephan Schüller	2017	125,000	25,000	150,000
Deputy Chairman	2016	125,000	24,000	149,000
York-Detlef Bülow	2017	125,000	24,000	149,000
Deputy Chairman	2016	125,000	23,000	148,000
Thomas Hawel	2017	65,000	10,000	75,000
	2016	65,000	13,000	78,000
Dieter Kirsch	2017	85,000	17,000	102,000
	2016	85,000	18,000	103,000
Richard Peters	2017	100,000	21,000	121,000
	2016	100,000	21,000	121,000
Dr Hans-Werner Rhein	2017	85,000	15,000	100,000
	2016	85,000	17,000	102,000
Sylvia Seignette	2017	90,000	10,000	100,000
	2016	90,000	13,000	103,000
Elisabeth Stheeman[1)]	2017	85,000	14,000	99,000
	2016	85,000	16,000	101,000
Hans-Dietrich Voigtländer	2017	115,000	24,000	139,000
	2016	115,000	25,000	140,000
Prof. Dr Hermann Wagner	2017	110,000	16,000	126,000
	2016	110,000	19,000	129,000
Beate Wollmann	2017	50,000	6,000	56,000
	2016	50,000	9,000	59,000
Total	**2017**	**1,300,000**	**215,000**	**1,515,000**
	2016	**1,300,000**	**231,000**	**1,531,000**

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

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 2017. Therefore, no additional remuneration was paid.

Additional disclosure on share-based remuneration

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:

	2017	2016
Quantity (number)		
Balance (outstanding) at 1 January	**538,679**	**519,195**
granted during the reporting period	163,172	207,668
vested during the reporting period	-	-
exercised during the reporting period	169,372	188,184
Balance (outstanding) at 31 December	**532,479**	**538,679**
of which: exercisable	-	-

The fair value of the virtual shares granted during the reporting period amounted to € 6.2 million (2016: € 7.4 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 € 35.61 (2016: € 27.71).

The virtual shares outstanding at 31 December 2017 have a limited contract term. The weighted average remaining contract term of these virtual shares amounts to 434.93 days (2016: 453.27 days).

Impact on financial performance

The total amount expensed for share-based payment transactions was € 9.4 million during the financial year 2017 (2016: € 13.4 million). The portion of the total amount expensed attributable to members of the Management Board amounted to € 3.0 million (2016: € 3.8 million) and can be broken down to the individual members of the Management Board as follows:

	2017	2016
€		
Hermann J. Merkens	1,018,900	1,424,186
Dagmar Knopek	593,432	842,891
Christiane Kunisch-Wolff [1)]	413,174	338,273
Thomas Ortmanns	604,019	946,738
Christof Winkelmann [2)]	410,542	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, € 0.1 million (2016: € 0.7 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 million (2016: € 0.0 million), since there were no exercisable virtual shares at that date. The obligation from share-based payment transactions as at 31 December 2017 amounted to € 27.8 million (2016: € 27.4 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 2017	1 Jan-31 Dec 2016
Short-term benefits	7,214	6,685
Post-employment benefits	2,710	811
Other long-term benefits	1,577	1,538
Termination benefits	-	-
Share-based remuneration	2,628	2,560
Total	**14,129**	**11,594**

Provisions for pension obligations concerning key executives totalled € 10.6 million as at 31 December 2017 (2016: € 7.9 million).

Other Disclosures

Declaration pursuant to section 28 of the German Pfandbrief Act (Pfandbriefgesetz – "PfandBG")

Public-sector lending

Total volume of outstanding public-sector Pfandbriefe and of the related cover assets in terms of nominal value and present value (section 28 (1) nos. 1 and 3 of the PfandBG):

	31 Dec 2017			31 Dec 2016		
€ mn	Cover assets pool	Pfandbriefe outstanding	Excess cover	Cover assets pool	Pfandbriefe outstanding	Excess cover
Nominal value	2,410.0	2,065.1	344.9	2,350.1	2,009.8	340.3
of which: derivatives	-	-	-	-	-	-
Present value	3,076.8	2,603.0	473.8	3,102.5	2,649.5	453.0
of which: derivatives	117.6	-	-	139.1	-	-
Risk-adjusted net present value[1)]	2,876.0	2,464.7	411.3	2,929.7	2,574.2	355.5

1) Dynamic method pursuant to section 5 PfandBarwertV/static method pursuant to section 6 PfandBarwertV

Maturity structure of outstanding public-sector Pfandbriefe and fixed-interest periods of the related cover assets (section 28 (1) no. 2 of the PfandBG):

	31 Dec 2017		31 Dec 2016	
	Cover assets pool	Pfandbriefe outstanding	Cover assets pool	Pfandbriefe outstanding
€ mn				
Up to 6 months	164.3	123.6	55.2	82.5
Between 6 months and 12 months	293.5	322.5	71.4	125.2
Between 12 months and 18 months	60.4	81.3	67.2	114.1
Between 18 months and 2 years	146.6	59.7	253.2	322.5
Between 2 years and 3 years	192.2	168.6	307.1	113.5
Between 3 years and 4 years	204.7	138.3	114.6	113.6
Between 4 years and 5 years	181.6	131.5	160.7	37.3
Between 5 years and 10 years	392.7	648.6	593.7	593.4
More than 10 years	774.0	391.0	727.0	507.7
Total	**2,410.0**	**2,065.1**	**2,350.1**	**2,009.8**

Breakdown of assets used as cover for public-sector Pfandbriefe (based on their nominal value) by their amount (section 28 (3) sentence 1 of the PfandBG):

	2017	2016
Amount classes		
Up to € 10 million	266.5	54.1
More than € 10 million and up to € 100 million	940.0	737.1
More than € 100 million	1,203.5	1,558.9
Total	**2,410.0**	**2,350.1**

Breakdown of assets used as cover assets for public-sector Pfandbriefe (based on their nominal value), by borrower's/guarantor's country of domicile, in line with section 28 (3) no. 2 of the PfandBG:

31 December 2017

	Total	Guarantees due to promotion of export activities	of which owed by				of which guaranteed by			
				Public-sector entities				Public-sector entities		
			Sover-eigns	Regional	Municipal	Other	Sover-eigns	Regional	Municipal	Other
€ mn										
Germany	1,990.8	-	2.0	1,255.7	383.9	224.5	0.2	5.9	97.3	21.3
EU institutions	118.9	-	-	-	-	-	118.9	-	-	-
France	1.3	-	-	-	1.3	-	-	-	-	-
Italy	39.0	-	39.0	-	-	-	-	-	-	-
Japan	20.0	-	-	-	20.0	-	-	-	-	-
Austria	100.0	-	75.0	25.0	-	-	-	-	-	-
Poland	25.0	-	25.0	-	-	-	-	-	-	-
Spain	115.0	-	-	115.0	-	-	-	-	-	-
Total	**2,410.0**	**-**	**141.0**	**1,395.7**	**405.2**	**224.5**	**119.1**	**5.9**	**97.3**	**21.3**

31 December 2016

	Total	Guarantees due to promotion of export activities	of which owed by				of which guaranteed by			
				Public-sector entities				Public-sector entities		
			Sover-eigns	Regional	Municipal	Other	Sover-eigns	Regional	Municipal	Other
€ mn										
Germany	1,844.1	-	53.0	1,418.4	-	316.5	0.8	4.6	28.1	22.7
EU institutions	149.9	-	-	-	-	-	149.9	-	-	-
France	57.1	-	55.0	-	2.1	-	-	-	-	-
Italy	39.0	-	39.0	-	-	-	-	-	-	-
Japan	20.0	-	-	-	20.0	-	-	-	-	-
Austria	100.0	-	75.0	25.0	-	-	-	-	-	-
Poland	25.0	-	25.0	-	-	-	-	-	-	-
Spain	115.0	-	-	115.0	-	-	-	-	-	-
Total	**2,350.1**	**-**	**247.0**	**1,558.4**	**22.1**	**316.5**	**150.7**	**4.6**	**28.1**	**22.7**

Additional cover assets (section 28 (1) nos. 4 and 5 of the PfandBG)

31 December 2017

€ mn	Equalisation claims pursuant to section 20 (2) no. 1	Money claims pursuant to section 20 (2) no. 2 Total	of which: covered bonds within the meaning of Art. 129 of EU Regulation No. 575/2013	Total
Countries				
Germany	-	35.0	-	35.0
	-	-	-	-
Total	**-**	**35.0**	**-**	**35.0**

31 December 2016

In accordance with section 28 (1) no. 4 and no. 5 of the PfandBG, the total volume of additional cover assets pursuant to section 20 (2) no. 1 and no. 2 of the PfandBG was €0.0 million.

Additional key figures for outstanding Pfandbriefe and related cover assets:

	2017		2016	
Outstanding Pfandbriefe	**2,065.1**	**€ mn**	**2,009.8**	**€ mn**
of which: share of fixed-income Pfandbriefe	79.5	%	76.8	%
Cover assets pool	**2,410.0**	**€ mn**	**2,350.1**	**€ mn**
of which: total volume of receivables above the percentage limits set out in section 20 (2) of the PfandBG	–	€ mn	–	€ mn
of which: share of fixed-income cover assets	87.9	%	90.3	%

Net present value pursuant to section 6 of the German Regulation of the Net Present Value of Pfandbriefe (Pfandbrief-Barwertverordnung) per foreign currency:

€ mn	Balance of assets and liabilities 2017	Balance of assets and liabilities 2016
Currency		
EUR	361.4	355.5
CHF	55.6	0.0
GBP	0.0	-0.1

There were no such payment arrears of 90 days or more in the reporting period, nor in the comparable period of the previous year.

Mortgage lending

Total volume of outstanding public-sector Pfandbriefe and of the related cover assets in terms of nominal value and present value (section 28 (1) nos. 1 and 3 of the PfandBG):

€ mn	31 Dec 2017 Cover assets pool	31 Dec 2017 Pfandbriefe outstanding	31 Dec 2017 Excess cover	31 Dec 2016 Cover assets pool	31 Dec 2016 Pfandbriefe outstanding	31 Dec 2016 Excess cover
Nominal value	13,416.0	10,334.2	3,081.8	11,712.0	9,036.7	2,675.3
of which: derivatives	190.6	-	-	-101.7	-	-
Present value	14,576.3	11,150.3	3,426.0	12,830.8	9,650.5	3,180.3
of which: derivatives	295.7	-	-	85.2	-	-
Risk-adjusted net present value[1)]	14,486.9	11,180.3	3,306.6	12,819.4	9,746.5	3,072.9

[1)] Dynamic method pursuant to section 5 PfandBarwertV/static method pursuant to section 6 PfandBarwertV

Maturity structure of outstanding mortgage Pfandbriefe and fixed-interest periods of the related cover assets (section 28 (1) no. 2 of the PfandBG):

€ mn	31 Dec 2017 Cover assets pool	31 Dec 2017 Pfandbriefe outstanding	31 Dec 2016 Cover assets pool	31 Dec 2016 Pfandbriefe outstanding
Up to 6 months	857.7	1,748.9	768.2	1,204.0
Between 6 months and 12 months	990.3	819.6	760.3	837.5
Between 12 months and 18 months	1,654.2	1,583.1	694.5	1,504.0
Between 18 months and 2 years	1,431.1	602.9	712.9	754.4
Between 2 years and 3 years	1,905.1	1,416.3	2,784.4	1,850.6
Between 3 years and 4 years	1,756.7	735.8	2,305.8	482.9
Between 4 years and 5 years	1,576.8	1,521.9	1,415.0	561.9
Between 5 years and 10 years	2,877.1	1,484.5	2,008.0	1,581.0
More than 10 years	367.0	421.2	262.9	260.4
Total	**13,416.0**	**10,334.2**	**11,712.0**	**9,036.7**

Breakdown of assets used as cover (based on their nominal value) by their amount (section 28 (2) sentence 1 no. 1a of the PfandBG)

€	Cover assets pool 2017	Cover assets pool 2016
Breakdown of the amounts measured at nominal value by volume		
Up to € 300 thousand	632.5	16.1
Between € 300 thousand and € 1 million	94.7	64.2
Between € 1 million and € 10 million	702.0	628.7
More than € 10 million	9,863.0	10,405.2
Total	**11,292.2**	**11,114.2**

Additional cover assets pursuant to section 28 (1) nos. 4, 5 and 6 of the PfandBG:

31 December 2017

€ mn	Equalisation claims pursuant to section 19 (1) no. 1	Money claims pursuant to section 19 (1) no. 2 – Total	Money claims pursuant to section 19 (1) no. 2 – of which: covered bonds within the meaning of Art. 129 of EU Regulation No. 575/2013	Debt securities pursuant to section 19 (1) no. 3	Total
Countries					
Germany	-	-	-	1,502.7	**1,502.7**
EU institutions	-	-	-	259.5	**259.5**
France	-	-	-	75.0	**75.0**
Austria	-	-	-	96.0	**96.0**
Total	**-**	**-**	**-**	**1,933.2**	**1,933.2**

31 December 2016

€ mn	Equalisation claims pursuant to section 19 (1) no. 1	Money claims pursuant to section 20 (2) no. 2 – Total	Money claims pursuant to section 20 (2) no. 2 – of which: covered bonds within the meaning of Art. 129 of EU Regulation No. 575/2013	Debt securities pursuant to section 19 (1) no. 3	Total
Countries					
Germany	-	-	-	445.5	**445.5**
EU institutions	-	-	-	30.0	**30.0**
France	-	-	-	95.0	**95.0**
Austria	-	-	-	129.0	**129.0**
Total	**-**	**-**	**-**	**699.5**	**699.5**

Additional key figures for outstanding Pfandbriefe and related cover assets:

	2017		2016	
Outstanding Pfandbriefe	**10,334.2**	**€ mn**	**9,036.7**	**€ mn**
of which: share of fixed-income Pfandbriefe	66.3	%	53.9	%
Cover assets pool	**13,416.0**	**€ mn**	**11,712.0**	**€ mn**
of which: total volume of receivables above the limits set out in section 13 (1) of the PfandBG	-	€ mn	-	€ mn
of which: total volume of receivables above the percentages set out in section 19 (1) no. 2 of the PfandBG	-	€ mn	-	€ mn
of which: total volume of receivables above the percentages set out in section 19 (1) no. 3 of the PfandBG	-	€ mn	-	€ mn
of which: share of fixed-income cover assets	50.9	%	39.2	%
Volume-weighted average age of receivables (seasoning)	**5.7**	**Years**	**5.0**	**Years**
Weighted average mortgage lending value ratio, based on mortgage lending value	**56.1**	**%**	**57.5**	**%**
Weighted average mortgage lending value ratio, based on market value	**37.0**	**%**	**37.8**	**%**

Net present value pursuant to section 6 of the German Regulation of the Net Present Value of Pfandbriefe (Pfandbrief-Barwertverordnung) per foreign currency:

€ mn	Balance of assets and liabilities 2017	Balance of assets and liabilities 2016
Currency		
CAD	18.6	31.9
CHF	15.7	10.4
CZK	0.0	0.0
DKK	118.3	82.0
EUR	3,011.6	2,757.8
GBP	81.6	174.8
JPY	0.0	0.0
NOK	0.0	0.5
SEK	3.8	24.5
USD	113.4	40.7

Distribution of the amounts measured at nominal value and used to cover mortgage Pfandbriefe by countries in which the real property collateral is located (section 28 (2) sentence 1 no. 1b, c of the PfandBG):

31 December 2017

	Commercial property							Residential property						
	Building plots only	New buildings not yet yielding returns	Office buildings	Retail property	Industrial	Other	**Total**	Building plots only	New buildings not yet yielding returns	Condominiums	One- and two-family homes	Multi-family homes	**Total**	**Total cover assets pool**
€ mn														
Belgium			109.0	101.5	9.0	18.5	**238.0**							238.0
Denmark		57.5	49.4		25.5	43.3	**175.7**					7.6	**7.6**	183.3
Germany	0.1	17.5	580.1	351.0	315.8	363.7	**1,628.2**			0.6	470.7	643.8	**1,115.1**	2,743.3
Estonia				18.7			**18.7**							18.7
Finland			83.5	101.8	11.8		**197.1**							197.1
France		32.3	696.7	185.8	77.3	131.2	**1,123.3**							1,123.3
UK			167.4	862.0	53.3	423.3	**1,506.0**							1,506.0
Italy			119.5	355.3	61.9	94.2	**630.9**					82.8	**82.8**	713.7
Canada						180.6	**180.6**							180.6
Luxembourg						4.5	**4.5**							4.5
Netherlands			91.2	76.5	30.8	220.7	**419.2**							419.2
Austria			25.8	47.9			**73.7**							73.7
Poland			159.2	287.2			**446.4**							446.4
Sweden				77.0	170.4		**247.4**							247.4
Switzerland						188.8	**188.8**							188.8
Spain			118.9	321.2	19.3	69.6	**529.0**							529.0
Czech Republic						17.4	**17.4**							17.4
Hungary			28.8	49.2			**78.0**							78.0
USA			1,355.3	571.9		374.9	**2,302.1**					81.7	**81.7**	2,383.8
Total	**0.1**	**107.3**	**3,584.8**	**3,407.0**	**775.1**	**2,130.7**	**10,005.0**			**0.6**	**470.7**	**815.9**	**1,287.2**	11,292.2

31 December 2016

€ mn	Commercial property							Residential property						
	Building plots only	New buildings not yet yielding returns	Office buildings	Retail property	Industrial	Other	**Total**	Building plots only	New buildings not yet yielding returns	Condominiums	One- and two-family homes	Multi-family homes	**Total**	**Total cover assets pool**
Belgium			103.8	99.3	9.0	18.5	**230.6**							230.6
Denmark		39.1	69.3	6.1	25.6	43.5	**183.6**		14.0			7.6	**21.6**	205.2
Germany		17.5	603.4	275.9	322.2	299.5	**1,518.5**			0.4	4.5	589.8	**594.7**	2,113.2
Estonia				18.7			**18.7**							18.7
Finland			41.6	127.2	11.8		**180.6**							180.6
France		12.4	694.0	131.0	186.0	248.9	**1,272.3**					3.8	**3.8**	1,276.1
UK			291.2	678.3	55.3	465.5	**1,490.3**							1,490.3
Italy			256.3	221.3	55.3	126.0	**658.9**					86.8	**86.8**	745.7
Canada						121.4	**121.4**							121.4
Luxembourg						4.5	**4.5**							4.5
Netherlands		15.8	96.0	135.4	23.4	195.0	**465.6**							465.6
Norway					5.3		**5.3**							5.3
Austria				102.3			**102.3**							102.3
Poland			188.4	342.5			**530.9**							530.9
Sweden			59.3	161.9	196.0		**417.2**							417.2
Switzerland						206.5	**206.5**							206.5
Spain		29.4	105.1	304.7		93.0	**532.2**							532.2
Czech Republic	3.8		28.8			25.2	**57.8**							57.8
US		15.3	1,450.0	583.9		292.2	**2,341.4**		22.0			46.7	**68.7**	2,410.1
Total	**3.8**	**129.5**	**3,987.2**	**3,188.5**	**889.9**	**2,139.7**	**10,338.6**		**36.0**	**0.4**	**4.5**	**734.7**	**775.6**	11,114.2

Arrears from mortgage loans used to cover mortgage Pfandbriefe (section 28 (2) no. 2 of the PfandBG)

€ mn	Aggregate payments which are at least 90 days overdue 2017	Total amount of these receivables, to the extent that the relevant amount overdue is not less than 5 % of the receivable 2017	Aggregate payments which are at least 90 days overdue 2016	Total amount of these receivables, to the extent that the relevant amount overdue is not less than 5 % of the receivable 2016
Germany	0.1	-	-	-
	-	-	-	-
Total	**0.1**	**-**	**-**	**-**

Additional disclosures on mortgage receivables (section 28 (2) no. 4 of the PfandBG):

During the financial year 2017, the Bank did not acquire any properties for the purpose of loss prevention (2016: –).

As at 31 December 2017, there were no foreclosures or forced administration procedures pending, and neither had any foreclosures been carried out (2016: –).

As at 31 December 2017, interest payments were overdue in the amount of € 1.2 million (2016: € 4.1 million) for commercial property, and in the amount of € 0.0 million (2016: € 0.0 million) for residential property.

Contingencies

By means of a Letter of Comfort in favour of the Monetary Authority of Singapore, Aareal Bank AG has undertaken to ensure that Aareal Bank Asia Ltd. is able to fulfil its obligations at any time.

Events after the reporting date

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

Loans to executive bodies of Aareal Bank

The following list provides an overview of existing loans to related parties:

€ mn	31 Dec 2017	31 Dec 2016
Management Board	-	-
Supervisory Board	-	0.0
Total	-	0.0

The credit line granted to a Supervisory Board member in the amount was repaid in 2017 (2016: € 0.04 million).

Employees

The average staffing level is shown below:

	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Yearly average		
Salaried employees	887	945
Executives	42	42
Total	**929**	**987**
of which: Part-time employees	197	201

Auditors' fees

The total fees charged by the auditor for the financial year 2017 are as follows:

	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
€ 000's		
Category		
Auditing fees	3,899.9	3,754.0
Other assurance services	140.0	31.5
Tax advisory services	2.1	12.9
Other services	478.9	1,075.9
Total	**4,520.9**	**4,874.3**

Other assurance services refer to, for example, the review in accordance with the German Securities Trading Act (WpHG), deposit protection, the bank levy, comfort letters and the separate non-financial statement. Tax advisory services relate to general tax advice rendered. Other services include regulatory advice.

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 2017, we were aware of the following shareholders holding a share in the voting rights of at least 3 % pursuant to section 33 (1) of the WpHG:

	Location	Total [1]	Notification date
Responsible entity			
VBL	Karlsruhe	6.50 %	3 February 2015
DEKA	Frankfurt	5.58 %	3 February 2015
Blackrock	Wilmington	4.95 %	23 October 2017
State of Norway (through Norges Bank)	Oslo	3.20 %	5 December 2017
Allianz Global Investors	Frankfurt	3.08 %	5 December 2016
Dimensional Fund	Austin	3.04 %	29 May 2012

[1] Direct and indirect holdings of voting rights

Corporate Governance Code

The Management Board and the Supervisory Board issued the Declaration of Compliance as stipulated in section 161 of the AktG, and made this Declaration available to shareholders. It is available to the public on the Company's website on www.aareal-bank.com/en/about-us/corporate-governance/.

Proposal on the appropriation of profits

The Management Board of Aareal Bank AG proposes to the Annual General Meeting that the net retained profit of € 149,643,052.50 for the financial year 2017, as reported under the German Commercial Code (HGB), be used to distribute a dividend of € 2.50 per notional no-par value share.

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 (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
(Non-commercial mandates)	
FAZIT – Stiftung Gemeinnützige Verlagsgesellschaft mbH	Shareholder and member of the Advisory Board
Städelsches Kunstinstitut und Städtische Galerie	Member of the Administration
Gesellschaft der Freunde der Alten Oper Frankfurt e.V.	Deputy Chairman of the Management Board
Stiftung Centrale für private Fürsorge	Chairman of the Management 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 *(liquidation planned)*	Deputy Chairman of the Supervisory Board *(not active)*
Howaldt & Co. Investmentaktiengesellschaft TGV	Chairman of the Supervisory Board
(Offices held at subsidiaries of Bankhaus Lampe KG)	
Lampe Equity Management GmbH	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 *(liquidation planned)*	Member of the Supervisory Board *(not active)*
(Non-commercial mandates)	
EAPSPI (European Association of Public Sector Pension Institutions)	Member of the Board of Directors
VBLV e.V.	Chairman of the Management Board

* Employee representative member of the Supervisory Board of Aareal Bank AG

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	
(Non-commercial mandates)		
Müller-Matthieu Stiftung	Chairman of the Management Board	
ARIAS Deutschland e.V.	Chairman of the Management Board	
St. Petri Stiftung, Hamburg	Member of the Management 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	
(Offices held with other listed companies)		
TLG Immobilien AG	Member of the Supervisory Board	
Korian SA	Member of the Supervisory Board	since 22 June 2017

Hans-Dietrich Voigtländer **Senior Partner at BDG Innovation + Transformation GmbH & Co. KG**		
Aareal Bank AG	Member of the Supervisory Board	

Prof. Dr Hermann Wagner, Chairman of the Audit Committee **German Chartered Accountant, tax consultant**		
Aareal Bank AG**	Member of the Supervisory Board	
btu beraterpartner Holding AG	Member of the Supervisory Board	
Squadra Immobilien GmbH & Co. KgaA	Member of the Supervisory Board	
(Offices held with other listed companies)		
PEH Wertpapier AG	Member of the Supervisory Board	
DEMIRE Deutsche Mittelstand Real Estate AG	Chairman 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

** The European Central Bank gave its consent to this office pursuant to section 25d (3) sentence 5 of the KWG.

Composition of Supervisory Board 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 & Controlling, Corporate Strategy, Project & Credit Portfolio Management, Corporate Communications, Investor Relations incl. Sustainability, Board Office, Human Resources, Legal, and Audit

(Offices held at companies of Aareal Bank Group)		
Aareal Estate AG	Chairman of the Supervisory Board	
Aareal Capital Corporation	Chairman of the Board of Directors	
Aareon AG	Deputy Chairman of the Supervisory Board	
Aareal Beteiligungen AG (formerly Corealcredit)	Chairman of the Supervisory Board	
SoftS IT Solutions AG	Deputy Chairman of the Supervisory Board	since 1 March 2017
Westdeutsche Immobilien Servicing AG (formerly: Westdeutsche ImmobilienBank AG)	Chairman of the Supervisory Board	until 11 August 2017

Dagmar Knopek, Member of the Management Board
Credit Management, Workout and Operations

HypZert GmbH	Chairman of the Supervisory Board	since 18 May 2017
(Offices held at companies of Aareal Bank Group)		
Aareon AG	Member of the Supervisory Board	
Westdeutsche Immobilien Servicing AG (formerly: Westdeutsche ImmobilienBank AG)	Member of the Supervisory Board	until 11 August 2017
Westdeutsche Immobilien Servicing AG (formerly: Westdeutsche ImmobilienBank AG)	Chairman of the Supervisory Board	since 11 August 2017

Christiane Kunisch-Wolff, Member of the Management Board
Risk Controlling, Regulatory Affairs and Compliance

(Offices held at companies of Aareal Bank Group)		
Westdeutsche Immobilien Servicing AG (formerly: Westdeutsche ImmobilienBank AG)	Member of the Supervisory Board	

Thomas Ortmanns, Member of the Management Board
Housing Industry, Treasury, Information Technology and Organisation

HypZert GmbH	Member of the Supervisory Board	until 18 May 2017
(Offices held at companies of Aareal Bank Group)		
Aareal First Financial Solutions AG	Chairman of the Supervisory Board	until 19 April 2017
Aareon AG	Chairman of the Supervisory Board	
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Chairman of the Supervisory Board	until 2 March 2017
SoftS IT Solutions AG	Chairman of the Supervisory Board	since 1 March 2017
Westdeutsche Immobilien Servicing AG (formerly: Westdeutsche ImmobilienBank AG)	Member of the Supervisory Board	until 31 July 2017

Christof Winkelmann, Member of the Management Board
Sales Unit Structured Property Financing

(Offices held at companies of Aareal Bank Group)		
Aareal Bank Asia Limited	Chairman of the Board of Directors	
Aareal Capital Corporation	Member of the Board of Directors	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 for financial reporting, the financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company, and the management report includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal opportunities and risks associated with the expected development of the Company.

Wiesbaden, 5 March 2018

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 Annual Financial Statements and of the Management Report

Audit Opinions

We have audited the annual financial statements of Aareal Bank AG, Wiesbaden, which comprise the balance sheet as of 31 December 2017, and the statement of profit and loss for the financial year from 1 January to 31 December 2017, and notes to the financial statements, including the recognition and measurement policies presented therein. In addition, we have audited the management report of Aareal Bank AG for the financial year from 1 January to 31 December 2017. We have not audited the content of the statement on corporate governance pursuant to § [Article] 289f HGB [Handelsgesetzbuch: German Commercial Code] in accordance with the German legal requirements.

In our opinion, on the basis of the knowledge obtained in the audit,

- the accompanying annual financial statements comply, in all material respects, with the requirements of German commercial law and give a true and fair view of the assets, liabilities and financial position of the Company as of 31 December 2017, and of its financial performance for the financial year from 1 January to 31 December 2017, in compliance with German Legally Required Accounting Principles, and

- the accompanying management report as a whole provides an appropriate view of the Company's position. In all material respects, this management report is consistent with the annual financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our audit opinion on the management report does not cover the content of the statement on corporate governance referred to above.

Pursuant to § 322 Abs. [paragraph] 3 Satz [sentence] 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the annual financial statements and of the management report

Basis for the Audit Opinions

We conducted our audit of the annual financial statements and of the management report in accordance with § 317 HGB and the EU Audit Regulation (No. 537/2014, referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's Responsibilities for the Audit of the Annual Financial Statements and of the Management Report" section of our auditor's report. We are independent of the Company in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions on the annual financial statements and on the management report.

Key Audit Matters in the Audit of the Annual Financial Statements

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the annual financial statements for the financial year from 1 January to 31 December 2017. These matters were addressed in the context of our audit of the annual financial statements as a whole, and in forming our audit opinion thereon; we do not provide a separate audit opinion on these matters.

In our view, the following matters were most important in our audit:

1. Recoverability of the Italian mortgage loan portfolio
2. Modification of the procedure to determine the allowance for credit losses in the lending business
3. Recoverability of properties acquired from previous loan exposures, as indirectly reported under "Investments in affiliated companies" in the balance sheet
4. Spin-off and transfer of the banking business of the subsidiary Westdeutsche Immobilien-Bank AG to Aareal Bank AG

The presentation of these particularly important audit matters is based on the following structure:

① Matter and issue

② Audit approach and findings

③ Reference to further information

Hereinafter we present the key audit matters:

1. Recoverability of the Italian mortgage loan portfolio

① In the annual financial statements of Aareal Bank AG, loans and advances to customers in the amount of EUR 2.8 billion that are secured by properties in Italy (hereinafter "Italian mortgage loan portfolio") are reported as of 31 December 2017. 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 realization 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 rent rolls provided, and generally reviews the market values of the corresponding 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 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 collateral is expected to be insufficient, the Company applies a specific valuation allowance. When determining the risk allowances for the Italian mortgage loan portfolio, the executive directors make 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 significance during our audit.

② As part of our audit we evaluated, inter alia, the existing documents relating to the financial circumstances and the recoverability of the pledged collateral in a risk-focused sample of exposures. We evaluated the valuations performed by the appraisers in terms of their suitability, up-to-dateness and methodology, as well as the transparency of the value calculation. At the same time, we gained an understanding of the original data, value parameters and assumptions on which the valuations were based, evaluated these critically and assessed whether they were within a justifiable range. In specific cases, we carried out our own property inspections. In addition, we based our assessment of the executive directors' assumptions concerning realisation and completion on general and sector-specific market expectations as well as on documentation and explanations from the executive directors about expected cash inflows and outflows. Furthermore, we examined the relevant credit processes within the Aareal Bank AG's internal control terms of the appropriateness of their design and tested their effectiveness. Taking account of the information available, we conclude that the assumptions made by the executive directors for testing the impairment of the Italian mortgage loan portfolio and the processes implemented are appropriate.

③ With respect to the allowance for credit losses, in this context please refer to the disclosures on loans and advances in the section "Accounting and valuation principles" in the notes to the financial statements. These contain information on the allowance for credit losses for the Italian real estate lending portfolio.

❷ Modification of the procedure to determine the allowance for credit losses in the lending business

① In financial year 2017, Aareal Bank AG refined and modified the procedure used to determine the allowance for credit losses. A specific valuation allowance will continue to be recognized if the borrower review identifies a default within the meaning of the supervisory requirements, and realization of the collateral is not expected to generate sufficient proceeds. The calculation of collateral proceeds was refined to the effect that, instead of the most probable amount of proceeds, it is now generally based on the expected value of proceeds taking into consideration various possible scenarios. Loans and advances for which no specific valuation allowance has been recognized are included in the calculation of the portfolio impairment allowance. This is calculated using a parameter-based procedure. The change in methodology for the portfolio impairment allowance concerns loans for which the default risk has increased significantly since the loan was granted. The expected loss over the entire period until maturity of these loans is now recognized, whereas to date only the expected loss for the next twelve months was taken into account. Taking into consideration discounting effects, these changes gave rise to a EUR 23 million net addition to the allowance for credit losses in 2017, which was recognized in the income statement under "Write-downs and valuation allowances of loans and advances and specific securities, as well as additions to loan loss provisions". We consider these matters to be of particular significance, especially due to the scope for discretion in calculating the proceeds from collateral and the material effects on the annual financial statements of Aareal Bank AG.

② As part of our audit, we initially assessed the modifications made to the methodology. We then examined, in a sample, whether the modifications had been implemented accordingly in determining the specific valuation and portfolio impairment allowances. In doing so, we took into particular account the determination of collateral proceeds relating to loans for which specific valuation allowances had been recognized, as well as the input parameters applied for the portfolio impairment allowances. This included critically evaluating those assumptions made by Aareal Bank AG that affected the expected value of the respective proceeds from collateral. Furthermore, we verified that the changes to the allowance for credit losses had been recorded in the accounting system and reported in the annual financial statements. Based on our audit procedures, we were able to satisfy ourselves that the estimates and assumptions made by the executive directors to modify the process to determine the allowance for credit losses were reasonable and adequately documented.

③ The Company's disclosures on determining the specific valuation and portfolio impairment allowances are contained in the section on loans and advances under "Accounting and valuation principles" in the notes to the annual financial statements.

❸ Recoverability of properties acquired from previous loan exposures, as indirectly reported under "Investments in affiliated companies" in the balance sheet

① In the annual financial statements of Aareal Bank AG, EUR 291 million in properties acquired from previous loan exposures held as real estate special purpose entities were reported under the "Investments in affiliated companies" balance sheet item as of 31 December 2017. Investment management at Aareal Bank AG tests the investments for impairment at each balance sheet date. This includes impairment testing on the properties acquired from previous loan exposures, which is carried out at least once a year on the basis of external valuations. The market values of the properties are determined in each case as the present values of the expected future cash flows using the discounted cash flow method, or on the basis of floor area-adjusted comparative values with the appraisers using the information and planning projections provided by the executive directors to derive assumptions about the future cash flows. In addition, the executive directors make assumptions about leasing and marketing. Given that even small changes in these assumptions have a significant influence on the market values of the properties and consequently the carrying amount of the investment, and that the measurements are thus subject to uncertainties, this matter was of particular significance during our audit.

② Our audit included in particular assessing the valuations carried out by external appraisers with respect to whether these were up to date, as well as the methodology applied and the transparency of the valuation. At the same time, we obtained an understanding of the source data, value inputs and assumptions underlying the appraisals, evaluated those factors critically and assessed whether they lay within a reasonable range. In this connection, we have involved our own real estate experts. In specific cases, we carried out our own property inspections. In addition, our assessment of the assumptions made by the executive directors with respect to leasing and marketing was based on inputs including a comparison with general and sector-specific market expectations as well as documents and explanations from the executive directors about expected cash flows. Based on the available information, our audit found that the assumptions made by the executive directors in conducting impairment testing on the properties acquired from previous loan exposures, as reported under "Investments in affiliated companies" in the balance sheet, were appropriate.

③ Please refer to the disclosures on investments in affiliated companies, which can be found in the section entitled "Accounting and valuation principles" in the notes to the financial statements.

❹ Spin-off and transfer of the banking business of the subsidiary Westdeutsche ImmobilienBank AG to Aareal Bank AG

① Until 30 June 2017, Westdeutsche ImmobilienBank AG, Mainz (hereinafter "WestImmo") was held as an indirect subsidiary of Aareal Bank AG via the wholly owned subsidiary GEV GmbH, Wiesbaden (hereinafter "GEV"), and was reported under the "Investments in affiliated companies" balance sheet item in the annual financial statements of Aareal Bank AG. In the course of integrating WestImmo's banking business into Aareal Bank AG, GEV was merged with Aareal Bank AG. The net gain from the merger amounted to EUR 7 million and was reported in the annual financial statements of Aareal Bank AG under extraordinary income in the income statement. WestImmo's banking business, in particular receivables and payables from customers, was subsequently spun off and transferred to Aareal Bank AG, which resulted in extraordinary income for Aareal Bank AG in the amount of EUR 77 million. The total assets acquired by Aareal Bank AG amounted to EUR 5.4 billion. After the spin-off of its banking operations, WestImmo was renamed Westdeutsche Immobilien Servicing AG and its object was changed to provision of credit servicing for the Aareal Bank Group. We consider these matters to be of particular significance, especially due to the complexity of the merger and the spin-off process and the effects on the annual financial statements of Aareal Bank AG.

② To audit the accounting treatment of the GEV merger and the spin-off and transfer of WestImmo's banking operations to Aareal Bank AG, we examined in particular the bases of the merger and the spin-off process under company and stock corporation law, and assessed the corresponding contractual agreements and documents, in particular the merger agreement, the spin-off and transfer agreement, and the respective excerpts from the commercial register. We verified that the carrying amounts of Aareal Bank AG's investment in GEV and GEV's equity, as applied during the course of the merger, matched the amounts reported in the annual financial statements, and thus that the gain on the merger was correctly calculated. Based on WestImmo's closing balance sheet prepared as part of the spin-off, we examined whether the assets and liabilities were allocated in accordance with the spin-off and transfer agreement, and whether these corresponded to the respective carrying amounts reported in the closing balance sheet. Furthermore, we assessed whether the extraordinary income from the spin-off was correctly calculated and whether the assets and liabilities transferred were appropriately presented in the annual financial statements of Aareal Bank AG. In conclusion, we were able to satisfy ourselves on the basis of these and other audit procedures that, based on the available information, the merger and spin-off process was appropriately presented.

③ The Company's disclosures on the merger and on the spin-off and transfer can be found under the heading "Acquisition of the spun-off banking operations of the former Westdeutsche ImmobilienBank AG" in the section entitled "Accounting and valuation principles" in the notes to the financial statements.

Other Information

The executive directors are responsible for the other information. The other information comprises the statement on corporate governance pursuant to § 289f HGB which we obtained prior to the date of our auditor's report.

The other information comprises further the remaining parts of the annual report, which we obtained prior to the date of our auditor's report, – excluding cross-references to external information – with the exception of the audited annual financial statements, the audited management report and our auditor's report.

The separate non-financial report pursuant to § 289b Abs. 3 HGB is expected to be made available to us after the date of the auditor's report.

Our audit opinions on the annual financial statements and on the management report do not cover the other information, and consequently we do not express an audit opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- is materially inconsistent with the annual financial statements, with the management report or our knowledge obtained in the audit, or
- otherwise appears to be materially misstated.

Responsibilities of the Executive Directors and the Supervisory Board for the Annual Financial Statements and the Management Report

The executive directors are responsible for the preparation of the annual financial statements that comply, in all material respects, with the requirements of German commercial law, and that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles. In addition, the executive directors are responsible for such internal control as they, in accordance with German Legally Required Accounting Principles, have determined necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, the executive directors are responsible for assessing the Company's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting, provided no actual or legal circumstances conflict therewith.

Furthermore, the executive directors are responsible for the preparation of the management report that as a whole provides an appropriate view of the Company's position and is, in all material respects, consistent with the annual financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, the executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the management report.

The supervisory board is responsible for overseeing the Company's financial reporting process for the preparation of the annual financial statements and of the management report.

Auditor's Responsibilities for the Audit of the Annual Financial Statements and of the Management Report

Our objectives are to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the management report as a whole provides an appropriate view of the Company's position and, in all material respects, is consistent with the annual financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our audit opinions on the annual financial statements and on the management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with § 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these annual financial statements and this management report.

We exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the annual financial statements and of the management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

- Obtain an understanding of internal control relevant to the audit of the annual financial statements and of arrangements and measures (systems) relevant to the audit of the management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an audit opinion on the effectiveness of these systems of the Company.

- Evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.

- Conclude on the appropriateness of the executive directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the annual financial statements and in the management report or, if such disclosures are inadequate, to modify our respective audit opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to be able to continue as a going concern.

- Evaluate the overall presentation, structure and content of the annual financial statements, including the disclosures, and whether the annual financial statements present the underlying transactions and events in a manner that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles.

- Evaluate the consistency of the management report with the annual financial statements, its conformity with German law, and the view of the Company's position it provides.

- Perform audit procedures on the prospective information presented by the executive directors in the management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate audit opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the annual financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

Other Legal and Regulatory Requirements

Further Information pursuant to Article 10 of the EU Audit Regulation

We were elected as auditor by the annual general meeting on 31 May 2017. We were engaged by the supervisory board on 6 June 2017. We have been the auditor of the Aareal Bank AG, Wiesbaden, and its legal predecessors without interruption since the financial year 1976.

We declare that the audit opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

German Public Auditor Responsible for the Engagement

The German Public Auditor responsible for the engagement is Stefan Palm.

Frankfurt/Main, 6 March 2018

PricewaterhouseCoopers GmbH

Wirtschaftsprüfungsgesellschaft

Stefan Palm	**Lukas Sierleja**
Wirtschaftsprüfer (German Public Auditor)	**Wirtschaftsprüfer (German Public Auditor)**

Report of the Supervisory Board of Aareal Bank AG, Wiesbaden

Dear shareholders,

Aareal Bank posted yet another successful financial performance during the 2017 financial year: once again, Aareal Bank Group has demonstrated its ability to successfully deal with a dynamic environment. From a strategic perspective, the financial year under review was a successful one for Aareal Bank – major milestones of the "Aareal 2020" programme for the future were achieved.

During the financial year under review, the Supervisory Board continually advised, monitored, and supervised the management of the Company. The Management Board informed the Supervisory Board regularly, without delay and comprehensively, both orally and in writing, upon all the issues important to the Bank. The Management Board reported on the Group's situation, business development, key financial indicators and market developments. In addition, detailed reports and explanations were given to the Supervisory Board regarding the current liquidity status and liquidity management measures taken, the prevailing risk situation, and on risk control and risk management measures taken within the Group. The Supervisory Board also received comprehensive reports on the development of the business segments, and on operative and strategic planning, and was involved in all important decisions. All material events were discussed and examined in detail; where a Supervisory Board resolution was required, the decision proposals were submitted to the Supervisory Board and a decision taken. In cases where resolutions needed to be passed in between scheduled Supervisory Board meetings, such resolutions were passed by way of circulation or via conference calls.

Furthermore, between the meetings of the Supervisory Board, the Chairman of the Management Board kept the Chairman of the Supervisory Board informed, on a continuous and regular basis, both orally and in writing, on all material developments of the Company. The Chairman of the Management Board maintained close contact with the Chairman of the Supervisory Board, in order to discuss key issues and important decisions personally.

Activities of the Plenary Meeting of the Supervisory Board

Six 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. Dealing with the still challenging market environment, the large number of regulatory adjustments that are yet required and the implementation of the "Aareal 2020" programme for the future were a focal point of the work and reporting in all scheduled meetings.

Throughout the financial year, in the course of all meetings as well as during the periods between meetings, the Management Board informed the Supervisory Board about economic and market developments and their potential impact on Aareal Bank Group, in a timely, complete and comprehensible manner. These also included the measures taken in response to the general market developments, the persistent low-interest rate environment, and central bank policy in general.

During the plenary meetings of the Supervisory Board, the Management Board reported to the Supervisory Board regularly and comprehensively; these reports also covered the development of the Structured Property Financing and Consulting / Services segments, focusing on current economic developments. In addition, the Supervisory Board was informed about the business development of the entire Aareal Bank Group. At regular intervals, the Supervisory Board was informed of the Bank's liquidity status and the related steps taken by the Bank's Treasury. The Management Board also reported regularly on the quality of the property financing portfolio, against the background of general market trends and expected changes on the various property markets.

The focal points of the individual meetings are outlined below.

During the January meeting, the Supervisory Board concerned itself with the target achievement level of the individual Management Board members and the impact of the new German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – “InstitutsVergV”), as well as the orientation of the lending business.

In the March meeting, the Supervisory Board concerned itself in detail with the financial statements and consolidated financial statements presented for the 2016 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 2017 financial year, as defined by the Supervisory Board. Upon recommendation of the Audit Committee, the Supervisory Board also agreed to subject the non-financial report for 2017 (required by law for the first time in the 2017 financial year) to an audit, to obtain limited assurance. Other issues covered during the March meeting included the preparations for the Annual General Meeting in May 2017. This meeting also discussed the annual reports submitted by Internal Audit and by the Compliance Officer. Remuneration issues were also addressed.

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.

The meeting in June exclusively comprised an extensive discussion of Aareal Bank Group’s strategy, during which the Supervisory Board discussed strategic initiatives with the Management Board in considerable depth and detail.

During the September meeting, current questions concerning strategic initiatives and the latest changes to the regulatory requirements were presented and discussed, in addition to the regular reports.

In the December meeting, the Management Board reported on the Group's corporate planning, and submitted and explained the corporate planning in detail to the Supervisory Board. Corporate governance issues were discussed as well. The requisite resolutions were passed and implemented. Furthermore, the Supervisory Board adopted the regular Declaration of Compliance, pursuant to section 161 of the German Public Limited Companies Act (Aktiengesetz – "AktG"), which was subsequently published on the Bank's website. Following the regulations of section 25c and d of the German Banking Act (Kreditwesengesetz – "KWG"), the Supervisory Board carried out the required evaluations. The Supervisory Board discussed the results of the evaluations in detail, and will incorporate these findings into its work.

Strategy documents were regularly discussed, in accordance with the Minimum Requirements for Risk Management in Banks (MaRisk). The Company's remuneration systems were also subjected to a scheduled review, with the reports submitted to the Supervisory Board. The Supervisory Board determined that the Company's remuneration systems are appropriate.

The Chairmen of Supervisory Board committees regularly gave account of the work in the committees to the plenary meeting, answering all related questions submitted by the plenary meeting in detail.

To the extent that any Supervisory Board decisions were taken by way of circulation, the 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 PricewaterhouseCoopers provided very detailed information on current changes and deliberations in the regulatory and legal framework, as well as on the potential impact of such trends upon Aareal Bank.

Activities of Supervisory Board Committees

The Supervisory Board has established six committees in order to perform its supervisory duties in an efficient manner: the Executive and Nomination Committee, the Risk Committee, the Committee for Urgent Decisions (as a sub-committee of the Risk Committee), the Audit Committee, the Remuneration Control Committee, and the Technology and Innovation Committee.

The Executive and Nomination Committee of the Supervisory Board convened for five meetings. During its meetings, the Executive and Nomination Committee prepared the plenary meetings of the Supervisory Board, concerned itself with the efficiency of the Supervisory Board and its committees, as well as with corporate governance issues. Within the scope of a regular dialogue with the Management Board, the Committee informed itself on the strategic development of Aareal Bank Group.

The Risk Committee held four meetings during the year under review. The committee regularly discussed reports on the Bank's risk situation, which were submitted and explained by the Management Board. Having discussed the contents with the Management Board, these were duly noted and approved by the members of the committee. Besides credit and country risks, the committee concerned itself with market risks, liquidity risks, and operational risks. The committee was also engaged with the analysis of Aareal Bank’s risk-bearing capacity and its capital ratios. Also, detailed reports were given regarding the Bank's liquidity status and management as well as its funding. Risks from existing investments, as well as all additional material risks were also presented. The 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 Management Board also 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, and also concerned itself with the banking and regulatory environment.

The Committee for Urgent Decisions is a sub-committee 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 2017, the Audit Committee received and discussed the preliminary results for the 2016 financial year. During its March meeting, the committee received the external auditors' report on the 2016 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 2017 during the same meeting.

During its meeting in May 2017, the Audit Committee also concerned itself with Aareal Bank Group's Sustainability Report and the audit undertaken to obtain limited assurance for this report.

In accordance with the requirements of the German Corporate Governance Code, during its meetings in May, August and November 2017, the Audit Committee discussed with the Management Board the quarterly results to be published.

The meetings also allowed the committee to deal with additional topics, such as a current overview of the services of the external auditors requiring approval in accordance with the new rules governing the EU Audit Regulation and Directive. It approved such services where necessary. Furthermore, the committee was informed about the review of the Internal Control System, in accordance with legal requirements; it duly acknowledged the report, following discussion. In addition to a report on the audit progress, the Management Board presented and explained the updated Group planning to the committee during its December meeting. The Audit Committee was also informed by the Management Board about the structure of sustainability reporting for the 2017 financial year, in accordance with the new requirements.

In its meetings, the committee also received reports submitted by Internal Audit, and the Compliance Report, requesting and receiving detailed explanations, and duly noting both reports.

During its eight meetings, the Remuneration Control Committee discussed issues related to the Bank's remuneration systems and all related matters, fulfilling its original assignment. For this purpose, and to the extent considered necessary, external legal and remuneration advisors were retained to provide support. 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 InstitutsVergV that came into effect on 3 August 2017. 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 2017. As a rule, support was provided to the Supervisory Board by preparing the corresponding recommendations.

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. Potential business opportunities arising from the growing digitalisation of business processes – and how these can be put to use by Aareal Bank Group for its clients – were explained by the employees of subsidiaries responsible for the development, among other things. Another key aspect of the regular discussions was the realignment of the 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	25 of 25
York-Detlef Bülow*	24 of 25
Thomas Hawel*	10 of 10
Dieter Kirsch*	17 of 18
Richard Peters	21 of 21
Dr Hans-Werner Rhein	15 of 15
Sylvia Seignette	10 of 10
Elisabeth Stheeman	14 of 14
Hans-Dietrich Voigtländer	24 of 24
Prof. Dr Hermann Wagner	16 of 16
Beate Wollmann*	6 of 6

* Employee representative

Financial Statements and Consolidated Financial Statements

The Supervisory Board instructed PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft, Frankfurt/Main, who were elected as auditors by the Annual General Meeting 2017, with the audit of the financial statements and the consolidated financial statements. The external auditors appointed submitted a statement regarding their independence to the Supervisory Board, who duly noted it. The Supervisory Board has no reason to doubt the accuracy of this statement of independence. Fulfilling their duties as commissioned by the Supervisory Board, PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft audited the financial statements prepared in accordance with the German Commercial Code (HGB) and the consolidated financial statements prepared in accordance with IFRSs, as well as the Management Report and the Group Management Report. Based on the results of their audit, PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft issued an unqualified audit opinion for the financial statements and consolidated financial statements.

All members of the Supervisory Board received the audit reports, including all annexes thereto, in good time before the meeting during which the financial statements and the consolidated financial statements were discussed. Having examined the documents provided, the Supervisory Board members formed their own judgement of audit results. The representatives of the external auditor participated in the meeting of the Supervisory Board, during which the financial statements and consolidated financial statements were discussed, and gave a detailed account of the results of their audit. The representatives of PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft were available to the Supervisory Board to answer further questions, and to provide additional information. All questions were answered to the full satisfaction of the Supervisory Board.

The financial statements and management report of Aareal Bank AG, prepared in accordance with the HGB, and the consolidated financial statements prepared in accordance with IFRSs, and the proposal of the Management Board regarding the appropriation of profit, and the audit reports, were all examined in detail. No objections were raised to the audit results. In its meeting on 22 March 2018, 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.

Non-financial Report

The Audit Committee and the Supervisory Board concerned themselves with sustainability issues and related reporting during their meetings on 23 March 2017, 10 May 2017, 27 June 2017 and 12 December 2017.

Moreover, during its meeting on 21 March 2018, the Audit Committee of the Supervisory Board discussed the non-financial report and the result of PwC's audit of that report. Representatives of the external auditors attended this Audit Committee meeting and reported on material results of their commercial review in accordance with ISAE 3000, undertaken to obtain limited assurance for this report. They answered supplementary questions from Committee members. The Audit Committee conducted a plausibility check of PwC's audit results, and presented its assessment of the non-financial report (and its analysis of PwC's audit results) to the plenary meeting of the Supervisory Board. The Audit Committee also issued a recommendation to the Supervisory Board to concur with the results of PwC's audit. The Supervisory Board followed this recommendation; in its meeting on 22 March 2018, it summarised its examination by stating that it had no objections against the non-financial report and the results of PwC's audit.

In conclusion, the Supervisory Board would like to thank the Management Board and all of the Group's employees for the strong commitment they have shown during the past 2017 financial year. All the employees have contributed to the Company's decisive success in overcoming the many challenges it faced and have enabled it to take the far-reaching steps that are necessary to secure a successful future. That enormous continued commitment – and strong motivation – demonstrated by all employees of Aareal Bank Group have made the Company's success possible.

Frankfurt/Main, March 2018

For the Supervisory Board

Marija Korsch

Marija Korsch (Chairman)

Report on Remuneration Transparency

In accordance with section 21 of the Act to Encourage Transparency of Remuneration Structures, Aareal Bank AG is required for the first time in 2018 to prepare a report on equal treatment and equal remuneration. In line with this Act, the reporting period is the calendar year 2016.

	Men			Women			
	Part-time employees	Full-time employees	Total	Part-time employees	Full-time employees	Total	Total
2016 average	28.00	498.25	526.25	172.60	266.60	439.20	965.45

Gender equality has been Aareal Bank AG's declared goal for many years. The Bank attaches great importance to the equal treatment of women and men, whether in the context of filling vacant positions, with regard to professional development within the company, or in terms of remuneration.

Skills and experience are the only relevant criteria when filling vacant positions. Within the scope of staffing procedures, all vacancies below officer level – both managerial and expert functions – are advertised internally so that all employees are given equal opportunities in the application procedure.

All employees are offered a wide array of training measures for developing their skills. The decisive factor is that all employees – both men and women – are able to fulfil their tasks and have the know-how required. No distinction is made between female and male employees when it comes to participating in such training measures. Employees, regardless of their gender, take part in all necessary seminars to the same extent. To support all employees in striking a better work-life balance, the Bank offers all employees a broad range of family-friendly support services. These include, for example, the support of childcare, parent-child workrooms, helping to find service providers for private childcare, childcare during holidays offered by the city of Wiesbaden, and also the option of working remotely or flexible working hours.

The Bank also deliberately tries to ensure that men and women are treated equally in terms of remuneration. The decisive criteria in this context are that they have the same areas of activity with the same scope of responsibility in the respective positions, and also provide the same performance in the sense of achieving the target agreed upon in advance on an annual basis. The determination of the fixed remuneration of female and male employees is based on the collective agreement applicable for the private banking sector for non-exempt employees. For exempt employees, the determination is based on the provisions of a works agreement in relation to fixed remuneration and positions, pursuant to which fixed remuneration ranges are allocated to the individual expert or managerial positions. Similarly, the variable remuneration components are defined on the basis of a corresponding works agreement. Within the scope of their co-determination rights, the employee representative bodies review whether these provisions are complied with for both men and women. The application of these rules thus provides a structure that results in equal remuneration of women and men as well as to a corresponding transparency. In order to have this structure reviewed externally, the Bank participated in a survey conducted by the German Federal Ministry for Family Affairs, Senior Citizens, Women and Youth regarding pay equality in companies (called "Logib-D") which analysed the remuneration structures of banks in Germany. It was identified that Aareal Bank has a very minor adjusted remuneration difference of 2 %. No action was required according to the survey. Therefore, Aareal Bank AG was granted the "Logib-D tested" certificate in December 2013.

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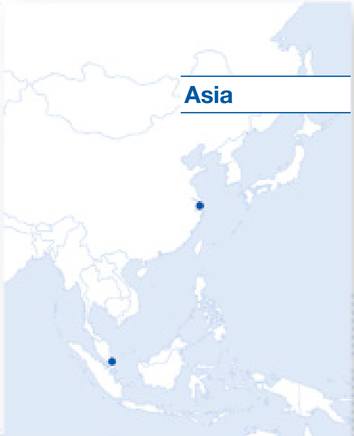
Financial Calendar

9 May 2018	Publication of results as at 31 March 2018
23 May 2018	Annual General Meeting – Kurhaus, Wiesbaden
14 August 2018	Publication of results as at 30 June 2018
13 November 2018	Publication of results as at 30 September 2018

Structured Property Financing

Structured Property Financing

Consulting / Services



Structured Property Financing

Aareal Bank, Real Estate Structured Finance: Brussels, Dublin, Istanbul, London, Madrid, Moscow, New York, Paris, Rome, Shanghai, Singapore, Stockholm, Warsaw, Wiesbaden | **Aareal Estate AG:** Wiesbaden | **Aareal Valuation GmbH:** Wiesbaden | **Westdeutsche Immobilien Servicing AG:** Mainz, Münster

Aareal Bank, Housing Industry: Berlin, Essen, Hamburg, Leipzig, Munich, Stuttgart, Wiesbaden | **Aareon AG:** Berlin, Bochum, Coventry, Dortmund, Emmen, Enschede, Gorinchem, Grathem, Hamburg, Hilversum, Hückelhoven, Karlskrona, Leipzig, Lund, Mainz, Meudon-la-Forêt, Mölndal, Munich, Nantes, Norrtalje, Orléans, Oslo, Piteå, Southampton, Stockholm, Stuttgart, Swansea, Toulouse | **Aareal First Financial Solutions AG:** Mainz | **Deutsche Bau- und Grundstücks-AG:** Berlin, Bonn, Dresden, Düsseldorf, Essen, Frankfurt / Main, Freiburg, Hanover, Leipzig, Moscow, Munich, Wuppertal

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