QUALITY® made by AAREAL

2016

Aareal Bank AG – Annual Report 2016

Aareal Bank

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

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Fundamental Information about the Group

The Group's business model

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

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

Aareal Bank Group's business model comprises two segments:

Structured Property Financing

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

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

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

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

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

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

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

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

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

Consulting / Services

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

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

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

In its Housing Industry division, Aareal Bank offers its customers process optimisation, electronic banking and asset management and markets its 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 and waste disposal industries form a second major client group of the Bank's Housing Industry division. This enables the offer of further products, facilitating the cross-sector cooperation of target groups and realising synergies via end-to-end digital processes. The use of the payment transaction products of Aareal Bank generates deposits that contribute significantly to Aareal Bank Group's refinancing base.

Management system

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

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

- **Group/consolidated:**
  - Net interest income (in accordance with IFRSs)
  - Allowance for credit losses (in accordance with IFRSs)
  - Net commission income (in accordance with IFRSs)
  - Administrative expenses (in accordance with IFRSs)
  - Operating profit (in accordance with IFRSs)
  - Return on equity (RoE) before taxes[1]

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

  - Earnings per ordinary share (EpS)[1]
  - Common Equity Tier 1 ratio (CET 1 ratio)
  - Liquidity Coverage Ratio (LCR)

- **Structured Property Financing segment**
  - New business[2]
  - 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, we ensure a high level of diversification and avoid risk concentrations.

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

Report on the Economic Position

Macro-economic environment

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

Economy

At 2.2 %, global economic output expanded in 2016 at a significantly lesser pace than in the previous year (2.7 %). Besides stagnating global trade, the structural transformation in China and political uncertainties

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

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

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

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

The German economy was more dynamic in early 2016 than in the second half of the year. All in all, the economy remained quite strong, however. Private consumption and strong construction activity boosted growth from mid-year onwards, while industrial production and exports weakened on the other hand over the course of the year. Consumer sentiment as well as expectations of the manufacturing industry were at a high level at the end of the year.

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

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

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

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

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

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

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

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

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

Annual rate of change in real gross domestic product in %

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

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

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

Financial and capital markets, monetary policy and inflation

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

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

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

Spread development on the covered bond market was defined by low volatility during the year under review, with spreads widening initially at the start of the year before moving towards a sideways trend. A high volume of new issues prevented spreads from tightening in the first quarter of the year. Spreads tightened significantly in the second and third quarter of 2016 as the number of new issues declined and the European Central Bank (ECB) continued to buy covered bonds within the scope of its third covered bond purchase programme. Even the British vote to leave the European Union failed to end this trend, and the outcome of the US election had no impact on the covered bond market. Spreads started to widen in mid-November, prompted by portfolio adjustments and profit-taking by covered bond investors.

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

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

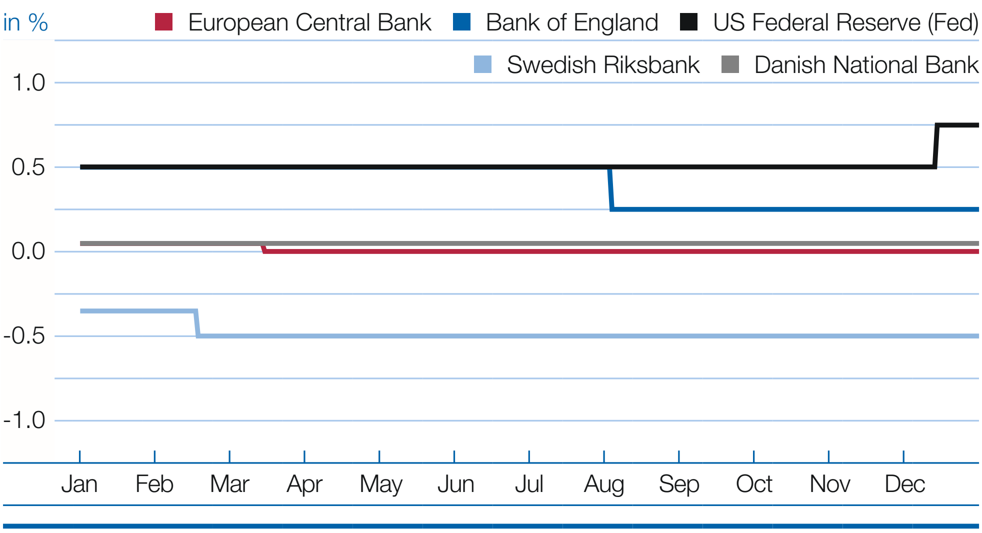
Long-term interest rates[1] in the most important currencies for Aareal Bank portrayed a similar pattern to that of government bond yields during the year under review. They fell significantly in the euro zone up to the third quarter, after which they rose again and remained slightly below the previous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

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

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

[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

Key rate developments in 2016 [1)]



1) The upper level of the corridor for the Fed Funds rate was set at 0.50 % to 0.75 %.

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

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

Regulatory environment

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

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

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

The ECB's Supervisory Review and Evaluation Process (SREP) ensures a common approach on the supervisory review of banks, within the framework of Pillar 2. The SREP is built around a business model analysis, an assessment of governance and controls, as well as of the capital and liquidity risks. The results of the individual areas are aggregated in a score value, from which the ECB derives supervisory measures on holding additional capital and/or additional liquidity requirements. The ECB converted the SREP requirements from a pure CET1 ratio to a total SREP ratio (total SREP capital requirements, TSCR) with effect from 1 January 2017. This will be 9.75 % as of 1 January 2017, and includes the 8 % total capital ratio for Pillar 1 and a (Pillar 2) capital requirement of 1.75 % from the ECB's SREP. In addition, the Bank is required to hold a capital conservation buffer of 1.25 % (phase-in), plus a countercyclical capital buffer of 0.03 % as of 2017. Aareal Bank's pure SREP-driven CET1 requirement has been 7.53 % since 1 January 2017, comprising 4.5 % for Pillar 1, the Pillar 2 capital buffer requirement of 1.75 % (as mentioned above), as well as the capital conservation buffer (1.25 %) and the countercyclical buffer (0.03 %). Additional liquidity requirements were not demanded of Aareal Bank.

Sector-specific and business developments

Structured Property Financing segment

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

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

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

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

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

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

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

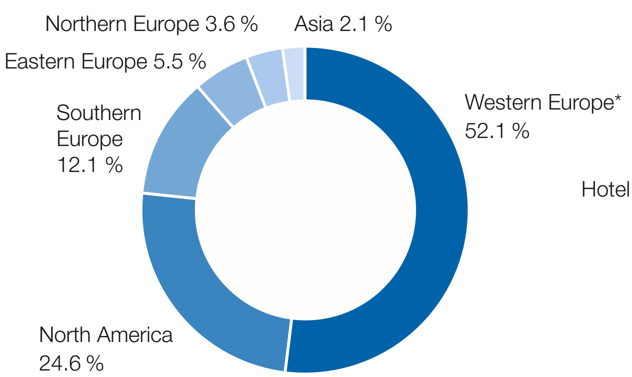
At 73.3 % (2015: 78.0 %), Europe accounted for the highest share of Aareal Bank Group's new business, followed by North America with 24.6 % (2015: 20.6 %) and Asia with 2.1 % (2015: 1.4 %)[2]. The slightly higher share of financings in North America reflects our growth strategy as part of the "Aareal 2020" programme for the future.

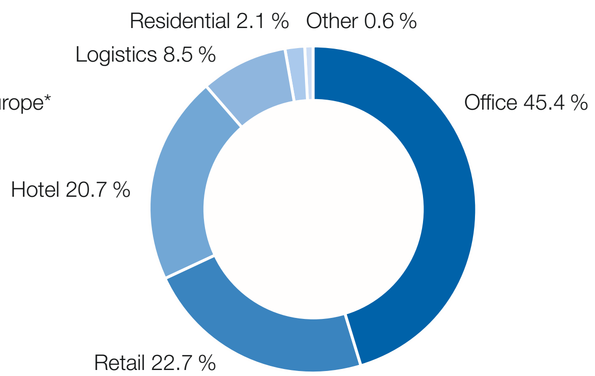
[1] Excluding new business for private clients and local authority lending by WestImmo.
[2] New business is allocated to the individual regions on the basis of the location of the property used as collateral. For exposures not collateralised by property, the allocation is based on the borrower's country of domicile.

With a share of 45.4 %, office properties accounted for the largest share in new business in terms of property type (2015: 43.1 %). This was followed by retail property, with 22.7 % (2015: 19.9 %), ahead of hotel property with 20.7 % (2015: 19 %) and logistics property with 8.5 % (2015: 9.8 %). The share of residential property was 2.1 % (2015: 6.0 %) while other property and financing amounted to 0.6 % (2015: 2.2 %).

New business 2016

by region | by type of property





* incl. Germany

Europe

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

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

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

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

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

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

The important indicator of average revenues per available room (RevPar) recorded a slight increase in 2016 compared with the previous year in the most European markets. Average revenues increased for example in Amsterdam, Barcelona, Berlin, Copenhagen, Hamburg and Madrid, and higher room rates could thus be achieved overall. As expected, average revenues fell significantly in Brussels, Istanbul and Paris as a consequence of the terrorist attacks. Marginal declines were observed in London and Munich, albeit remaining at a high level in both cases.

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

North America

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

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

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

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

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

Asia

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

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

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

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

Consulting / Services segment

Bank division Housing Industry

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

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

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

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

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

We also invested in products in 2016 that simplify and automate processes. Special attention was paid to the improvement in the collaboration of our target industries – housing industry and energy industry – for example through BK01 eConnect, which facilitates the total automation of invoicing and settlement.

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

Aareon

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

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

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

Germany

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

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

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

International Business

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

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

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

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

Net Assets, Financial Position and Financial Performance

Financial performance

Aareal Bank AG closed the financial year 2016 – which was characterised by a demanding and challenging market environment, as in the previous year – with an operating profit (excluding loan loss provisions) of € 256.0 million (2015: € 239.0 million).

The aggregate of net interest income and net commission income amounted to € 566.9 million, down € 38.2 million compared to the previous year. Interest income from lending and money-market transactions fell by € 131.2 million year-on-year, whilst interest income from securities declined by € 39.2 million. Interest expenses were down by € 103.8 million. Current income of € 70.0 million during the year under review (2015: € 37.3 million) was attributable to interests in affiliated companies. Net commission income of € 8.5 million was down € 4.3 million year-on-year.

Administrative expenses (including depreciation and amortisation of intangible assets and tangible fixed assets) of € 296.5 million were € 52.6 million lower than in the previous year. Main reasons for the marked decline included lower personnel expenses as well as lower integration costs for Westdeutsche ImmobilienBank AG.

Net other operating income and expenses improved by € 2.6 million year-on-year, to € -14.4 million.

The balance of provisions for loan losses and the result from securities held as liquidity reserve amounts to € -86.1 million (2015: € -139.0 million). This figure includes expenditure for specific and general loan loss provisions. 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.

Net other income and expenses of € 4.9 million (2015: € -5.6 million) includes 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 liability of €53.1 million (2015: net income tax asset of € 4.9 million), the Bank posted net income of € 121.7 million (2015: € 99.3 million), which permitted Aareal Bank AG to achieve its targets of preserving capital, and its ability to distribute dividends. Likewise the Bank 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 € 701 million, € 97 million in allowance for credit losses, net commission income of € 193 million and administrative expenses of €547 million. Overall Aareal Bank generated consolidated operating profit of € 366 million, earnings per ordinary share of € 3.33, and RoE before taxes of 13.2 %.

Net assets

Aareal Bank AG's total assets as at 31 December 2016 amounted to € 40.3 billion, after € 43.2 billion as at 31 December 2015. The reduction in total assets was mostly attributable to a decline in the volume of property financings, as well as lower securities investments.

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 € 7.6 billion as at 31 December 2016 (31 December 2015: € 9.3 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 € 22.7 billion as at 31 December 2016, a decline of approximately 10 % compared to the 2015 year-end figure of € 25.3 billion.

Aareal Bank AG's property financing portfolio comprises financings of office, residential and retail properties, as well 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 2016.

Customer deposits

As part of our business activities, we generate deposits from housing industry customers, and from institutional investors. The volume of deposits from the housing industry could be increased during the reporting period. As at 31 December 2016, they amounted to € 9.2 billion (2015: € 8.4 billion). Deposits from institutional investors amounted to € 4.5 billion as at 31 December 2016 (2015: € 4.8 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, trust preferred securities as well as regulatory Additional Tier 1 instruments.

The long-term refinancing portfolio totalled € 20.9 billion as at 31 December 2016 (31 December 2015: € 24.6 billion), comprising € 14.1 billion (2015: € 16.6 billion) in Mortgage Pfandbriefe and Public Sector Pfandbriefe, € 5.6 billion (2015: € 6.7 billion) in unsecured funding, € 0.9 billion (2015: € 1.0 billion) in subordinated funding, plus € 0.3 billion (2015: € 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

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

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

Equity

Aareal Bank AG's total equity, as disclosed in the balance sheet, amounted to € 1,944.5 million as at 31 December 2016 (31 December 2015: € 1,921.6 million).

Regulatory capital[1)]

	31 Dec 2016 [2)]	31 Dec 2015
€ mn		
Common Equity Tier 1 (CET1)	2,351	2,298
Tier 1 (T1)	2,896	2,882
Total capital (TC)	3,994	3,977
%		
Common Equity Tier 1 ratio (CET1 ratio)	16.2	13.8
Tier 1 ratio (T1 ratio)	19.9	17.2
Total capital ratio (TC ratio)	27.5	23.8

[2)] After confirmation of the 2016 financial statements of Aareal Bank AG.
The inclusion of retained earnings transferred as part of Aareal Bank AG's liable equity as at 31 December 2016 is subject to approval by the Annual General Meeting.

Our Employees

Personnel data as at 31 December 2016

	31 Dec 2016	31 Dec 2015	Change
Number of employees of Aareal Bank Group	2,728	2,861	-4.7%
Number of employees of Aareal Bank AG	933	1,009	-7.5%
of which: outside Germany	75	84	
of which: proportion of women	45.1%	45.5%	
Proportion of women in executive positions	22.9%	21.7%	
Years of service	13.9 years	14.0 years	-0.1 years
Average age	45.8 years	46.1 years	-0.3 years
Staff turnover rate	1.1%	1.6%	
Part-time ratio	19.7%	20.5%	
Retired employees and surviving dependants	745	728	2.3%

Age structure and fluctuation

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

Qualification and training programmes

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

For this purpose, Aareal Bank Group operates a human resources approach aimed at the further qualification of its managers, experts and employees. In line with the corporate strategy, the Bank’s human resources approach was adjusted during the period under review to incorporate training

[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.

innovations and new qualification methods. Aareal Bank Group supports employees' change processes and promotes lifelong professional training.

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

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

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

Aareal Bank Group supports all employees willing to develop themselves throughout the different phases of their professional paths, thus establishing a culture of lifelong learning within the Company. Against this background, Aareal Bank established, in 2016, a new concept aimed at the further qualification of its managers, and another system for the qualification of experts, each covering different stages of professional development.

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

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

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

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

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

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

Promoting the next generation

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

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

Aareal Bank and Aareon held the Girls' Day and the Boys' Day in 2016 again as part of its measures for promoting the next generation. A total of 64 boys and girls aged between 8 and 12 years visited the Aareon Science Camps "Batteries and solar cells – energetic experiments", which aim at stimulating and promoting interest in technology at an early age. This was the fourth anniversary for Aareon Science Camps, which have now been attended by a total of more than 250 participants.

Aareon awarded the Aareon IT Award "WohnIT" for the first time in 2016. The price was awarded to the Internatsschule Schloss Hansenberg for the development of "IntLight" (Indoor Location for Smart Homes). With this competition, Aareon addressed pupils of all ages and types of school, aiming to spark enthusiasm for the topics of "IT" and "future housing".

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

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

Remuneration system

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

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

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

Work-life balance

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

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

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

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

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

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

Health

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

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

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

Aareon operated its corporate health management in 2016 under the motto “fit for the working environment 4.0”, since the employee survey and the INQA audit had shown that this topic is of particular interest.

A mixture of a large variety of seminars – covering subjects such as “recharge your batteries”, “Healthy leadership”, “deceleration”, “time management”, a presentation on “how to better deal with the flood of information”, an E-Learning-Tool on mental health, massages, influenza vaccinations, and last but not least the Aareon Health Day – support a healthy work environment at Aareon.

Diversity

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

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

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

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

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

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

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

Equal treatment

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

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

In Germany, Aareal Bank and Aareon apply the German General Equal Treatment Act (Allgemeines Gleichbehandlungsgesetz – “AGG”), with specially-appointed AGG Officers overseeing compliance. At the same time, AGG training is held for all employees. In the US, the employee manual contains anti-harassment rules to avoid harassment and discrimination in the workplace.

Risk Report

Aareal Bank 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. Besides this purely economic motivation for a highly-developed risk management system, extensive regulatory requirements apply to the risk management as well. We therefore continued to drive the development of our processes for identifying, measuring, limiting and managing risks in the financial year under review too.

Risk management – scope of application and areas of responsibility

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

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

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

Type of risk		Risk management	Risk monitoring
Market price risks		Treasury, Dispo Committee	Risk Controlling
Liquidity risks		Treasury	Risk Controlling
Credit risks	Property Finance Single exposures	Business & Syndication Management, Credit Management	Risk Controlling, Credit Management
Credit risks	Property Finance Portfolio risks	Credit Management, Portfolio Management & Controlling	Risk Controlling
Credit risks	Treasury business	Treasury	Risk Controlling
Credit risks	Country risks	Treasury, Credit Management	Risk Controlling
Operational risks		Process owners	Risk Controlling
Investment risks		Acquisitions & Subsidiaries	Risk Controlling, Acquisitions & Subsidiaries, Controlling bodies

Process-independent monitoring: Audit

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

Strategies

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

Risk-bearing capacity and risk limits

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

In accordance with this approach, potential risk cover is determined using data derived from the income statement and from the statement of financial position; this derivation also forms the basis for determining regulatory capital. This involves setting aside the maximum amount of own funds required as potential risk cover to offset risks without causing a breach of minimum requirements pursuant to the Capital Requirements Regulation (CRR). Aareal Bank has decided to considerably exceed this minimum requirement, and to prudently apply a Tier 1 ratio (calculated in accordance with the CRR) equivalent to 8 % of forecast risk-weighted assets (RWA), plus buffer. The Bank switched to full Basel III implementation during the year under review. Only free own funds exceeding this level are applied as potential risk cover, of which a further minimum of 10 % (currently 11 %) is retained as a risk cushion. This cushion is not applied to risk limits, and is thus available for risk types that cannot be quantified (for example, reputational or strategic risks).

We adopt an equally conservative stance with respect to setting risk limits. The aggregation of individual limits is based on the assumption that no risk-mitigating correlation effects exist amongst different types of risk. Taking into account the prior deduction of a minimum Tier 1 ratio of 8 % of RWA, the value-at-risk models used to quantify risks are based on a confidence interval of 95 % and a one-year holding period (250 trading days). A monthly report submitted to the Management Board provides information regarding the utilisation of individual limits for the material types of risk, as well as on the overall limit utilisation. The following table summarises the Group's overall risk-bearing capacity as at 31 December 2016.

Risk-bearing capacity of Aareal Bank Group as at 31 December 2016

- Going concern approach -

€ mn	31 Dec 2016	31 Dec 2015
Own funds for risk cover potential	2.598	2.937
less 8 % of RWA (Tier 1 capital (T1))	1.477	1.606
Freely available funds	**1.121**	**1.331**
Utilisation of freely available funds		
Credit risks	317	313
Market risks	207	244
Operational risks	106	100
Investment risks	24	65
Total utilisation	**654**	**721**
Utilisation as a percentage of freely available funds	**58%**	**54%**

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

Stress testing

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

Organisational structure and workflows

Lending business

Division of functions and voting

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

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

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

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

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

Process requirements

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

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

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

Early risk detection procedures

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

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

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

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

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

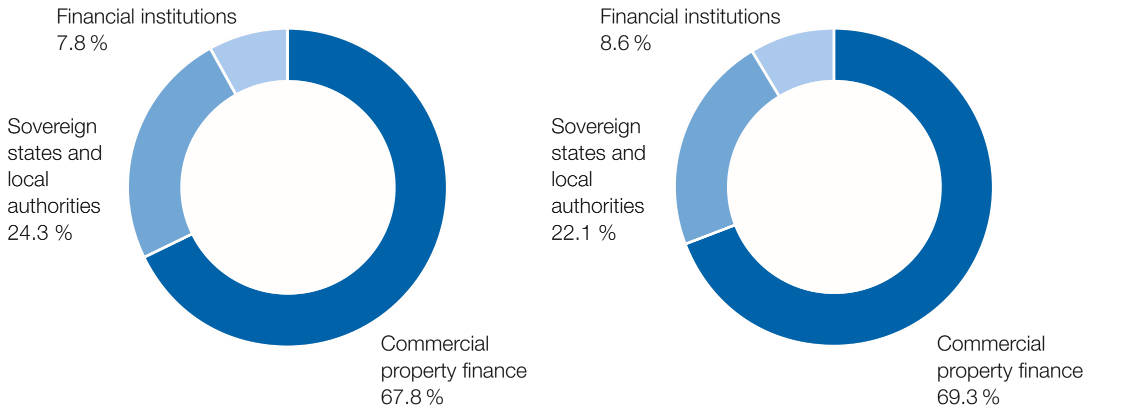
Risk classification procedures

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

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

Breakdown of exposure by rating procedure

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



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

Property financing business

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

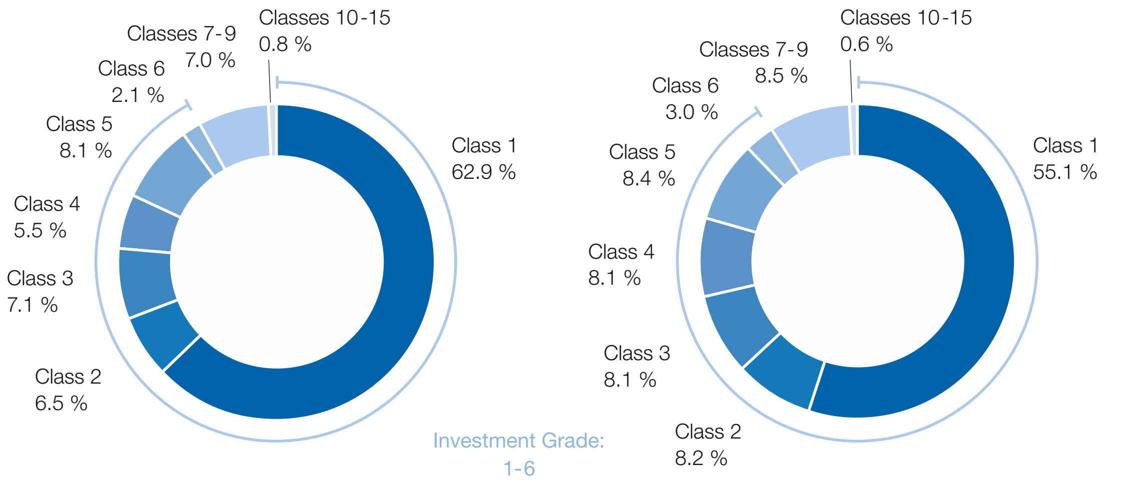
In a first step, the client's probability of default (PD) is determined using a rating procedure. The method used in this context comprises two main components, a property rating and a corporate rating.

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

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

Large-sized commercial property finance

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



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

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

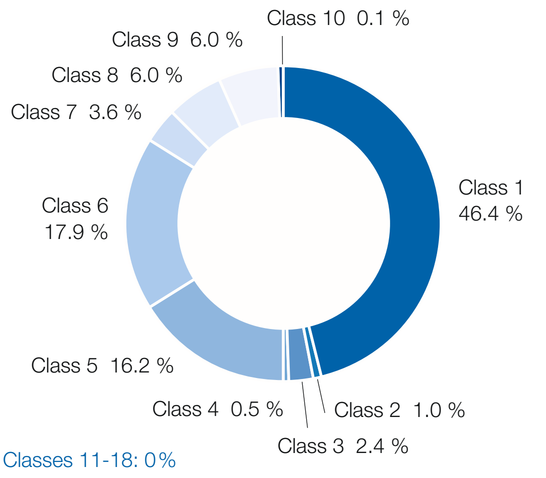
The diagrams shown above depict the distribution of lending volume by EL classes as at 31 December 2015 and 31 December 2016, based on the maximum current or future drawdown. The distribution excludes exposures for which no rating has been concluded, or which are in default (as defined under the CRR).

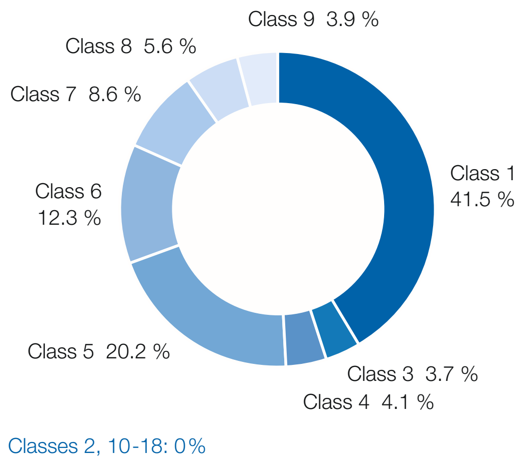
Financial institutions

Aareal Bank employs an internal rating procedure for financial institutions, which incorporates qualitative and quantitative factors as well as our client's 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 2016 | as at 31 Dec 2015





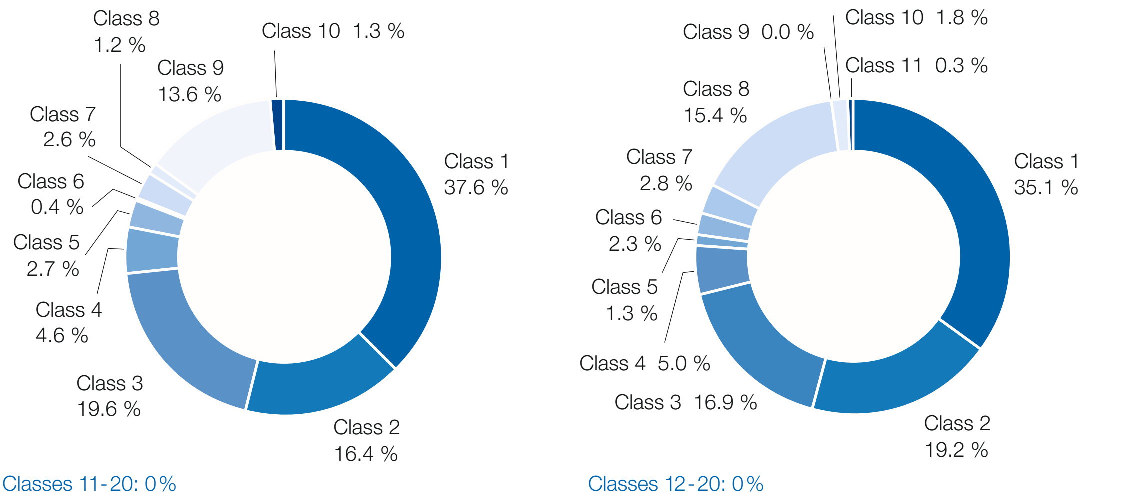
Sovereign states and local authorities

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

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

Sovereign states and local authorities

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



Trading activities

Functional separation

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

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

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

The detailed assignment of responsibilities is outlined below.

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

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

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

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

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

Process requirements

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

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

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

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

Risk exposure by type of risk

Credit risks

Definition

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

Credit risk strategy

Based on the Bank's overall business strategy, Aareal Bank's credit risk strategy sets out all material aspects of the Group's credit risk management and policies. Proposals for the credit risk strategy are prepared jointly by Sales units and Credit Management, adopted by the entire Management Board, and duly acknowledged by the Supervisory Board. The credit risk strategy will be reviewed, at least once a year, as to its suitability regarding the Bank's risk-bearing capacity and its business environment; amendments will be made as necessary. This process is instigated by management, and implemented by the Sales units and Credit Management, who submit a proposal (on which they both agreed) to management. Designed in principle for a medium-term horizon, the credit risk strategy is adapted when necessary to reflect material changes in the Group's credit risk and business policies, or in the Group's business environment (as in the case of the financial markets crisis).

Aareal Bank's credit risk strategy comprises the Group credit risk strategy (as a general guideline) plus individual sub-strategies called Lending Policies. Given the hierarchical structure of the credit risk strategy, the Group credit risk strategy overrides individual sub-strategies. These rules serve as a guideline for generating new business.

Risk measurement and monitoring

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

Based on the results of these models, the Bank's decision-makers are regularly informed of the performance and risk content of property finance exposures, and of business with financial institutions. The models permit to identify, measure, monitor and manage risks at a portfolio level.

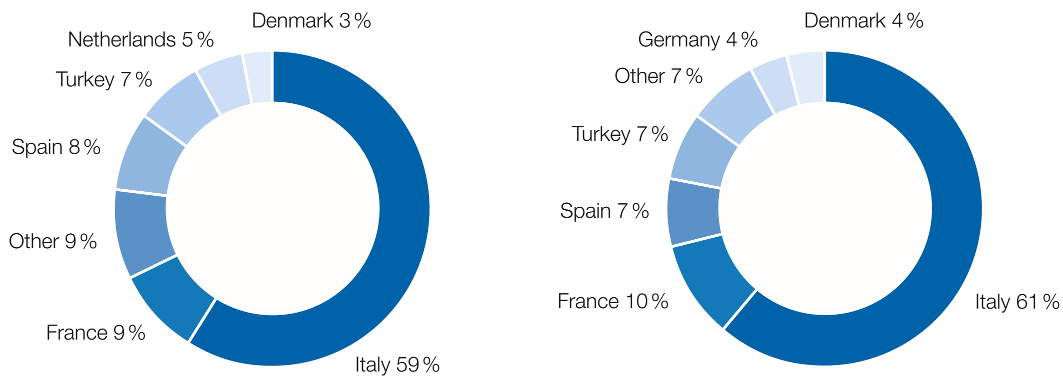
The Bank focuses in particular on the identification, monitoring and management of risk concentrations, where both quantitative and qualitative methods are being used. With regard to counterparty credit risk, these include for example, the regular analysis of our largest borrower units and the analysis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

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

Within the process-oriented monitoring of individual exposures, the Bank uses specific tools to monitor exposures on an ongoing basis: besides the tools already described, this includes rating reviews, monitoring of construction phase loans or residential property developers, the monitoring of payment arrears, and the regular, individual analysis of the largest exposures.

Individually impaired property financing[1] (amounts drawn)

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



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

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

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

All trades are immediately taken into account for the purposes of borrower-related limits. Compliance with limits is monitored in real time by Risk Controlling. Any limit breaches are documented, together with action taken in response. Where limit transgressions exceed an amount defined in line with 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.

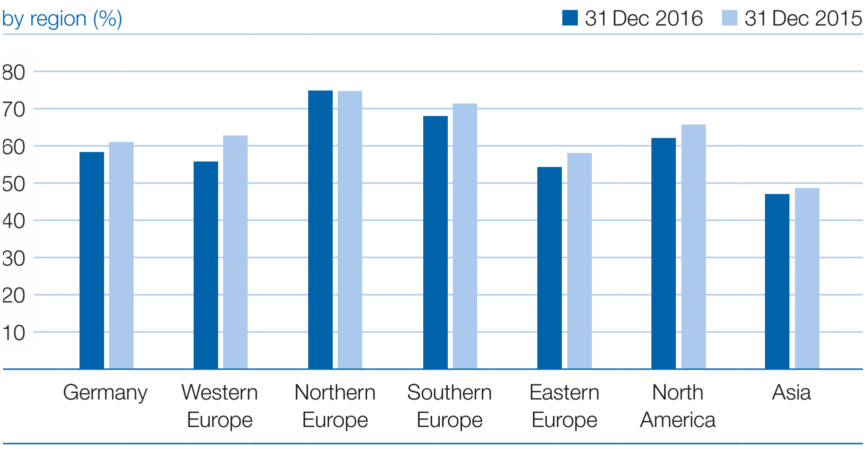
The Bank also accepts guarantees or indemnities as well as financial collateral (such as securities or payment claims) as standard forms of collateral. The collateral value of the indemnity or guarantee is determined by the guarantor's credit quality. For this purpose, the Bank differentiates between 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.

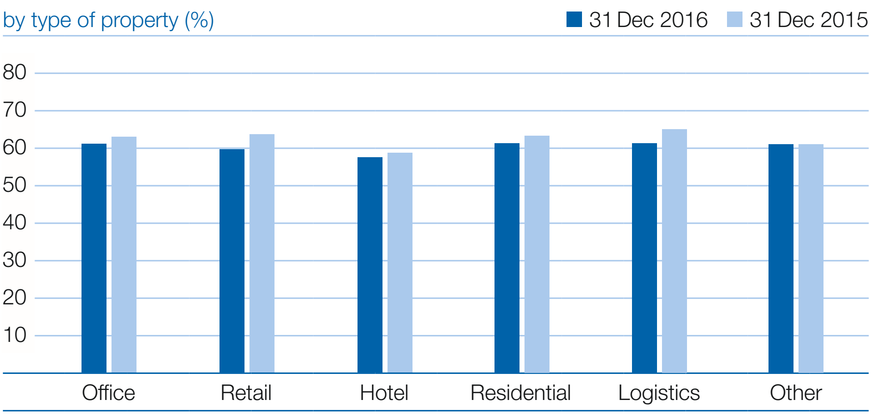
Average LTV of property financing[1)]

by region (%)



Average LTV of property financing[1)]

by type of property (%)



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

Note that the loan-to-value ratios are calculated on the basis of market values, including supplementary collateral with sustainable value.

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

The derivatives master agreements used by the Bank contain mutual netting agreements to reduce prepayment risk at a single transaction level (payment netting), and arrangements for the termination of individual or all transactions under a master agreement (close-out netting). For repo transactions, depending on the counterparty, payment or delivery netting is agreed upon.

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

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

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

Only cash collateral is accepted for derivatives, whereas collateral for repos can be provided in cash or in securities. Some of the collateral agreements the Bank has entered into provide for a higher amount of collateral to be provided in the event of a downgrade of the Bank's external rating.

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

Country risk

Definition

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

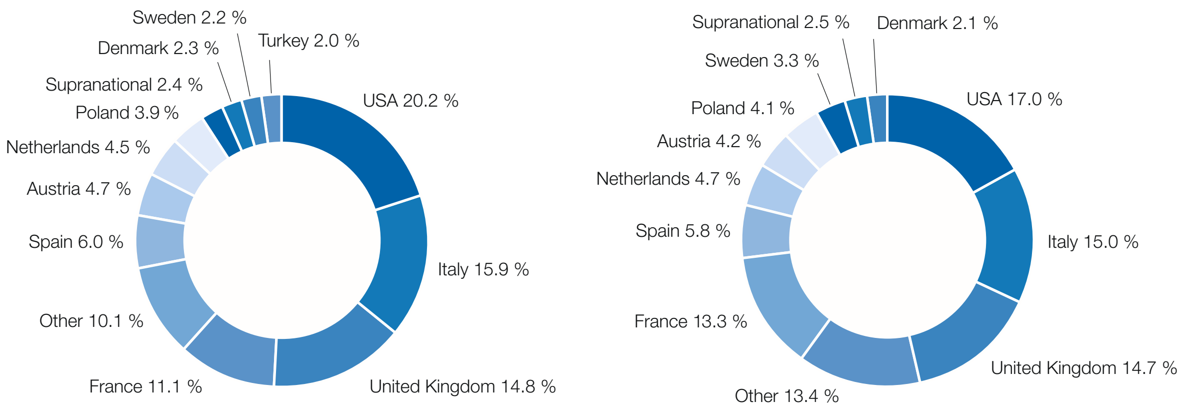
Country risk measurement and monitoring

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

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

Breakdown of country exposure in the international business

in % 31 Dec 2016 | 31 Dec 2015



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 counter-measures take effect. Since this is a statistical approach, the forecast for the potential loss that may be incurred within a specific period of time is for a given confidence interval only.

A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. Determined on a daily basis for the Group and all its operating units, 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	MAX	MIN	Mean	Limit
Year-to-date (full previous year), 95 %, 250-day holding period				
Aareal Bank Group – general market price risk	305.0 (422.3)	161.1 (187.5)	224.5 (263.3)	- (-)
Group VaR (interest rates)	211.6 (404.4)	103.0 (119.5)	149.5 (216.5)	- (-)
Group VaR (FX)	185.9 (170.5)	102.2 (61.0)	135.5 (114.7)	- (-)
VaR (funds)	5.8 (4.7)	3.5 (2.8)	4.6 (3.7)	20.0 (20.0)
Aggregate VaR in the trading book (incl. specific VaR)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	5.0 (5.0)
Trading book VaR (interest rates)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	- (-)
Trading book VaR (FX)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	- (-)
VaR (equities)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	- (-)
Group VaR (specific risks)	85.9 (92.0)	62.8 (72.3)	73.3 (83.8)	- (-)
Aggregate VaR – Aareal Bank Group	311.5 (428.7)	174.0 (207.5)	237.5 (277.4)	390.0 (435.0)

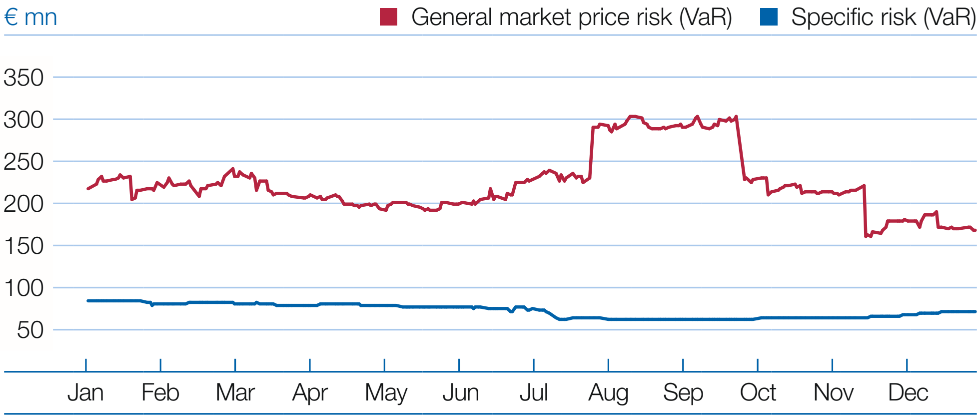
To ensure that Aareal Bank's figures are comparable to those published by other institutions, the risk parameters shown below were determined for a one-day holding period:

€ mn	MAX	MIN	Mean	Limit
Year-to-date (full previous year), 95 %, 1-day holding period				
Aareal Bank Group – general market price risk	19.3 (26.7)	10.2 (11.9)	14.2 (16.7)	- (-)
Group VaR (interest rates)	13.4 (25.6)	6.5 (7.6)	9.5 (13.7)	- (-)
Group VaR (FX)	11.8 (10.8)	6.5 (3.9)	8.6 (7.3)	- (-)
VaR (funds)	0.4 (0.3)	0.2 (0.2)	0.3 (0.2)	1,3 (1,3)
Aggregate VaR in the trading book (incl. specific VaR)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.3 (0.3)
Trading book VaR (interest rates)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	- (-)
Trading book VaR (FX)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	- (-)
VaR (equities)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	- (-)
Group VaR (specific risks)	5.4 (5.8)	4.0 (4.6)	4.6 (5.3)	- (-)
Aggregate VaR – Aareal Bank Group	19.7 (27.1)	11.0 (13.1)	15.0 (17.5)	24.7 (27.5)

Aggregate VaR – Aareal Bank Group

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

General market price risk and specific risk during 2016

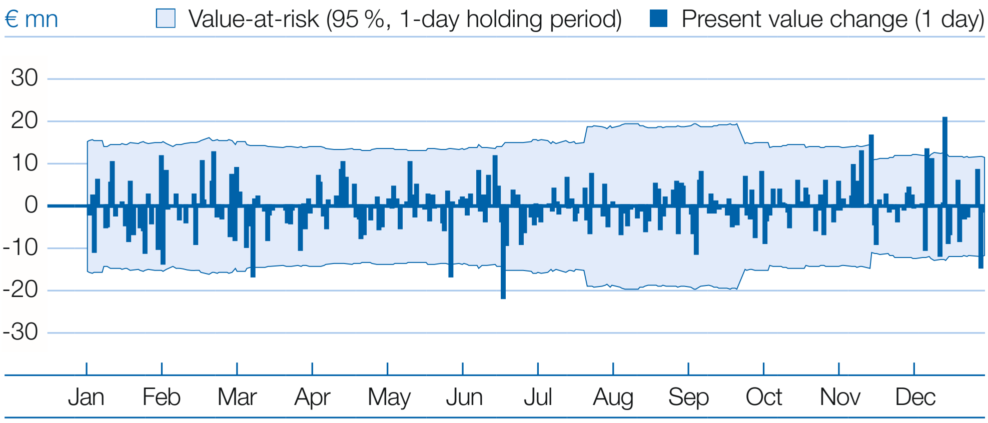


VaR movements in July, September and November resulted from market fluctuations (due to the "Brexit", for example) and related adjustments to statistical model parameters.

Backtesting

The quality of forecasts made using this statistical model is checked through a weekly backtesting process. The quality of the statistical procedure used to measure risk is checked using a binomial test, whereby daily profits and losses from market fluctuations are compared with the upper projected loss limit (VaR) forecast on the previous day (known as "clean backtesting"). In line with the selected confidence level of 95 %, only a small number of events are expected to break out of the VaR projection (≤17 for a 250-day period). Four negative outliers at Group level occurred during the last 250 trading days, affirming the high forecasting quality of the VaR model we use. During the year under review, the statistical model was expanded, in order to better reflect the development of market data – specifically, the low-interest rate environment.

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



Stress testing

Although VaR has become a standard tool, the concept may fail to adequately project the actual risk in extreme situations – for example, the end-2008 phase of the financial markets crisis. For this reason, the VaR projection is supplemented by simulating stress scenarios on a monthly basis.

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

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

Interest rate sensitivity

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

Interest rate gap analysis

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

Trading book

Being authorised to maintain a trading book, Aareal Bank AG is the Group entity that is in a position to assign transactions to the trading portfolio as defined by the German Banking Act. Given that no such trades were concluded during the financial year under review, trading book risks played a negligible role in the overall risk scenario during the period.

Liquidity risks

Definition

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

Risk measurement and monitoring

Treasury is responsible for managing liquidity risks, whilst Risk Controlling ensures the continuous monitoring, including a daily liquidity report submitted to Treasury, and a contribution to the monthly risk report to the entire Management Board. The following tools are used for this purpose:

a) Cash flow forecast

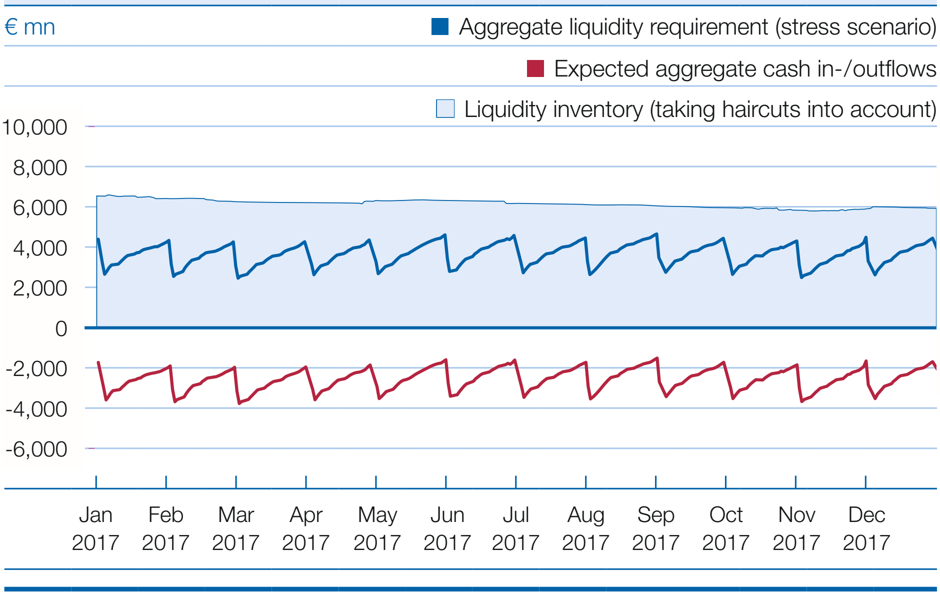
We have developed a cash flow forecast, tracking cash flows from all balance sheet items and derivatives, on a daily basis, over a ten-year period. This liquidity risk information helps to assess the Bank's short-term liquidity position, broken down by currency or product. Strategic liquidity is taken into account using this ten-year cash flow profile. We use statistical modelling to incorporate the expected cash flow profile of products without a fixed contractual lifetime.

b) Liquidity run-off profile

The appropriateness of the Bank's liquidity is assessed using a liquidity run-off profile: the aggregate of all potential cash inflows and outflows over a three-month period is compared to the liquidity stock. This liquidity stock comprises all assets that can be liquidated at very short notice. The difference of both figures (in absolute terms) indicates excess liquidity, once all claims assumed in the run-off profile have been fulfilled through the liquidity stock. There were no liquidity shortages throughout the period under review.

The 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 2017. This presentation demonstrates that the liquidity stock will always exceed liquidity requirements, even under unfavourable conditions.

Liquidity

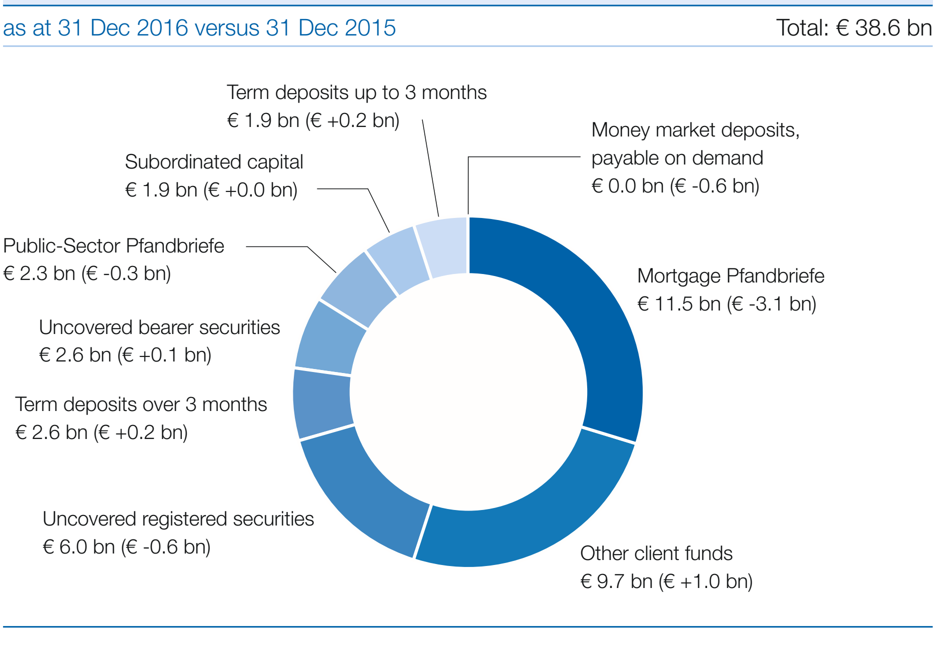


Further details are provided in the comments on the Bank's liquidity in the section on "Refinancing and Equity".

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



Stress testing

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

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

Operational risks

Definition

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

Risk measurement and monitoring

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

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

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

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

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

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

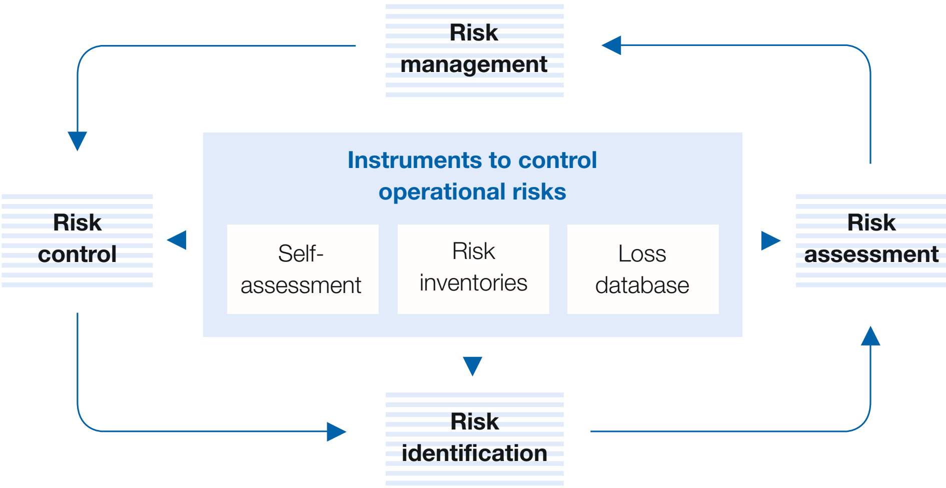
Aareal Bank's legal department deals with any litigation the Bank is involved in, as well as with any legal issues of fundamental importance – where necessary, using the support of external lawyers.

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

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

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

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.

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

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

Other risks

Definition

Aareal Bank uses the category of 'other risks' to aggregate those types of risk that cannot be quantified exactly: primarily, this includes reputational and strategic risks.

Reputational risk is defined as the risk of events that negatively affect the Bank's reputation with investors, analysts, or clients.

Strategic risk is typically associated with the threat of incorrect assumptions regarding market developments, burdening a bank's performance as a result.

Risk measurement and monitoring

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

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

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

Accounting-related Internal Control and Risk Management System

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

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

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

Organisation of the accounting-related ICS and RMS

The Internal Control System of Aareal Bank takes into account the principles established by the Minimum Requirements for Risk Management (MaRisk) related to company-specific design of the ICS. The design of this Internal Control System comprises organisational and technical measures to control and monitor the Company's activities. 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 division. Finance manages the centralised processes for preparing Aareal Bank AG's annual and interim financial statements. Amongst other tasks, Finance 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 division is adequate, as are their qualifycations. Furthermore, they possess the necessary knowledge and experience relevant for their functions.

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

Internal Audit also has a process-independent monitoring function. It reports directly to the Management Board, and provides objective and risk-oriented 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. 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. Any detected weaknesses regarding the identification, evaluation and reduction of risks are reported and addressed within the context of specific action plans.

To perform its tasks, Internal Audit has full and unrestricted information rights with respect to activities, processes and IT systems of Aareal Bank AG. 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 Bank's operational and business processes (including the accounting and financial reporting process), 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 workflows help to fulfil the monitoring duties concerning the accounting and financial reporting process within the framework of its Internal Control System.

A prerequisite for the monitoring system to work efficiently is a written set of procedural rules governing the distribution of tasks between the individual divisions and the scope of the respective activities. The organisational structure of the Finance division is set out in the Bank's organisational guidelines. Aareal Bank 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 the Bank's posting units. If necessary, results are reconciled across divisions or companies.

Activities required within the scope of preparing the financial statements are defined by internal accounting instructions. Aareal Bank AG's voucher documentation rules set out the rules governing accounting vouchers for all of the Bank's posting entities. Legal requirements and the relevant accounting standards are set out in detail in the accounting instructions, and by reference to the plan of accounts. The Finance division regularly reviews these documents, and updates them if necessary. The valuation techniques used, as well as the underlying parameters, are controlled regularly, and adjusted if necessary. Where valuation units (Bewertungseinheiten) are used for measurement purposes, defined criteria are reviewed on a regular basis. 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 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. Reconciliation of balances and positions with clients and counterparties is carried out in line with existing regulations. Control processes in accordance with MaRisk have been implemented for credit risk provisioning. Reconciliations take place between the main ledger and upstream position-management systems, as well as on the level of individual accounts. Adequate control processes have been implemented for both manual and automated accounting transactions. Additional control processes are in place to ascertain the complete recording of all transactions in the Bank's accounting systems.

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 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

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

Macro-economic environment

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

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

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

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

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

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

Economy

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

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

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

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

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

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

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

Financial and capital markets, monetary policy and inflation

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

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

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

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

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

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

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

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

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

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

Regulatory environment

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

The ECB will also review the internal model of Pillar 1 (Target Review of Internal Models) in 2017, whereby the exact impact on banks – and the consequences – cannot be fully assessed at present.

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

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

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

Sector-specific and business developments

Structured Property Financing segment

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

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

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

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

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

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

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

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

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

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

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

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

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

We see the hotel markets in the large Asian cities as being stable. Seasonal volatility is highly likely in all markets in 2017.The intense competition of previous years is also likely to persist in many markets during the current year, with less of an incentive to lower the margins. We do not anticipate any notable increases in loan-to-value ratios.

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

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

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

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

Consulting/Services segment

Bank division Housing Industry

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

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

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

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

We see good opportunities during 2017 to acquire new clients and to intensify the business relationships with our existing client base. We will also benefit from the product innovations in 2016, such as BK01 eConnect, which facilitates the total automation of invoicing and settlement, as well as internet applications that can further streamline and speed up our client's processes.

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

Aareon

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

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

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

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

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

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

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

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

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

Given prevailing uncertainty with regard to future regulatory requirements as well as any potential deterioration to economic developments, and considering our dividend policy, we project the fully-phased in Common Equity Tier 1 ratio (CET1 – assuming full implementation of Basel III) by the end of 2017 to be moderately higher than the current level of 15.7 %. Further, we expect the Liquidity Coverage Ratio (LCR), which should be at least 100 %, to largely remain at a very high level.

Corporate Governance Statement pursuant to Section 289a of the HGB

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

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

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

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

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

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

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

For each financial year, the Supervisory Board sets a target level for the Common Equity Tier 1 ratio (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 these two targets have not been achieved. The Supervisory Board also defines the sectional and individual targets for every member of the Management Board, for each financial year.

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

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

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

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

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

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

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

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

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

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

Additional fixed remuneration for membership of the other committees amounts to €1 5,000 p.a.; or € 30,000 p.a. for the chairmanship of such other committee. The meeting attendance compensation amounts to € 1,000.00 for each meeting attended (except for the Committee for Urgent Decisions).

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

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

Explanatory Report by the Management Board in Accordance with Section 289 (4) of the German Commercial Code (Handelsgesetzbuch)

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

Conditional capital

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

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

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

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

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

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

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

Annual Financial Statements

Income Statement of Aareal Bank AG
for the period from 1 January to 31 December 2016

€ mn			2016		2015
Expenses					
Interest expenses			**714.2**		818.0
including positive interest from lending and money-market transactions -2.8 (2015: -0.2)					
Commission expenses			**16.8**		9.4
General administrative expenses					
a) Staff costs					
aa) Wages and salaries	121.9			144.1	
ab) Social security contributions, pensions and other employee benefits	16.2	138.1		31.7	
including for pensions 3.7 (2015: 19.4)					
b) Other administrative expenses		154.4	**292.5**	168.9	344.7
Amortisation, depreciation and write-downs of intangible and tangible fixed assets			**4.0**		4.4
Other operating expenses			**40.5**		41.9
Write-downs and valuation allowances of loans and advances and specific securities, as well as additions to loan loss provisions			**86.1**		139.0
Amortisation and write-downs on participating interests, interests in affiliated companies and securities held as fixed assets			**-**		1.2
Expenses for assumption of losses			**87.5**		78.0
Net income taxes			**53.1**		-4.9
Other taxes not reported under other operating expenses			**0.1**		0.6
Net income			**121.7**		99.3
Total expenses			**1,416.5**		**1,531.6**
Net income/net loss			**121.7**		99.3
Profit carried forward from the previous year			**0.5**		-
Withdrawals from retained earnings					
from the reserve for shares in a parent or majority investor			-		-
from other retained earnings			-		-
Transfer to retained earnings					
to the reserve for shares in a parent or majority investor			-		-
to other retained earnings			-		-
Net retained profit			**122.2**		**99.3**

€ mn		2016		2015
Income				
Interest income from				
a) Lending and money market transactions	946.4		1,077.6	
including negative interest from lending and money-market transactions -13.2 (2015: -3.9)				
b) Fixed-income securities and debt register claims	256.2	**1,202.6**	295.4	1,373.0
Current income from				
a) Equities and other non-fixed-income securities	-		-	
b) Participating interests	-		-	
c) Interests in affiliated companies	70.0	**70.0**	37.3	37.3
Income from profit pools, profit transfer agreements or partial profit transfer agreements		**14.1**		5.7
Commission income		**25.3**		22.2
Income from write-ups to participating interests, shares in affiliated companies and securities held as fixed assets		**78.4**		-
Other operating income		**26.1**		24.9
Extraordinary income		-		68.5
Total income		**1,416.5**		**1,531.6**

Balance Sheet of Aareal Bank AG as at 31 December 2016

€mn			2016		2015
Assets					
Cash funds					
a) Cash on hand		0.0		0.0	
b) Balances with central banks		1,785.5	**1,785.5**	1,281.1	1,281.1
including: with Deutsche Bundesbank 1,778.8 (2015: 1,255.7)					
Loans and advances to banks					
a) Loans secured by charges on real property		6.2		40.4	
b) Loans to local authorities		15.0		76.6	
c) Other loans and advances		2,418.5	**2,439.7**	2,292.5	2,409.5
including: payable on demand 1,355.5 (2015: 1,376.8)					
collateralised by pledged securities - (2015: -)					
Loans and advances to customers					
a) Loans secured by charges on real property		21,520.3		24,112.9	
b) Loans to local authorities		1,107.6		1,145.3	
c) Other loans and advances		3,368.6	**25,996.5**	3,035.8	28,294.0
including: collateralised by pledged securities - (2015: -)					
Debt and other fixed-income securities					
a) Money market instruments		-		-	
b) Bonds and notes					
ba) Public-sector issuers	6,223.5			7,000.3	
including: with Deutsche Bundesbank 5,900.8 (2015: 6,539.6)					
,	868.1	7,091.6		1,404.7	
including: with Deutsche Bundesbank 868.1 (2015: 1,262.5)					
c) Own bonds		504.2	**7,595.8**	899.3	9,304.3
Nominal amount: 502.0 (2015: 896.2)					
Equities and other non-fixed-income securities			**101.3**		103.0
Participating interests			**0.6**		0.7
including: interests in banks - (2015: -)					
interests in financial services providers - (2015: -)					
Investments in affiliated companies			**1,385.0**		1,187.4
including: interests in banks 9.1 (2015: 9.1)					
interests in financial services providers - (2015: -)					
Trust assets			**23.4**		41.8
including: trustee loans 21.9 (2015: 40.3)					
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		2.7		2.4	
c) Goodwill		-		-	
d) Advance payments made		-	**2.7**	-	2.4
Tangible fixed assets			**14.9**		13.4
Other assets			**446.9**		88.4
Prepaid expenses					
a) From new issues and lending		175.2		136.5	
b) Other		64.2	**239.4**	69.2	205.7
Deferred tax assets			**255.8**		311.4
Total assets			**40,287.5**		**43,243.1**

€mn			2016		2015
Equity and liabilities					
Liabilities to banks					
a) Outstanding registered mortgage Pfandbriefe		392.9		356.1	
b) Outstanding registered public sector Pfandbriefe		25.4		19.8	
c) Other liabilities		1,316.3	**1,734.6**	1,265.2	1,641.1
including: payable on demand 799.9 (2015: 750.8)					
Liabilities to customers					
a) Outstanding registered mortgage Pfandbriefe		2,841.5		2,999.1	
b) Outstanding registered public sector Pfandbriefe		1,984.3		2,134.4	
c) Savings deposits					
ca) With an agreed notice period of three months	-			-	
cb) With an agreed notice period of more than three months	-	-		-	
d) Other liabilities		19,728.0	**24,553.8**	19,547.9	24,681.4
including: payable on demand 7,300.1 (2015: 7,091.2)					
Certificated liabilities					
a) Bonds issued					
aa) Mortgage bonds	6,088.8			8,632.5	
b) Public sector Pfandbriefe	45.0			45.0	
ac) Other debt securities	2,685.3	8,819.1		2,866.1	
b) Other certificated liabilities		-	**8,819.1**	-	11,543.6
including: money market instruments - (2015: -)					
Trust liabilities			**23.4**		41.8
including: trustee loans 21.9 (2015: 40.3)					
Other liabilities			**927.0**		956.0
Prepaid expenses					
a) From new issues and lending		83.5		85.3	
b) Other		52.4	**135.9**	72.2	157.5
Deferred tax liabilities			**23.8**		27.4
Provisions					
a) Provisions for pensions and similar obligations		164.5		172.2	
b) Tax provisions		23.7		33.9	
c) Other provisions		129.6	**317.8**	203.1	409.2
Subordinated liabilities			**1,275.8**		1,331.6
including: maturing within two years 43.5 (2015: 91.0)					
Profit-participation certificates			**48.8**		48.9
including: maturing within two years 46.0 (2015: 35.0)					
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		122.2	**1,944.5**	99.3	1,921.6
Total equity and liabilities			**40,287.5**		**43,243.1**

€mn		2016		2015
Contingent liabilities				
a) Contingent liabilities from discounted forwarded bills	-		-	
b) Liabilities from guarantees and indemnity agreements	64.3		169.5	
c) Liability from the pledging of collateral for third-party liabilities	-	**64.3**	-	169.5
Other commitments				
a) Repurchase obligations from securities repurchase agreements	-		-	
b) Placement and underwriting obligations	-		-	
c) Irrevocable loan commitments	4,786.3	**4,786.3**	3,088.8	3,088.8

Notes

Basis of accounting

Aareal Bank AG is a public limited company incorporated under German law, with its registered office in Wiesbaden, Germany.

The financial statements of Aareal Bank AG for the financial year ended on 31 December 2016 were prepared in accordance with the provisions – as applicable at the reporting date – 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”). The reporting currency is the euro (€).

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

Portfolio-based valuation allowances are recognised for risks which have already materialised, but which cannot be allocated to individual loans and advances due to lack of knowledge. For this purpose, groups of financial assets with comparable default risk profiles are combined in portfolios. The valuation allowances are calculated using a formula-based procedure, based on the following Basel III parameters used in the advanced IRB Approach: expected loss given default (LGD), probability of default (PD) and the LIP (Loss Identification Period) factor. The LIP factor is a correction factor to adjust the one-year probability of default (used in Basel III) to the estimated time period, between the date the loss is incurred and the identification of the actual loss.

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). 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. Where 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.

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 carryforwards 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 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 € 4,247.9 million are hedged against changes in value attributable to interest rate risk, on the basis of so-called "micro hedges” (2015: € 4,449.0 million). 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 € 518.0 million (2015: € 559.8 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 and in accordance with the imparity principle.

The Bank continues to establish hedging relationships between repurchased own bonds in a nominal amount of € 504.2 million (2015: € 896.9 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 2016.

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.

Structured products subject to significantly higher or additional risks or rewards are accounted for separately as individual receivables or liabilities.

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.

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	2016	2015
Germany	469.8	529.6
Europe/Americas/Asia	854.2	927.8
Total	**1,324.0**	**1,457.4**

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 € 26.1 million (2015: € 24.9 million) and comprises income from the reversal of provisions in the amount of € 13.7 million (2015: € 18.1 million) as well as income under agency contracts for other Group subsidiaries in the amount of € 3.6 million (2015: € 3.0 million).

Other operating expenses total € 40.5 million (2015: € 41.9 million) and include expenses for subsidiaries in the amount of € 1.1 million (2015: € 14.1million), which are mostly attributable to agency contracts for other Group companies. The result from currency translations amounted to € -16.2 million (2015: € -7.4 million). In addition, the item includes expenses in the amount of € 8.7 million (2015: € 8.8 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.

In order to allow for a more accurate allocation of income and expenses incurred in connection with agency contracts agreed upon to acquire banking and non-banking service business, expenses in the amount of

€ 4.0 million incurred for banking services, previously disclosed under other operating income and expenses, were disclosed within net commission income in the year under review.

Net income taxes

The net income tax position amounts to expenses of € 53.1 million (2015: income of € 4.9 million), of which expenses of € 1.8 million (2015: € 32.1 million) included in current taxes were payable in Germany: this figure comprises € 19.1 million (2015: € 12.6 million) in corporation tax and solidarity surcharge and € 19.6 million (2015: € 12.1 million) in trade tax payable for the current year, as well as € 36.9 million in tax income for previous years. The net income tax position also includes € 14.2 million (2015: € 34.5 million) in expenses from the reduction of German deferred tax assets as well as € 37.1 million (2015: € 2.5 million) in expenses for 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 % (2015: 31.4 %), 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 2016	31 Dec 2015
Income before income taxes	174.8	94.4
Expected income tax expenses; tax rate: 31.7% (2015: 31.4%)	55.4	29.6
Reconciliation		
Different foreign tax burden	-4.1	7.0
Tax attributable to tax-exempt income	-44.6	-46.4
Tax attributable to non-deductible expenses	22.8	15.1
Remeasurement of deferred taxes	24.5	6.8
Prior-period actual taxes	2.8	-18.2
Effect of changes in tax rates	-2.0	0.0
Other tax effects	-1.7	1.2
Reported income tax expenses	53.1	-4.9
Effective tax rate (%)	30.4	-5.2

Prohibition of distribution

Pursuant to section 268 (8) of the HGB, € 235.0 million (2015: € 287.5 million) in profits is subject to a prohibition of distribution, of which € 232.0 million (2015: € 284.0 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 € 3.0 million (2015: € 3.5 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 € 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.

Prohibition of distribution totalled € 262.8 million (2015: € 287.5 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 2016	Unlisted 31 Dec 2016	Listed 31 Dec 2015	Unlisted 31 Dec 2015
Debt and other fixed-income securities	7,595.8	0.0	9,304.3	0.0
Equities and other non-fixed-income securities	0.0	0.0	0.0	0.0
Participating interests	-	-	-	-
Investments in affiliated companies	0.0	290.9	0.0	3.2

Hedging relationships as defined by section 254 of the HGB have been created with respect to negotiable securities in an aggregate amount of € 4,752.1 million (2015: € 5,436.3 million).

Bonds and notes of € 7,595.8 million (2015: € 9,304.3 million) (including accrued interest) reported under debt and other fixed-income securities include € 368.4 million (2015: € 979.9 million) in securities which are not eligible as collateral with Deutsche Bundesbank. Of that amount, € 113.5 million (2015: € 132.4 million) relate to sovereign foreign-currency bonds, which are eligible for securities lending.

The total amount of the balance sheet item „interests in affiliated companies“ consists of interests in Aareon AG, Aareal Beteiligungen AG, Aareal First Financial 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 2016	Market value 31 Dec 2016	Book value 31 Dec 2015	Market value 31 Dec 2015
DBB INKA	101.3	101.3	101.3	101.3
Aareal Altersvorsorge BV 97	43.1	43.1	38.4	38.4
Arsago Multistrategie	0.0	0.0	1.7	1.9
Total	**144.4**	**144.4**	**141.4**	**141.6**

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.

During the financial year under review, Arsago Multistrategie Fonds was redeemed in full.

The value of investment fund units as defined by sections 168 and 278 of the German Capital Investment Act (Kapitalanlagegesetzbuch – "KAGB") was € 144.4 million (2015: € 141.6 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 2016	31 Dec 2015
Loans and advances to banks	-	-
Loans and advances to customers	5.4	1.6
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 2016	**3,244.6**	**2.0**	**1,215.3**	**46.6**	**39.2**	**0.1**
Additions	32.7	0.0	238.8	1.5	4.6	0.0
Disposals	516.5	0.3	43.1	7.9	2.1	0.0
Changes in inventory/ transfers	0.0	0.0	0.0	0.0	0.0	0.0
As at 31 Dec 2016	**2,760.8**	**1.7**	**1,411.0**	**40.2**	**41.7**	**0.1**
Depreciation, amortisation and write-downs						
As at 1 Jan 2016	**0.0**	**1.3**	**27.9**	**44.2**	**25.9**	**0.0**
Additions[1)]	0.0	0.0	0.0	0.0	0.0	0.0
Depreciation and amortisation	0.0	0.0	0.0	1.1	2.9	0.0
Write-downs	0.0	0.0	0.0	0.0	0.0	0.0
Disposals[1)]	0.0	0.2	0.5	7.8	1.9	0.0
Transfers	0.0	0.0	0.0	0.0	0.0	0.0
Write-ups	0.0	0.0	1.5	0.0	0.0	0.0
As at 31 Dec 2016	**0.0**	**1.1**	**25.9**	**37.5**	**26.9**	**0.0**
Book value as at 31 Dec 2016	**2,760.8**	**0.6**	**1,385.1**	**2.7**	**14.8**	**0.1**
Book value as at 31 Dec 2015	**3,244.6**	**0.7**	**1,187.4**	**2.4**	**13.3**	**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 Act Regulating the Transformation of Companies (Umwandlungsgesetz – "UmwG"), applying unchanged carrying amounts

As at 31 December 2016, the securities held as fixed assets include bonds of North American financial institutions as well as securities issued by Eastern and Southern European debtors. The following performance was recognised:

€ mn	Book value 31 Dec 2016	Market value 31 Dec 2016	Book value 31 Dec 2015	Market value 31 Dec 2015
Asset-backed securities	-	-	123.6	118.0
Bank bonds	94.7	104.1	335.7	351.9
Covered bonds	314.6	322.6	372.3	390.6
Public-sector issuer	2,351.5	3,001.2	2,413.0	3,074.2
Total	**2,760.8**	**3,427.9**	**3,244.6**	**3,934.7**

Securities with a nominal amount of € 2,755.7 million (2015: € 3,241.0 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 € 256.5 million (2015: € 223.5 million) is higher than the market value of € 248.2 million (2015: € 213.8 million). The measurement at the lower of cost or market as at 31 December 2016 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 2016		Enterprises with a participatory interest 2016		Affiliated companies 2015		Enterprises with a participatory interest 2015	
€ mn	Certificated	Not certificated	Certificated	Not certificated	Certificated	Not certificated	Certificated	Not certificated
Loans and advances to banks	-	753.2	-	-	-	549.4	-	-
Loans and advances to customers	-	3,208.8	-	-	-	2,963.5	-	-
Debt and other fixed-income securities	-	-	-	-	-	-	-	-
Liabilities to banks	-	188.2	-	-	-	35.7	-	-
Liabilities to customers	-	768.5	-	-	-	630.2	-	-
Certificated liabilities	208.0	-	-	-	208.0	-	-	-
Subordinated liabilities	-	250.0	-	-	-	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 2016	31 Dec 2015
Trust assets		
Loans and advances to banks	0	0
Loans and advances to customers	21.9	40.3
Equities and other non-fixed-income securities	1.5	1.5
Total trust assets	**23.4**	**41.8**
Trust liabilities		
Liabilities to banks	2.6	13.2
Liabilities to customers	20.8	28.6
Total trust liabilities	**23.4**	**41.8**

Other assets

Other assets include, 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 (€ 84.1 million). In addition, other assets include 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.

In the previous year, other assets included € 39.2 million in receivables from profit distributions or profit assumptions, € 10.1 million in tax receivables and € 31.1 million in assets recognised from currency translation as well as receivables from the collateralisation of the irrevocable payment obligation to the FMSA in the amount of € 4.8 million resulting from the bank levy.

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 € 239.4 million (2015: € 205.7 million) primarily include € 5.4 million (2015: € 2.7 million) in premiums on originated loans, in accordance with section 340e (2) sentence 3 of the HGB and € 169.8 million (2015: € 133.8 million) in discounts on bonds issued and borrowings pursuant to section 250 (3) of the HGB. The item also includes € 51.0 million (2015: € 62.4 million) from upfront payments/option premiums in connection with derivatives.

€ 135.9 million (2015: € 157.5 million) of deferred income refers to upfront payments/option premiums in connection with derivatives (€ 52.2 million; 2015: € 72.1 million), while € 9.5 million (2015: € 11.7 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 € 65.6 million (2015: € 69.0 million).

Deferred taxes

As at 31 December 2016, € 255.8 million (2015: € 311.4 million) in deferred tax assets and € 23.8 million (2015: € 27.4 million) in deferred tax liabilities were reported on the balance sheet. 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 (2015: 31.4 %).

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 € 1.6 million (2015: € 17.9 million) were recognised for loss carryforwards, relating exclusively to foreign permanent establishments of Aareal Bank AG.

Deferred tax liabilities were recognised primarily for flat-rate specific provisions on receivables of the Bank's permanent establishment in Rome.

Current tax assets and current tax liabilities developed as follows during the financial year 2016:

€ mn	31 Dec 2016	31 Dec 2015	Change
Deferred tax assets	255.8	311.4	-55.6
Deferred tax liabilities	23.8	27.4	-3.6

Other liabilities

Other liabilities include profit entitlements from silent participations in the amount of € 3.4 million. 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.

In the previous financial year, other liabilities included € 3.6 million in profit entitlements from silent participations, In addition, other liabilities included € 840.4 million in liabilities recognised from currency translation, € 78.0 million in liabilities from profit and loss transfer agreements and € 8.5 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 2016 (cut-off date), not as at the balance sheet date:

	31 Dec 2016	31 Dec 2015
Actuarial method applied:	Projected unit credit method	Projected unit credit method
Fundamental assumptions for calculation:		
Discount rate in %	4.00	3.89
Reference period for discount rate	10 years	7 years
Fluctuation (%)	ca. 3,00	ca. 3,00
Expected w age and salary increases in %	2.00	2.25
Adjustments of current pension payments (%)	1.00	1.00
Mortality tables used	"Richttafeln 2005G" mortality tables by Prof Dr Klaus Heubeck	"Richttafeln 2005G" mortality tables by Prof Dr Klaus Heubeck

In 2016, the reference period used as a basis for the notional interest rate was extended from seven to ten years. The difference between the two valuations amounted to € 27.8 million.

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 2016	31 Dec 2015
Pension obligation	233.1	235.1
Fair value of plan assets	68.6	62.9
Cost of plan assets	65.6	59.4
Provisions for pensions and similar obligations	**164.5**	**172.2**

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

Fund units are measured at fair value, while reinsurance claims are measured at their asset value.

€ mn	31 Dec 2016	31 Dec 2015
Fund units	43.1	38.4
Bonds	-	-
Reinsurance cover	25.5	24.5
Fair value of plan assets	**68.6**	**62.9**

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 2016	31 Dec 2015
Interest cost on pension obligations	8.7	9.3
Income from plan assets	1.5	1.5
Net interest expense	**7.2**	**7.8**

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 2016 totalled € 63.0 million (2015: € 64.5 million), including an amount of € 26.6 million (2015: € 27.4 million) for accrued interest payments not yet due.

Aareal Bank AG has € 250.0 million (2015: € 250.0 million) in subordinated equity from Aareal Bank Capital Funding LLC, Delaware, USA, at its disposal. The amount exceeds 10 % of the aggregate nominal value of all subordinated liabilities; this bears interest at 7.135 %. These subordinated funds are due for repayment on 31 December 2026. The Bank has had a right to terminate, on a quarterly basis, since 31 December 2006; the creditors do not have any early termination rights.

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 € 4.1 million (2015: € 11.2 million).

	Nominal amount € mn	Issue currency	Interest rate (% p.a.)	Maturity
Registered profit-participation certificates:				
	5.0	EUR	7.22	2002 - 2016
	5.0	EUR	7.22	2002 - 2016
	5.0	EUR	6.31	2003 - 2017
	5.0	EUR	5.38	2004 - 2016
	10.0	EUR	5.95	2004 - 2016
	10.0	EUR	5.95	2004 - 2016
	5.0	EUR	5.83	2005 - 2017
	1.0	EUR	5.83	2005 - 2017
	46.0			

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 eight (2015: eight) profit-participation certificates as at the balance sheet date.

€ 2.8 million (2015: € 3.3 million) in interest expenses were incurred in the financial year 2016 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 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 (2015: € 22.8 million), including an amount of € 15.4 million (2015: € 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 Management Board was authorised by means of a resolution of the General Meeting held on 20 May 2015, pursuant to section 71 (1) no. 8 of the AktG, to purchase own shares up to a volume of 10 % of the share capital for purposes other than trading in treasury shares. This authorisation expires on 19 May 2020. Shares may be acquired via the stock exchange or by means of a public offer to buy, directed at all shareholders, and at purchase prices stipulated in the authorisation and based on the prevailing market price of the Company's shares. This authorisation may be exercised, in full or in part, on one or more occasions.

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

The Management Board was also authorised to effect the acquisition of treasury shares by using put or call options. 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

	Subscribed capital	Capital reserves	Retained earnings		Net retained profit	Equity
			Legal reserve	Other retained earnings		
€ mn						
As at 1 Jan 2016	**369.8**	**727.8**	**4.5**	**720.2**	**99.3**	**1,921.6**
Capital increase	0.0	0.0	-	-	-	0.0
(of which: contributions by silent partners)	(190.2)	-	-	-	-	(190.2)
Dividends distributed in 2016	-	-	-	0.0	-98.8	-98.8
Transfer from net income 2016	-	-	-	-	121.7	121.7
As at 31 Dec 2016	**369.8**	**727.8**	**4.5**	**720.2**	**122.2**	**1,944.5**
(of which: contributions by silent partners)	(190.2)	-	-	-	-	(190.2)

Subscribed capital amounts to € 179.6 million (2015: € 179.6 million) and is divided into 59,857,221 (2015: 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 23 May 2012. Accordingly, the Management Board is authorised to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 89,785,830 (Authorised Capital 2012) by issuance of new no-par value bearer shares for contribution in cash or in kind, subject to the approval of the Supervisory Board; this authority will expire on 22 May 2017. In the event of a capital increase against cash contributions, the shareholders shall be granted a subscription right, unless the Management Board exercises its authority to exclude shareholder's pre-emptive subscription rights. The Management Board may exclude shareholders' subscription rights, subject to approval by the Supervisory Board and the conditions set out below:

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

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

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

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

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

When exercising this authorisation, the Management Board will restrict the exclusion of shareholders' pre-emptive rights to a total of 20 % of the Company's share capital. Accordingly, the aggregate exclusion of shareholders' subscription rights upon exercise of this authorisation must not exceed 20 % of the share capital at the time said authorisation comes into effect or is exercised. This limit also includes shares issued by the Company on the basis of the authorisation by the General Meeting on 23 May 2012, under convertible bonds and/or bonds with warrants issued excluding the pre-emptive rights of shareholders.

The authorised capital has not 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. For instance, a conversion obligation may be provided for if the Bank falls short of certain capital ratios (to be defined in the terms of convertible profit-participation certificates) or other financial indicators; conversion is required, in the opinion of the Company's Management Board and Supervisory Board, to safeguard the Company's continued existence; or if conversion is instructed by a supervisory authority within the scope of its powers.

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

The new shares will be issued at the conversion price to be set as defined in the resolution passed by the Annual 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 € 18.3 million (2015: € 43.5 million) are granted to domestic borrowers and € 46.0 million (2015: € 126.0 million) to foreign borrowers. These include € 2.9 million (2015: € 22.5 million) in maximum default guarantees extended to DEPFA Deutsche Pfandbriefbank AG (within the scope of splitting the former DEPFA Group), for the purpose of providing cover against risks of default with respect to the property loan portfolio held by pbb Deutsche Pfandbriefbank AG.

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 € 2,994.3 million (2015: € 1,136.1 million) are granted to domestic borrowers and € 1,792.0 million (2015: € 1,952.7 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 2016	31 Dec 2015
Loans and advances to banks	**2,439.7**	**2,409.5**
with a residual term of		
Payable on demand	1,355.5	1,376.8
Up to 3 months	334.7	555.1
Between 3 months and 1 year	446.0	106.4
Between 1 year and 5 years	13.7	27.5
More than 5 years	13.6	48.2
Pro rata interest	276.2	295.5
Loans and advances to customers	**25,996.5**	**28,294.0**
with a residual term of		
Payable on demand	322.7	641.9
Up to 3 months	901.5	626.8
Between 3 months and 1 year	2,013.2	2,980.2
Between 1 year and 5 years	16,403.6	17,893.8
More than 5 years	6,246.6	6,014.5
Indefinite maturity	-	-
Pro rata interest	108.9	136.8
Debt and other fixed-income securities maturing in the following year (nominal amount)	**859.1**	**1,018.0**
Liabilities to banks	**1,734.6**	**1,641.1**
with a residual term of		
Payable on demand	799.9	750.8
Up to 3 months	61.4	18.1
Between 3 months and 1 year	59.2	44.4
Between 1 year and 5 years	277.5	284.3
More than 5 years	336.5	337.5
Pro rata interest	200.1	206.0
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	**24,553.8**	**24,681.4**
With a residual term of		
Payable on demand	7,300.1	7,091.2
Up to 3 months	4,348.0	3,463.8
Between 3 months and 1 year	3,669.0	3,459.5
Between 1 year and 5 years	3,402.6	4,103.4
More than 5 years	5,633.9	6,341.1
Pro rata interest	200.2	222.4
Bonds issued maturing in the following year (nominal amount)	**2,515.6**	**3,209.8**
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
			in %	€ mn	€ mn
1	1st Touch Ltd	Southampton	100.0	GBP 2.2 mn	GBP -0.2 mn 2)
2	Aareal Bank Asia Limited	Singapore	100.0	SGD 17.3 mn	SGD 0.4 mn 1)
3	Aareal Bank Capital Funding LLC	Wilmington	0.0	250.0	17.8 5)
4	Aareal Bank Capital Funding Trust	Wilmington	0.0	250.0	17.8 5)
5	Aareal Beteiligungen AG	Frankfurt	100.0	297.8	0.0 3)
6	Aareal Capital Corporation	Wilmington	100.0	USD 219.4 mn	USD 1.5 mn 1)
7	Aareal Estate AG	Wiesbaden	100.0	5.1	2.3 1)
8	Aareal First Financial Solutions AG	Mainz	100.0	3.2	0.0 3)
9	Aareal Gesellschaft für Beteiligungen und Grundbesitz Erste mbH & Co. KG	Wiesbaden	94.9	2.5	0.1 1)
10	Aareal Holding Realty LP	Wilmington	100.0	USD 206.1mn	USD 42.8 mn 7)
11	Aareal Immobilien Beteiligungen GmbH	Wiesbaden	100.0	454.3	0.0 3)
12	Aareal Valuation GmbH	Wiesbaden	100.0	0.5	0.0 3)
13	Aareon AG	Mainz	100.0	94.8	15.9
14	Aareon Deutschland GmbH	Mainz	100.0	33.9	0.0 3)
15	Aareon France S.A.S.	Meudon-la-Forêt	100.0	7.3	2.5 2)
16	Aareon Immobilien Projekt GmbH	Essen	100.0	0.7	0.0 3)
17	Aareon International Solutions GmbH	Mainz	100.0	0.0	0.0
18	Aareon Nederland B.V.	Emmen	100.0	20.5	1.8 2)
19	Aareon UK Ltd.	Coventry	100.0	GBP 4.4 mn	GBP 0.2 mn 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	27.4	1.0
23	BauGrund Immobilien-Management GmbH	Bonn	100.0	0.5	0.0 3)
24	BauGrund TVG GmbH	Munich	100.0	0.1	0.0
25	BauSecura Versicherungsmakler GmbH	Hamburg	51.0	3.2	3.1
26	BVG - Grundstücks- und Verwertungs-gesellschaft mit beschränkter Haftung	Frankfurt	100.0	217.3	0.0 3)
27	Capital Funding GmbH & Co. KG	Frankfurt	100.0	0.0	0.0 6)

1) Preliminary figures as at 31 December 2016; 2) Equity and results as at 31 December 2015;

3) Profit transfer agreement/control and profit transfer agreement; 4) Different financial year;

5) 100% of voting rights, diverging from the equity interest held; 6) 10% of voting rights, diverging from the equity interest held;

7) Disclosures in accordance with IFRSs

No.	Company name	Registered office	Shareholding	Equity	Results
			in %	€ mn	€ mn
28	Deutsche Bau- und Grundstücks-Aktiengesellschaft	Berlin	100.0	1.4	0.1 [1]
29	Deutsche Structured Finance GmbH	Wiesbaden	100.0	6.2	1.7 [1]
30	DSF Flugzeugportfolio GmbH	Wiesbaden	100.0	0.0	0.0 [3]
31	DSF German Office Fund GmbH & Co. KG	Wiesbaden	94.0	0.4	-0.9 [1]
32	DSF PP Justizzentrum Thüringen GmbH & Co. KG	Frankfurt	48.4	0.4	0.0 [2]
33	DSF Vierte Verwaltungsgesellschaft mbH	Wiesbaden	100.0	2.2	0.0 [3]
34	Esplanade Realty LP	Wilmington	100.0	USD 23.3 mn	USD 0.6 mn [7]
35	Facilitor B.V.	Enschede	100.0	0.5	0.7 [2]
36	GEV Besitzgesellschaft mbH	Wiesbaden	100.0	30.0	0.0 [3]
37	GEV Beteiligungsgesellschaft mbH	Wiesbaden	100.0	0.1	0.0 [1]
38	GEV GmbH	Wiesbaden	100.0	358.0	0.0 [3]
39	GVN-Grundstücks- und Vermögensverwaltungs-gesellschaft mit beschränkter Haftung	Frankfurt	100.0	0.5	0.0 [3]
40	Incit AB	Mölndal	100.0	SEK 23.3 mn	SEK 2.6 mn [2]
41	Incit AS	Oslo	100.0	NOK 0.1 mn	NOK -1.1 mn [2]
42	Incit Nederland B.V.	Gorinchem	100.0	-0.1	0.3 [2]
43	IV Beteiligungsgesellschaft für Immobilieninvestitionen mbH	Wiesbaden	100.0	2.3	0.0 [1]
44	Izalco Spain S.L.	Madrid	100.0	10.2	-0.9 [1]
45	Jomo S.p.r.l.	Brussels	100.0	44.0	-0.6 [1]
46	Konsortium BauGrund/TREUREAL	Bonn	50.0	0.0	0.0
47	La Sessola Holding GmbH	Wiesbaden	100.0	84.1	-18.8 [1]
48	La Sessola S.r.l.	Rome	100.0	119.7	-12.2 [1]

1) Preliminary figures as at 31 December 2016; 2) Equity and results as at 31 December 2015;

3) Profit transfer agreement/control and profit transfer agreement; 4) Different financial year;

5) 100% of voting rights, diverging from the equity interest held; 6) 10% of voting rights, diverging from the equity interest held;

7) Disclosures in accordance with IFRSs

No.	Company name	Registered office	Shareholding	Equity	Results
			in %	€ mn	€ mn
49	La Sessola Service S.r.l.	Rome	100.0	2.2	1.5 1)
50	Manager Realty LLC	Wilmington	100.0	USD 0.0 mn	USD 0.0 mn 7)
51	Mercadea S.r.l.	Rome	100.0	7.1	0.1 1)
52	Mirante S.r.l.	Rome	100.0	11.2	-2.2 1)
53	Northpark Realty LP	Wilmington	100.0	USD 86.3 mn	USD 2.3 mn 7)
54	Participation Achte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 3)
55	Participation Neunte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 3)
56	phi-Consulting GmbH	Bochum	100.0	1.4	0.2
57	Real Verwaltungsgesellschaft mbH	Schönefeld	100.0	27.8	0.9 1)
58	Sedum Grundstücksverwaltungsgesellschaft mbH & Co. Vermietungs KG	Mainz	94.9	-2.4	-1.5 1)
59	SG2ALL B.V.	Huizen	100.0	0.2	0.2 2)
60	Square DMS B.V.	Grathem	100.0	0.4	0.6 2)
61	Terrain-Aktiengesellschaft Herzogpark	Wiesbaden	99.9	4.7	0.0 3)
62	Terrain Beteiligungen GmbH	Wiesbaden	94.0	50.3	0.5 1)
63	Westdeutsche ImmobilienBank AG	Mainz	100.0	451.9	0.0 3)
64	Westhafen Haus GmbH & Co. Projektentwicklungs KG i.L.	Frankfurt	25.0	-0.2	0.0 2)
65	Westhafen-Gelände Frankfurt am Main GbR i.L.	Frankfurt	33.3	0.0	0.4 2)
66	WP Galleria Realty LP	Wilmington	100.0	USD 90.1 mn	USD 1.7 mn 7)

1) Preliminary figures as at 31 December 2016; 2) Equity and results as at 31 December 2015;

3) Profit transfer agreement/control and profit transfer agreement; 4) Different financial year;

5) 100% of voting rights, diverging from the equity interest held; 6) 10% of voting rights, diverging from the equity interest held;

7) Disclosures in accordance with IFRSs

Assets pledged as collateral

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

€ mn	31 Dec 2016	31 Dec 2015
Liabilities to banks	1,498.3	1,556.3
Liabilities to customers	0.0	0.0
Total	**1,498.3**	**1,556.3**

Other assets include the cash-collateralised and irrevocable payment obligation to the FMSA resulting from the bank levy, for which € 7.4 million (2015: € 4.8 million) in cash collateral has been pledged.

Repurchase agreements

As at 31 December 2016, no bonds were used as part of repurchase agreements (2015: € –).

Assets and liabilities in foreign currencies

The aggregate equivalent amount of assets denominated in foreign currencies was € 12,590.8 million (2015: € 12,574.7 million) at the balance sheet date, while liabilities totalled € 2,324.5 million (2015: € 1,663.1 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 2016:

- **Transactions based on interest rates**
  Caps, floors, swaptions, interest rate swaps
- **Transactions based on exchange rates**
  Spot and forward foreign exchange transactions, cross-currency interest rate swaps
- **Other transactions**
  Credit default swaps, 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. Spot and forward foreign exchange transactions are almost exclusively used for refinancing purposes. Credit derivatives are primarily used to assume credit risks for the purpose of portfolio diversification. The credit default swaps entered into for that purpose are regularly reviewed as to whether a provision for anticipated losses shall be recognised based on pre-determined criteria.

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

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					
Credit default swaps					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
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**

31 December 2015

€ mn	Up to 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total as at 31 Dec 2015
Interest rate instruments					
Interest rate swaps					
Cash inflows	191.6	532.1	1,799.6	671.0	3,194.3
Cash outflows	180.6	356.8	1,450.3	584.0	2,571.7
Forward rate agreements					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Swaptions					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Caps, floors					
Cash inflows	0.2	1.3	7.9	3.3	12.7
Cash outflows	0.2	1.3	8.0	3.3	12.8
Currency-related instruments					
Spot and forward foreign exchange transactions					
Cash inflows	2,071.8	269.3	-	-	2,341.1
Cash outflows	2,067.4	269.7	-	-	2,337.1
Cross-currency swaps					
Cash inflows	11.4	730.0	5,779.1	1,513.9	8,034.4
Cash outflows	24.5	909.7	6,720.1	1,574.7	9,229.0
Other transactions					
Credit default swaps					
Cash inflows	-	0.4	-	-	0.4
Cash outflows	-	-	-	-	-
Options, futures					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Other derivative transactions					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Total cash inflows	**2,275.0**	**1,533.1**	**7,586.6**	**2,188.2**	**13,582.9**
Total cash outflows	**2,272.7**	**1,537.5**	**8,178.4**	**2,162.0**	**14,150.6**

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

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 2016.

€ mn	Nominal amount as at 31 Dec 2016	Market value as at 31 Dec 2016		Market value as at 31 Dec 2015	
		positive	negative	positive	negative
Interest rate instruments					
OTC products					
Interest rate swaps	42,800.8	2,143.2	2,166.1	2,311.2	2,175.5
Caps, floors	5,013.4	6.9	6.9	12.6	12.5
Total interest rate instruments	**47,814.2**	**2,150.1**	**2,173.0**	**2,323.8**	**2,188.0**
Currency-related instruments					
OTC products					
Spot and forward foreign exchange transactions	2,766.3	7.2	64.2	13.2	8.5
Cross-currency swaps	8,575.4	314.0	749.4	101.1	930.7
Total currency-related instruments	**11,341.7**	**321.2**	**813.6**	**114.3**	**939.2**
Other transactions					
OTC products [1)]					
Credit default swaps	-	-	-	0.5	-
Total other transactions	**0.0**	**0.0**	**0.0**	**0.5**	**0.0**
Total	**59,155.9**	**2,471.3**	**2,986.6**	**2,438.6**	**3,127.2**

1) This includes derivatives subject to the country risk of Hungary and embedded in an Austrian bank bond.

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 2016		Market value as at 31 Dec 2015	
	positive	negative	positive	negative
OECD public-sector authorities				
OECD banks	2,265.2	2,972.2	2,160.4	3,103.6
Non-OECD banks				
Companies and private individuals	206.1	14.4	278.2	23.6
Total	**2,471.3**	**2,986.6**	**2,438.6**	**3,127.2**

Remuneration report

The remuneration report for the 2016 financial year contains detailed information on the remuneration of Aareal Bank AG Management Board members, its senior executives, and its employees. As a significant institution, Aareal Bank publishes a description of its remuneration systems (qualitative disclosure) in the Group Annual Report for the financial year 2016 in accordance with section 16 (1) of the amendment to the German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – "InstVergV"), as amended on 16 December 2013, as well as the Capital Requirements Regulation (CRR). The Supervisory Board and the Management Board carried out the annual review of the remuneration systems, involving the Human Resources division, the Remuneration Officer, and internal control units in line with their respective functions, and supported by external legal and remuneration advisors. External advisors were retained, amongst other things, for examining the appropriateness of remuneration systems, and remuneration for members of the Management Board and employees, as well as regarding the design of the Group-wide remuneration strategy. The quantitative disclosures on the remuneration of Management Board members, employees as well as senior executives required according to the CRR will be disclosed by the end of June in the following year, on Aareal Bank AG's homepage at the latest.

According to Article 450 (1) of the CRR, institutions shall additionally disclose the information specified in the Regulation regarding the remuneration policy and practices of the institution for those categories of staff whose professional activities have a material impact on their risk profile (so-called risk takers). The following section provides information on the remuneration system for Management Board members of Aareal Bank AG applicable as at 1 January 2014.

Remuneration system for the Management Board

Responsibilities and procedures of Aareal Bank AG regarding remuneration policies

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

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

The Supervisory Board defines – at the beginning, but no later than immediately after the beginning of every financial year – the Management Board members' targets with respect to performance-related remuneration components. The Supervisory Board assesses Management Board members' success and performance after the end of every financial year.

Success criteria and parameters

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

Performance-related remuneration

Remuneration parameters

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

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 these two targets have not been achieved. The Supervisory Board also defines the sectional and individual targets for every member of the Management Board, for each financial year.

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

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

Retention of variable remuneration components and penalty criteria

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

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

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

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

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

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

Share Bonus Plan

According to the rules for the share bonus plan, a portion of the variable remuneration will be converted into an equivalent number of virtual shares and credited to the beneficiary. The calculation of the number of virtual shares is henceforth based on the weighted average price on the basis of five (Xetra®) exchange trading days after publication of the preliminary results for the respective financial year (subscription price). The date of publication of the preliminary results is used as the reference date. The virtual shares so determined are paid into a virtual account and are automatically and without delay converted into a cash amount and paid out following the Supervisory Board meeting which resolves to accept the annual financial statements for the third financial year following the financial year for which the virtual shares were granted ("holding period"). The conversion will be effected using the weighted average price calculated on the basis of the five (Xetra®) exchange trading days following the publication of the preliminary business figures for the year preceding the payout. Since the 2013 financial year, the payout amount of the share bonus of a given financial year may vary depending on the share price development and has been limited to a maximum of 300 % of the agreed initial value (ceiling).

The virtual shares granted for the financial years prior to the 2014 financial year will continue to have as the applicable subscription price the weighted average price on the basis of the five (Xetra®) exchange trading days following publication of the annual financial statements for the respective financial year. The ceiling is not applicable to these virtual shares, with the exception of those virtual shares granted for the 2013 financial year.

If dividends are paid on the Company's shares during the time period between the reference date and the conversion, a payout is made as a salary component in an amount equivalent to the dividends and the proportion of the phantom shares.

Share Deferral Plan

Under the Share Deferral Plan, a portion of the variable remuneration is credited to the beneficiary. This credit, however, does not convey an entitlement or a claim regarding a later payout or grant of virtual shares. Interest accrues on the amount credited in the form of a share deferral. The reference rate is the interest rate of the European Central Bank for deposits from private households with a term of up to one year. As above, the credit of interest does not convey an entitlement or a claim regarding the interest amount. In the three years following the credit (retention period), the Supervisory Board decides whether in each case a third of the share deferral, including interest, should be converted.

The question as to whether a third of the virtual shares is converted and, if yes, in which amount, is based on the principles set out above (see section on Retention of variable remuneration components and penalty criteria). In particular, the Supervisory Board checks the application of the penalty rules provided. Equivalent provisions to the share bonus plan are applied in the calculation of the amount of the virtual shares – except for the holding period, which is reduced from three years to two years. The ceiling value is applicable for the conversion of the virtual shares which were granted for the 2013 financial year and the following financial years, with the proviso that the payout amount following the conversion of the virtual shares of a tranche (plus interest) into a cash payment must not exceed 300 % of the share deferral (30 % of the granted variable remuneration) set for the respective financial year (which may have been reduced following the application of a penalty rule or as a result of an instruction by BaFin). The payout amount for virtual shares which were granted for prior financial years or are yet to be granted, respectively, are not subject to any ceiling.

Remuneration

The requirements according to section 25a (5) of the KWG – regarding a ratio of variable to fixed remuneration for members of the Management Board of 1:1, and the maximum target achievement threshold – are complied with at all times.

The following table shows the target remuneration granted (fixed annual salary and variable remuneration based on a 100 % target achievement) in the year under review, in accordance with articles 4.2.4 and 4.2.5 of the German Corporate Governance Code.

Remuneration granted	Hermann J. Merkens – Chairmen of the Management Board				Dagmar Knopek			
	2015 [1]	2016	2016 (Min) [2]	2016 (Max) [3]	2015 [1]	2016	2016 (Min) [2]	2016 (Max) [3]
€								
Fixed remuneration	1,214,667	1,300,000	1,300,000	1,300,000	880,000	880,000	880,000	880,000
Ancillary benefits	46,594	38,511	38,511	38,511	34,087	41,449	41,449	41,449
Total	**1,261,260**	**1,338,511**	**1,338,511**	**1,338,511**	**914,087**	**921,449**	**921,449**	**921,449**
Variable remuneration based on a single-year assessment	226,071	280,000	-	420,000	160,000	160,000	-	240,000
Variable remuneration based on a multiple-year assessment								
Cash deferral 2016 (March 2020)	-	420,000	-	630,000	-	240,000	-	360,000
Share bonus 2016 (March 2020)	-	280,000	-	420,000	-	160,000	-	240,000
Share deferral 2016 (March 2022)	-	420,000	-	630,000	-	240,000	-	360,000
Cash deferral 2015 (March 2019)	339,107	-	-	-	240,000	-	-	-
Share bonus 2015 (March 2019)	226,071	-	-	-	160,000	-	-	-
Share deferral 2015 (March 2021)	339,107	-	-	-	240,000	-	-	-
Total	**1,130,356**	**1,400,000**	**-**	**2,100,000**	**800,000**	**800,000**	**-**	**1,200,000**
Benefit expense	329,035	1,032,350	1,032,350	1,032,350	357,210	526,355	526,355	526,355
Total remuneration	**2,720,651**	**3,770,861**	**2,370,861**	**4,470,861**	**2,071,297**	**2,247,804**	**1,447,804**	**2,647,804**

Remuneration granted	Christiane Kunisch-Wolff [4]				Thomas Ortmanns			
	2015 [1]	2016	2016 (Min) [2]	2016 (Max) [3]	2015 [1]	2016	2016 (Min) [2]	2016 (Max) [3]
€								
Fixed remuneration	-	561,244	561,244	561,244	880,000	880,000	880,000	880,000
Ancillary benefits	-	27,595	27,595	27,595	33,259	35,945	35,945	35,945
Total	**-**	**588,839**	**588,839**	**588,839**	**913,259**	**915,945**	**915,945**	**915,945**
Variable remuneration based on a single-year assessment	-	102,120	-	153,180	160,000	160,000	-	240,000
Variable remuneration based on a multiple-year assessment								
Cash deferral 2016 (March 2020)	-	153,180	-	229,770	-	240,000	-	360,000
Share bonus 2016 (March 2020)	-	102,120	-	153,180	-	160,000	-	240,000
Share deferral 2016 (March 2022)	-	153,180	-	229,770	-	240,000	-	360,000
Cash deferral 2015 (March 2019)	-	-	-	-	240,000	-	-	-
Share bonus 2015 (March 2019)	-	-	-	-	160,000	-	-	-
Share deferral 2015 (March 2021)	-	-	-	-	240,000	-	-	-
Total	**-**	**510,601**	**-**	**765,902**	**800,000**	**800,000**	**-**	**1,200,000**
Benefit expense	-	51,707	51,707	51,707	363,678	725,906	725,906	725,906
Total remuneration	**-**	**1,151,147**	**640,546**	**1,406,448**	**2,076,937**	**2,441,851**	**1,641,851**	**2,841,851**

Remuneration granted	Christof Winkelmann [5]			
	2015	2016	2016 (Min) [2]	2016 (Max) [3]
€				
Fixed remuneration	-	352.000	352.000	352.000
Ancillary benefits	-	12.125	12.125	12.125
Total	**-**	**364.125**	**364.125**	**364.125**
Variable remuneration based on a single-year assessment	-	64.000	-	96.000
Variable remuneration based on a multiple-year assessment				
Cash deferral 2016 (March 2020)	-	96.000	-	144.000
Share bonus 2016 (March 2020)	-	64.000	-	96.000
Share deferral 2016 (March 2022)	-	96.000	-	144.000
Cash deferral 2015 (March 2019)	-	-	-	-
Share bonus 2015 (March 2019)	-	-	-	-
Share deferral 2015 (March 2021)	-	-	-	-
Total	**-**	**320.000**	**-**	**480.000**
Benefit expense	-	66.747	66.747	66.747
Total remuneration	**-**	**750.872**	**430.872**	**910.872**

[1] Details differ partially from the previous year's figures, due to the fact that in the previous year variable remuneration amounts granted were calculated on the basis of individual target achievement of each member of the Management Board. Dr Wolf Schumacher was granted a total remuneration in the amount of € 13,911,704 in the previous year.
[2] Minimum amount of the remuneration component granted in the year under review
[3] Maximum amount of the remuneration component granted in the year under review
[4] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.
[5] 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 Chairmen of the Management Board		Dagmar Knopek		Christiane Kunisch-Wolff [1]	
	2016	2015	2016	2015	2016	2015
€						
Fixed remuneration	1,300,000	1,214,667	880,000	880,000	561,244	-
Ancillary benefits	38,511	46,594	41,449	34,087	27,595	-
Total	**1,338,511**	**1,261,261**	**921,449**	**914,087**	**588,839**	**-**
Variable remuneration based on a single-year assessment	299,544	202,400	212,640	201,920	-	-
Variable remuneration based on a multiple-year assessment	-	-	-	-	-	-
Cash deferral 2012 (April 2016)	104,797	-	-	-	-	-
Cash deferral 2013 (April 2016)	110,985	-	64,741	-	-	-
Cash deferral 2014 (April 2016)	102,111	-	101,869	-	-	-
Share bonus 2012 (May 2016)	328,146	-	-	-	-	-
Share deferral 2011 (April 2016)	-	-	-	-	-	-
Share deferral 2012 (April 2016)	167,896	-	-	-	-	-
Cash deferral 2011 (April 2015)	-	-	-	-	-	-
Cash deferral 2012 (April 2015)	-	102,411	-	-	-	-
Cash deferral 2013 (April 2015)	-	109,269	-	-	-	-
Share bonus 2011 (May 2015)	-	370,183	-	63,740	-	-
Share deferral 2011 (April 2015)	-	-	-	-	-	-
Dividends	73,961	47,428	38,522	13,228	-	-
Total	**1,187,440**	**831,691**	**417,772**	**278,888**	**-**	**-**
Benefit expense	1,032,350	329,035	526,355	357,210	51,707	-
Total remuneration	**3,558,301**	**2,421,987**	**1,865,576**	**1,550,185**	**640,546**	**-**

Remuneration paid	Thomas Ortmanns		Christof Winkelmann [2]		Dr. Wolf Schumacher [3]	
	2016	2015	2016	2015	2016	2015
€						
Fixed remuneration	880,000	880,000	352,000	-	-	1,012,500
Ancillary benefits	35,945	33,259	12,125	-	90	26,177
Total	**915,945**	**913,259**	**364,125**	**-**	**90**	**1,038,677**
Variable remuneration based on a single-year assessment	211,360	200,800	-	-	275,940	7,207,069
Variable remuneration based on a multiple-year assessment	-	-	-	-	-	-
Cash deferral 2012 (April 2016)	104,797	-	-	-	176,804	-
Cash deferral 2013 (April 2016)	110,985	-	-	-	187,244	-
Cash deferral 2014 (April 2016)	101,304	-	-	-	178,270	-
Share bonus 2012 (May 2016)	328,146	-	-	-	553,620	-
Share deferral 2011 (April 2016)	-	-	-	-	-	-
Share deferral 2012 (April 2016)	167,896	-	-	-	283,260	-
Cash deferral 2011 (April 2015)	-	-	-	-	-	-
Cash deferral 2012 (April 2015)	-	102,411	-	-	-	172,779
Cash deferral 2013 (April 2015)	-	109,269	-	-	-	184,350
Share bonus 2011 (May 2015)	-	370,183	-	-	-	370,183
Share deferral 2011 (April 2015)	-	-	-	-	-	-
Dividends	68,575	47,380	-	-	111,776	80,378
Total	**1,093,063**	**830,043**	**-**	**-**	**1,766,914**	**8,014,759**
Benefit expense	725,906	363,678	66,747	-	-	4,639,618
Total remuneration	**2,734,914**	**2,106,980**	**430,872**	**-**	**1,767,004**	**13,693,054**

[1] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.
[2] Mr Christof Winkelmann was appointed to the Management Board on 1 July 2016.
[3] Dr Wolf Schumacher resigned with effect from 30 September 2015. € 275,940 in variable remuneration was granted to Dr Schumacher in 2015, as one-year variable remuneration for the 2015 financial year. For the remaining term of the Management Board contract, the contractually agreed fixed remuneration of € 3,354,045.95, lost variable remuneration components of € 3,433,663.00, as well as the equivalent of company-car use of € 66,000, were disbursed as one-off payments. Due to the resignation of Dr Schumacher, with effect from 30 September 2015, € 4,023,736 was recognised in benefit expenses for 2015, in line with his pension agreement, thus increasing the Bank's pension obligations.

Remuneration paid	Dirk Große Wördemann [1]	
	2016	2015
€		
Fixed remuneration	-	-
Ancillary benefits	-	-
Total	**-**	**-**
Variable remuneration based on a single-year assessment	-	-
Variable remuneration based on a multiple-year assessment	-	-
Cash deferral 2012 (April 2016)	85,080	-
Cash deferral 2013 (April 2016)	-	-
Cash deferral 2014 (April 2016)	-	-
Share bonus 2012 (May 2016)	266,409	-
Share deferral 2011 (April 2016)	179,144	-
Share deferral 2012 (April 2016)	136,308	-
Cash deferral 2011 (April 2015)	-	97,015
Cash deferral 2012 (April 2015)	-	83,143
Cash deferral 2013 (April 2015)	-	-
Share bonus 2011 (May 2015)	-	488,267
Share deferral 2011 (April 2015)	-	250,492
Dividends	27,954	39,471
Total	**694,895**	**958,388**
Benefit expense	-	-
Total remuneration	**694,895**	**958,388**

[1] Mr Große Wördemann resigned with effect from 31 May 2013.

Pursuant to section 285 no. 9a of the HGB, the following table shows fixed and other remuneration for members of the Management Board as well as the total target achievement amounts of variable remuneration, determined by the Supervisory Board as follows:

	Year	Fixed remuneration	Variable remuneration				Other remuneration [4]	Total remuneration [5]
			Cash component		Share-based component			
			Cash bonus	Cash deferral [3]	Share bonus	Share deferral [3]		
€								
Hermann J. Merkens	2016	1,300,000	377,720	566,580	377,720	566,580	38,511	3,227,111
	2015	1,214,667	299,544	449,317	299,544	449,317	46,594	2,758,983
Dagmar Knopek	2016	880,000	212,320	318,480	212,320	318,480	41,449	1,983,049
	2015	880,000	212,640	318,960	212,640	318,960	34,087	1,977,287
Christiane Kunisch-Wolff [1]	2016	561,244	135,309	202,964	135,309	202,964	27,595	1,265,385
	2015	-	-	-	-	-	-	-
Thomas Ortmanns	2016	880,000	213,600	320,400	213,600	320,400	35,945	1,983,945
	2015	880,000	211,360	317,040	211,360	317,040	33,259	1,970,059
Christof Winkelmann [2]	2016	352,000	85,120	127,680	85,120	127,680	12,125	789,725
	2015	-	-	-	-	-	-	-
Total	**2016**	**3,973,244**	**1,024,069**	**1,536,104**	**1,024,069**	**1,536,104**	**155,625**	**9,249,215**
	2015	**2,974,667**	**723,544**	**1,085,317**	**723,544**	**1,085,317**	**113,940**	**6,706,329**

[1] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.
[2] Mr Christof Winkelmann was appointed to the Management Board on 1 July 2016.
[3] The deferral shown are subject to the criteria on retention of variable remuneration components and penalty criteria, as set out above.
[4] Other remuneration includes payments (in particular for company cars) as well as benefits related to social security contributions.
[5] Dr Wolf Schumacher was granted a total remuneration in the amount of € 9,272,086 in the previous year.

No benefits were granted to any member of the Management Board by third parties with respect to his/her Management Board activities during the year under review.

The following initial values for variable remuneration at an overall target achievement level of 100 % were agreed upon in the service contracts of the Management Board members:

€	Reference values for variable remuneration 2016	Reference values for variable remuneration 2015
Hermann J. Merkens [1)]	1,400,000	1,130,356
Dagmar Knopek	800,000	800,000
Christiane Kunisch-Wolff [2)]	510,601	-
Thomas Ortmanns	800,000	800,000
Christof Winkelmann [3)]	320,000	-
Dr. Wolf Schumacher [4)]	-	1,050,000
Total	**3,830,601**	**3,780,356**

[1)] Upon the appointment of Hermann J. Merkens as Chairman of the Management Board, on 17 September 2015, the reference value for variable remuneration was raised to € 1,400,000.

[2)] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016; the reference value was set at € 640,000 p.a.

[3)] Christof Winkelmann was appointed to the Management Board on 1 July 2016; the reference value was set at € 640,000 p.a.

[4)] Dr Schumacher resigned with effect from 30 September 2015.

The following table shows the portion of the variable component attributable to share-based payment arrangements as well as the corresponding number of virtual shares granted in 2016/2015:

		Share-based payments [1)]	
	Year	Value (€)	Quantity (number)[2)]
Hermann J. Merkens	2016	944,300	26,399
	2015	748,861	27,202
Dagmar Knopek	2016	530,800	14,839
	2015	531,600	19,310
Christiane Kunisch-Wolff [3)]	2016	338,273	9,457
	2015	-	-
Thomas Ortmanns	2016	534,000	14,929
	2015	528,400	19,194
Christof Winkelmann [4)]	2016	212,800	5,949
	2015	-	-

[1)] Dr Wolf Schumacher was granted a total share-based remuneration in the amount of € 689,850 (25,058 shares) in the previous year.

[2)] The stated number of virtual shares granted for 2016 is a preliminary figure, based on the price of Aareal Bank AG's share on 31 December 2016 (€ 35.77). The final conversion rate may only be determined after publication of preliminary results for 2016.

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

[4)] Christof Winkelmann was appointed to the Management Board on 1 July 2016.

Other remuneration

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

Every Management Board member is covered by the group accident insurance in case of death or invalidity.

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

The ancillary benefits shown in the tables are equivalent to the total of such other remuneration.

Pensions, retirement benefits and severance pay

The benefit regulations as agreed in the service contract apply to the members of the Management Board. Management Board members who were appointed prior to 1 January 2013 are entitled to claim pension benefits upon completion of their 60th year of age. For members of the Management Board who were appointed [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.

	2016			2015 [4]		
€ 000's	Pension claims p.a.[1]	Balance of pension obligations (DBO) as at 31 Dec 2016	Increase of pension obligations (DBO) in 2016	Pension claims p.a.[1]	Balance of pension obligations (DBO) as at 31 Dec 2015	Increase of pension obligations (DBO) in 2015
Hermann J. Merkens	265	3,275	244	244	3,031	809
Dagmar Knopek	125	1,146	307	125	839	324
Christiane Kunisch-Wolff [2]	-	33	33	-	-	-
Thomas Ortmanns	254	3,366	190	241	3,176	760
Christof Winkelmann [3]	-	36	36	-	-	-
Total	**644**	**7,856**	**810**	**610**	**7,046**	**1,893**

[1] Pension claims are calculated based on the earliest possible pension payment.
[2] Ms Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.
[3] Mr Christof Winkelmann was appointed to the Management Board on 1 July 2016.
[4] The previous year's figures also include pension obligations for Dr Schumacher, who resigned as from 30 September 2015: an additional € 0.441 million p.a. in pension claims, € 9.306 million in balance of pension obligations and € 4.515 million in increase of pension obligations.

The pension claims are adjusted to take account of the development of standard wages within the private banking sector as from the beginning of actual payments of pensions, to the extent that these are based on defined benefit plans. If the payments refer to defined contribution plans, the guaranteed amount is adjusted by 1 % p.a. The pension paid to widows/widowers amounts to 60 % of the pension of the member of the Management Board, while pensions to half-orphans and orphans amount to 10 % and not more than 25 %, respectively. Service cost incurred in the 2016 financial year in connection with the pension claims of members of the Management Board totalled € -0.9 million (2015: € 6.9 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 decreased by € 0.5 million in the year under review (2015: increase of € 7.2 million). The total amount of pension obligations was € 32.8 million (2015: € 33.3 million). Of that amount, € 24.9 million related to former members of the Management Board and their surviving dependants (2015: € 26.2 million). Payments to former Management Board members of Aareal Bank AG and their surviving dependants totalled € 0.9 million (2015: € 0.8 million).

The agreements concluded with members of the Management Board do not include any obligation to make severance payments in case of an early termination of employment relationships. However, severance payments may be included in individual termination agreements. In the case of an early termination of a Management Board position without good cause within the meaning of section 4.2.3. of the Code, payments (including contractually-agreed benefits) are limited to twice the annual remuneration (severance cap) as well as to the remainder of the term of the contract.

In the case of a termination of a Management Board position due to a change of control, the following provisions are applicable: in the case of a compulsory loss of a Management Board position, the Management Board members are to be paid the fixed remuneration component, the performance-based remuneration as well as the contractually-agreed benefits for the remainder of the term of the contract. The performance-related remuneration is subject to the above-mentioned conditions; that is, in particular the deferral periods, the holding periods and the penalty rules are applicable. In addition, the extent to which sectional and individual targets were achieved on average during the last three years prior to the termination of the Management Board position will be used as a basis to determine the target achievement level for

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.

Risk takers (employees and senior executives who exert a material influence on the institution's overall risk profile according to section 18 (1) and (2) of the InstitutsVergV).

The remuneration system for risk takers is subject to the same basic conditions as the remuneration system for Management Board members, and is also aligned with the business and risk strategy of Aareal Bank AG or Aareal Bank Group, respectively. These remuneration systems form part of Aareal Bank AG's efforts to ensure that employees remuneration is in line with market conditions and the performance achieved. At the same time, they help to align the Bank's remuneration intentions with current regulatory requirements. In this context, Aareal Bank aims to respect the interests of employees, management and shareholders alike, while safeguarding the positive development of the Bank on a sustainable basis. The structure of the variable remuneration does not provide incentives to assume inappropriately high risks: it promotes the performance, target and results orientation of employees and senior executives.

The remuneration of all employee groups consists of a fixed and a variable remuneration, plus other contractually agreed benefits, if applicable. Regarding the group of risk takers, the variable component features particular characteristics in order to provide for the specific requirements of the InstitutsVergV.

The Management Board decides on the total amount of the variable remuneration for employees at the end of the financial year in a formalised, transparent and conceivable process. This total amount also includes the variable remuneration components for risk takers. The pool for the variable remuneration consists of a performance component and a profit component. The performance component takes into account the target-dependant remuneration of all employees, while the profit component takes into account the Group's overall profit by means of including the profit factor. The Group's overall profit depends on Aareal Bank Group's sustainable business results by taking into consideration the operating profit before taxes as well as underlying risk (measured as risk-weighted assets). The so-called profit factor is calculated by multiplying the target achievement regarding the operating profit before taxes with the target achievement regarding risk-weighted assets, finally influencing the profit component. The Bank's Management Board and Supervisory Board jointly determine the target values for the operating profit before taxes and the risk-weighted assets based on the Bank’s medium-term planning no later than at the beginning of every financial year. Maximum target achievement regarding operating profit before taxes is limited to 150 %; regarding risk-weighted assets, it is limited to 125 %. In the case of a negative target achievement regarding operating profit before taxes and risk-weighted assets, not only the profit component might be cancelled, but the performance component might also be set to nil. This being the case, the pool for the variable remuneration would be entirely cancelled.

Performance measurement on Group level additionally requires the Common Equity Tier 1 ratio as a measurement threshold in order to ensure adherence to the regulatory capital adequacy. In the case of a negative overall success of the Bank in the current financial year or an insufficient capital adequacy or liquidity situation, the Management Board may set the pool for the variable remuneration to nil.

The Management Board may take additional quantitative and/or qualitative success factors into account for the adjustment of the overall pool if exceptional and unexpected market developments occur, or substantial special projects need to be conducted during the year.

Cornerstones of the risk analysis carried out

The InstitutsVergV stipulates that the remuneration system of Aareal Bank AG (as a significant institution) needs to fulfil special requirements regarding “employees who exert a material influence on the institution's overall risk profile” (so-called risk takers). In order to identify this group of employees, Aareal Bank carries out an independent risk analysis, selecting the respective employees based on a uniform set of criteria. In addition, Aareal Bank AG (as a parent institution) has to identify risk takers on Group level.

Aareal Bank carried out a risk analysis to identify risk takers in the financial year 2016, covering all employee groups below Management Board level, i.e. senior executives, non-tariff employees and tariff employees of Aareal Bank AG including its branches, representative offices and subsidiaries in Germany and abroad.

The identification of the entities and risk takers affected is being repeated annually to ensure the fulfilment of the InstVergV's requirements at all times. Additional checks are carried out for newly hired employees and in the case of internal changes of function.

Remuneration model for risk takers

The determination of the variable remuneration (total incentive) for risk takers takes into account the Group's overall profit, the individual employee's performance contribution as well as the performance contribution of the organisational unit. The target for risk takers whose activities can clearly be allocated to a single business segment shall be assigned as the pro-rata share of their business segment (Structured Property Financing or Consulting/Services) in the operating profit before taxes. Risk takers whose activities can be allocated to staff and corporate services divisions, or to Credit Management, shall be assigned as target the cost 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 InstVergV 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 € 50,000.00 p.a. for each Supervisory Board member. The Chairman of the Supervisory Board shall receive three times this amount, while the deputy shall receive one and a half times as much as a normal member. The fixed remuneration is increased for each membership in a committee (with the exception of the Committee for Urgent Decisions, which is part of the Risk Committee). This additional fixed remuneration amounts to € 20,000 p.a. for membership of the Risk Committee and the Audit Committee; fixed remuneration is increased by € 40,000 p.a. for the chairmanship of one of these committees. The additional fixed remuneration for other committees amounts to € 15,000 p.a. for membership and € 30,000 p.a. for chairmanship of one of these committees.

The meeting attendance compensation amounts to € 1,000.00 for each meeting attended (except for meetings of the Committee for Urgent Decisions).

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

The individual amount of the remuneration for the Supervisory Board is shown in the following table. Statutory value-added tax in the amount of 19 % will be reimbursed on top of the figures shown in the table.

€	Year	Fixed remuneration	Attendance fees	Total remuneration
Marija Korsch	2016	265,000	33,000	298,000
Chairman	2015	279,208	33,000	312,208
Prof. Dr Stephan Schüller	2016	125,000	24,000	149,000
Deputy Chairman (since 20 May 2015)	2015	125,000	25,000	150,000
York-Detlef Bülow	2016	125,000	23,000	148,000
Deputy Chairman	2015	125,000	25,000	150,000
Thomas Hawel	2016	65,000	13,000	78,000
	2015	59,208	9,000	68,208
Dieter Kirsch	2016	85,000	18,000	103,000
	2015	85,000	16,000	101,000
Richard Peters	2016	100,000	21,000	121,000
	2015	80,694	15,000	95,694
Dr Hans-Werner Rhein	2016	85,000	17,000	102,000
(since 20 May 2015)	2015	52,181	10,000	62,181
Sylvia Seignette	2016	90,000	13,000	103,000
(since 20 May 2015)	2015	42,972	7,000	49,972
Elisabeth Stheeman[1)]	2016	85,000	16,000	101,000
(since 20 May 2015)	2015	52,181	9,000	61,181
Hans-Dietrich Voigtländer	2016	115,000	25,000	140,000
(since 20 May 2015)	2015	70,597	12,000	82,597
Prof. Dr Hermann Wagner	2016	110,000	19,000	129,000
(since 20 May 2015)	2015	67,528	10,000	77,528
Beate Wollmann	2016	50,000	9,000	59,000
(since 20 May 2015)	2015	30,694	4,000	34,694
Total	**2016**	**1,300,000**	**231,000**	**1,531,000**
	2015 [2)]	**1,070,264**	**175,000**	**1,245,264**

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

2) Totals for 2015 diverge from the totals shown for 2015, which still included six Supervisory Board members who retired during 2015. Totals for the year under review were € 1,262,764 in fixed remuneration and € 211,000 in meeting attendance compensation, leading to total remuneration of € 1,473,764. The previous year's figures were adjusted for VAT.

Depending on the period of service on the Supervisory Board, remuneration is paid on a pro-rata basis.

The members of the Supervisory Board did not provide any consulting or agency services, or other personal services in 2016. Therefore, no additional remuneration was paid.

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:

Quantity (number)	2016	2015 [1]
Balance (outstanding) at 1 January	**519,195**	**535,370**
granted during the reporting period	207,668	143,809
vested during the reporting period	-	-
exercised during the reporting period	188,184	159,984
Balance (outstanding) at 31 December	**538,679**	**519,195**
of which: exercisable	-	-

[1] The disclosures differ from the previous year's figures, due to slight changes to the presentation, and to the calculation methodology.

The fair value of the virtual shares granted during the reporting period amounted to € 7.4 million (2015: € 4.2 million) as at the balance sheet date. The calculation method described earlier was used in both cases.

The virtual shares exercised during the reporting period were converted at a weighted average price of the Aareal Bank AG share of € 27.71 (2015: € 38.30).

The virtual shares outstanding at 31 December 2016 have a limited contract term. The weighted average remaining contract term of these virtual shares amounts to 453.27 days (2015: 389.43 days).

Impact on financial performance

The total amount expensed for share-based payment transactions was € 13.4 million during the financial year 2016 (2015: € 10.0 million). The portion of the total amount expensed attributable to members of the Management Board amounted to € 3.8 million (2015: € 3.3 million) and can be broken down to the individual members of the Management Board as follows:

€	2016	2015
Hermann J. Merkens	1,424,186	860,758
Dagmar Knopek	842,891	593,536
Christiane Kunisch-Wolff [1]	338,273	-
Thomas Ortmanns	946,738	717,971
Christof Winkelmann [2]	212,800	-

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

In addition, € 0.7 million (2015: € 1.1 million) was expensed for former members of the Management Board.

The intrinsic value of the virtual shares exercisable at the reporting date amounted to € 0.0 (2015: € 0.0), since there were no exercisable virtual shares at that date. The obligation from share-based payment transactions as at 31 December 2016 amounted to € 27.4 million (2015: € 28.4 million). It is reported in the statement of financial position in the line item "Provisions".

Remuneration for key executives

The definition of executives in key positions within Aareal Bank Group includes members of management or supervisory bodies of Aareal Bank AG.

Total remuneration of executives in key positions is analysed below:

€ 000's	1 Jan - 31 Dec 2016	1 Jan-31 Dec 2015
Short-term benefits	6,685	6,848
Post-employment benefits	811	5,690
Other long-term benefits	1,538	1,468
Termination benefits	-	6,854
Share-based payments	2,560	2,446
Total	**11,594**	**23,306**

Provisions for pension obligations concerning key executives totalled € 7.9 million as at 31 December 2016 (2015: € 7.0 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):

€ mn	31 Dec 2016 Cover assets pool	31 Dec 2016 Pfandbriefe outstanding	31 Dec 2016 Excess cover	31 Dec 2015 Cover assets pool	31 Dec 2015 Pfandbriefe outstanding	31 Dec 2015 Excess cover
Nominal value	2,350.1	2,009.8	340.3	2,493.4	2,151.4	342.0
of which: Derivatives	-	-	-	-	-	-
Present value	3,102.5	2,649.5	453.0	3,248.3	2,830.0	418.3
of which: Derivatives	139.1	-	-	135.9	-	-
Risk-adjusted net present value *	2,929.7	2,574.2	355.5	3,051.3	2,709.5	341.8

* 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 2016		31 Dec 2015	
€ mn	Cover assets pool	Pfandbriefe outstanding	Cover assets pool	Pfandbriefe outstanding
Up to 6 months	55.2	82.5	106.6	49.7
Between 6 months and 12 months	71.4	125.2	59.2	56.0
Between 12 months and 18 months	67.2	114.1	54.1	82.3
Between 18 months and 2 years	253.2	322.5	72.4	125.7
Between 2 years and 3 years	307.1	113.5	343.6	426.1
Between 3 years and 4 years	114.6	113.6	154.5	118.5
Between 4 years and 5 years	160.7	37.3	176.7	123.6
Between 5 years and 10 years	593.7	593.4	673.9	609.2
More than 10 years	727.0	507.7	852.4	560.3
Total	**2,350.1**	**2,009.8**	**2,493.4**	**2,151.4**

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):

Amount classes	2016	2015
Up to € 10 million	54.1	57.9
More than € 10 million up to € 100 million	737.1	653.6
More than € 100 million	1,558.9	1,781.9
Total	**2,350.1**	**2,493.4**

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 2016

			of which owed by				of which guaranteed by			
				Public-sector entities				Public-sector entities		
€ mn	Total	Guarantees due to promotion of export activities	Sovereigns	regional	municipal	Other	Sovereigns	regional	municipal	Other
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**

31 December 2015

€ mn	Total	Guarantees due to promotion of export activities	of which owed by Sovereigns	Public-sector entities regional	Public-sector entities municipal	Other
Germany	1,800.2	-	9.1	1,439.7	32.3	319.1
EU institutions	149.9	-	-	-	-	149.9
France	57.9	-	55.0	-	2.9	-
Italy	39.0	-	39.0	-	-	-
Japan	20.0	-	-	-	20.0	-
Austria	286.4	-	217.4	25.0	-	44.0
Poland	25.0	-	25.0	-	-	-
Spain	115.0	-	-	115.0	-	-
Total	**2,493.4**	**-**	**345.5**	**1,579.7**	**55.2**	**513.0**

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

31 December 2016

€ mn	Equalisation claims pursuant to section 20 (2) 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	Total
Countries				
	-	-	-	-
Total	**-**	**-**	**-**	**-**

31 December 2015

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:

	2016		2015	
Outstanding Pfandbriefe	**2,009.8**	**€ mn**	**2,151.4**	**€ mn**
of which: share of fixed-income Pfandbriefe	76.8	%	77.6	%
Cover assets pool	**2,350.1**	**€ mn**	**2,493.4**	**€ 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	90.3	%	85.3	%

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 2016	Balance of assets and liabilities 2015
Currency		
EUR	355.5	341.8
GBP	-0.1	-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):

	31 Dec 2016			31 Dec 2015		
€ mn	Cover assets pool	Pfandbriefe outstanding	Excess cover	Cover assets pool	Pfandbriefe outstanding	Excess cover
Nominal value	11,712.0	9,036.7	2,675.3	14,684.3	11,670.2	3,014.1
of which: Derivatives	-101.7	-	-	-273.0	-	-
Present value	12,830.8	9,650.5	3,180.3	16,104.9	12,447.3	3,657.6
of which: Derivatives	85.2	-	-	-	49.4	-
Risk-adjusted net present value *	12,819.4	9,746.5	3,072.9	16,003.5	12,418.2	3,585.3

* 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):

	31 Dec 2016		31 Dec 2015	
€ mn	Cover assets pool	Pfandbriefe outstanding	Cover assets pool	Pfandbriefe outstanding
Up to 6 months	768.2	1,204.0	1,313.9	1,463.7
Between 6 months and 12 months	760.3	837.5	1,081.5	1,089.5
Between 12 months and 18 months	694.5	1,504.0	737.3	1,185.6
Between 18 months and 2 years	712.9	754.4	1,003.2	839.8
Between 2 years and 3 years	2,784.4	1,850.6	2,229.2	2,302.5
Between 3 years and 4 years	2,305.8	482.9	3,041.6	1,850.5
Between 4 years and 5 years	1,415.0	561.9	2,158.0	494.9
Between 5 years and 10 years	2,008.0	1,581.0	2,711.1	2,044.0
More than 10 years	262.9	260.4	408.5	399.7
Total	**11,712.0**	**9,036.7**	**14,684.3**	**11,670.2**

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

€ mn	Cover assets pool 2016	Cover assets pool 2015
Breakdown of the amounts measured at nominal value by volume		
Up to € 300 thousand	16.1	24.9
Between € 300 thousand and € 1 million	64.2	78.0
Between € 1 million and € 10 million	628.7	910.3
More than € 10 million	10,405.2	12,356.2
Total	**11,114.2**	**13,369.4**

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

31 December 2016

€ mn	Equalisation claims pursuant to section 19 (1) no. 1	Money claims pursuant to section 19 (1) no. 2		Debt securities pursuant to section 19 (1) no. 3	Total
		Total	of which: covered bonds within the meaning of Art. 129 of EU Regulation No. 575/2013		
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**

31 December 2015

€ mn	Equalisation claims pursuant to section 19 (1) no. 1	Money claims pursuant to section 20 (2) no. 2		Debt securities pursuant to section 19 (1) no. 3	Total
		Total	of which: covered bonds within the meaning of Art. 129 of EU Regulation No. 575/2013		
Countries					
Germany	-	-	-	833.9	**833.9**
EU institutions	-	-	-	160.0	**160.0**
France	-	-	-	220.0	**220.0**
Austria	-	-	-	374.0	**374.0**
Total	**0.0**	**0.0**	**0.0**	**1,587.9**	**1,587.9**

Additional key figures for outstanding Pfandbriefe and related cover assets:

	2016		2015	
Outstanding Pfandbriefe	**9,036.7**	**€ mn**	**11,670.2**	**€ mn**
of which: share of fixed-income Pfandbriefe	53.9	%	49.5	%
Cover assets pool	**11,712.0**	**€ mn**	**14,684.3**	**€ 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	39.2	%	39.8	%
Volume-weighted average age of receivables (seasoning)	**5.0**	**years**	**4.6**	**years**
Weighted average mortgage lending value ratio based on mortgage lending value	**57.5**	**%**	**57.2**	**%**
Weighted average mortgage lending value ratio based on market value	**37.8**	**%**	**39.4**	**%**

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 2016	Balance of assets and liabilities 2015
Currency		
CAD	31.9	25.3
CHF	10.4	17.8
CZK	0.0	6.9
DKK	82.0	78.6
EUR	2,757.8	3,338.6
GBP	174.8	119.5
NOK	0.5	0.5
SEK	24.5	29.1
USD	40.7	5.0

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 2016

	Commercial property							Residential property						
Mio. €	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**

31 December 2015

	Commercial property							Residential property						
Mio. €	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			147.1	99.3	9.0	33.4	288.8							288.8
Denmark		38.9	33.8	7.9	25.5	45.8	151.9		7.1			7.6	14.7	166.6
Germany		43.8	813.3	432.9	347.5	306.5	1,944.0			1.4	8.6	858.7	868.7	2,812.7
Estonia				18.7			18.7							18.7
Finland			57.6	141.1	11.8		210.5							210.5
France		30.0	1,041.4	179.9	397.4	288.6	1,937.3							1,937.3
UK			372.4	843.0	110.7	565.6	1,891.7							1,891.7
Italy			378.8	304.3	112.9	66.6	862.6					85.7	85.7	948.3
Canada						113.9	113.9							113.9
Netherlands		14.9	141.8	154.4	80.4	193.3	584.8					137.8	137.8	722.6
Norway					5.1		5.1							5.1
Austria				102.3			102.3							102.3
Poland			204.8	343.2	22.9	39.9	610.8							610.8
Sweden	0.1		171.0	278.8	200.9	22.4	673.2							673.2
Switzerland						203.1	203.1							203.1
Spain		13.0	105.1	310.4	19.8	62.4	510.7							510.7
Czech Republic	3.8		47.6		11.8	59.2	122.4							122.4
US		121.2	1,059.9	471.6		287.1	1,939.8		21.3			69.6	90.9	2,030.7
Total	**3.9**	**261.8**	**4,574.6**	**3,687.8**	**1,355.7**	**2,287.8**	**12,171.6**		**28.4**	**1.4**	**8.6**	**1,159.4**	**1,197.8**	**13,369.4**

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 2016	Total amount of these receivables, to the extent that the relevant amount overdue is not less than 5 % of the receivable 2016	Aggregate payments which are at least 90 days overdue 2015	Total amount of these receivables, to the extent that the relevant amount overdue is not less than 5% of the receivable 2015
Belgium	-	-	-	0.0
Denmark	-	-	-	0.0
Germany	-	-	0.3	0.3
Estonia	-	-	-	0.0
Finland	-	-	-	0.0
France	-	-	-	0.0
UK	-	-	-	0.0
Italy	-	-	-	0.0
Canada	-	-	-	0.0
Luxembourg	-	-	-	0.0
Netherlands	-	-	-	0.0
Norway	-	-	-	0.0
Austria	-	-	-	0.0
Poland	-	-	-	0.0
Sweden	-	-	-	0.0
Switzerland	-	-	-	0.0
Slovakia	-	-	-	0.0
Spain	-	-	0.3	0.0
Czech Republic	-	-	-	0.0
US	-	-	-	0.0
Total	**-**	**-**	**0.6**	**0.3**

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

During the financial year 2016, the Bank did not acquire any properties for the purpose of loss prevention (2015: –).

As at 31 December 2016, there were no foreclosures or forced administration procedures pending, and neither had any foreclosures been carried out (2015: –).

As at 31 December 2016, interest payments were overdue in the amount of € 4.1 million (2015: € 1.6 million) for commercial property, and in the amount of € 0.0 million (2015: € 0.0 million) for residential property.

Contingencies

By means of a letter of comfort, Aareal Bank AG ensures that Aareal Bank Capital Funding LLC, Wilmington, is able to fulfil its contractual obligations.

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

Events after the reporting date

As part of the continued future development of our indirectly-held affiliate WestImmo, the Bank decided that during the course of 2017, WestImmo will surrender its bank licence, as well as its licence to issue Pfandbriefe, and will henceforth perform the role of a service entity for banking business then to be transferred to Aareal Bank.

Aareal Bank Capital Funding Trust will redeem all of the 10,000,000 Trust Preferred Securities on the next scheduled termination date of 31 March 2017, at a redemption price of 100 %, equivalent to a total of € 250 million, plus accrued interest. The purpose of this measure is to optimise Aareal Bank Group's capital structure, in line with corresponding plans.

There were no other material events after the end of the period under review.

Loans to executive bodies of Aareal Bank

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

€ mn	31 Dec 2016	31 Dec 2015
Management Board	-	-
Supervisory Board	0.0	0.0
Other related parties	-	-
Total	0.0	0.0

The credit line granted to a Supervisory Board member in the amount of € 0.04 million (2015: € 0.04 million) has a term of ten years and bears interest at a (nominal) rate of 5.12 %. Collateral was provided in line with usual market practice.

Employees

The average staffing level is shown below:

Yearly average	1 Jan - 31 Dec 2016	1 Jan - 31 Dec 2015
Salaried employees	945	928
Executives	42	36
Total	**987**	**964**
of which: Part-time employees	201	200

Auditors' fees

The total fees charged by the auditor for the financial year 2016 are as follows:

€ 000's	1 Jan - 31 Dec 2016	1 Jan - 31 Dec 2015
Category		
Audit services	3,754.0	2,942.7
Other assurance services	31.5	144.5
Tax advisory services	12.9	235.2
Other services	1,075.9	3,769.7
Total	**4,874.3**	**7,092.1**

The fees for the financial year are disclosed in accordance with the revised requirements set out in the Accounting Practice Statement IDW RS HFA 36, as amended, issued by the Institute of Public Auditors in Germany (IDW). Accordingly, services directly associated with the audit of financial statements, such as the audit of the securities services and custody business, are reported under “Auditing fees” rather than “Other assurance services”.

Disclosures pursuant to section 160 (1) no. 8 of the AktG

Pursuant to the German Securities Trading Act (WpHG), any investor whose shareholding in a listed company reaches, exceeds or falls short of certain threshold values in terms of voting rights (whether by purchase, sale or by any other means) must notify the Company and the German Federal Financial Supervisory Authority. The lowest threshold for this notification requirement is 3 %. 100 % of Aareal Bank AG shares are held in free float.

As at 31 December 2016, we were aware of the following shareholders holding a share in the voting rights of at least 3% pursuant to section 21 (1) of the WpHG:

	Location	Total [1]	Notification date
Responsible entity			
VBL	Karlsruhe	6.50%	3 February 2015
DEKA	Frankfurt	5.58%	3 February 2015
Dimensional Fund	Austin	3.04%	29 May 2012
State of Norway (through Norges Bank)	Oslo	3.30%	31 August 2016
Allianz Global Investors	Frankfurt	3.08%	5 December 2016
Blackrock	Wilmington	3.32%	9 December 2016

[1] Direct and indirect holdings of voting rights

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 http://www.aareal-bank.com/ueber-uns/corporate-governance/entsprechenserklaerung-gemaess-161-aktg/.

Proposal on the appropriation of profits

The Management Board of Aareal Bank AG proposes to the Annual General Meeting that a partial amount of € 119,714,442.00 of Aareal Bank AG's net retained profit of € 122,214,442.00 for the financial year 2016, as reported under the German Commercial Code (HGB), be used to distribute a dividend of € 2.00 per notional no-par value share.

The Management Board also proposes to the Annual General Meeting to carry forward the remaining distributable profit of € 2,500,000.00.

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
Prof. Dr Stephan Schüller, Deputy Chairman of the Supervisory Board	
Spokesman of the General Partners of Bankhaus Lampe KG	
Aareal Bank AG	Deputy Chairman of the Supervisory Board
DePfa Holding Verwaltungsgesellschaft mbH	Deputy Chairman of the Supervisory Board
Universal-Investment-Gesellschaft mbH	Member of the Supervisory Board
Howaldt & Co. Investmentaktiengesellschaft TGV	Chairman of the Supervisory Board
York-Detlef Bülow*, Deputy Chairman of the Supervisory Board	
Aareal Bank AG	
Aareal Bank AG	Deputy Chairman of the Supervisory Board
Thomas Hawel*	
Aareon Deutschland GmbH	
Aareal Bank AG	Member of the Supervisory Board
Aareon Deutschland GmbH	Deputy Chairman of the Supervisory Board
Dieter Kirsch*	
Aareal Bank AG	
Aareal Bank AG	Member of the Supervisory Board
Richard Peters	
President and Chairman of the Management Board of Versorgungsanstalt des Bundes und der Länder	
Aareal Bank AG	Member of the Supervisory Board
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board
Dr Hans-Werner Rhein	
German Lawyer (Rechtsanwalt)	
Aareal Bank AG	Member of the Supervisory Board
Deutsche Familienversicherung AG	Chairman of the Supervisory Board
Gothaer Allgemeine Versicherung AG	Member of the Supervisory Board

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

Sylvia Seignette	
Former CEO for Germany and Austria, Crédit Agricole CIB (formerly Calyon)	
Aareal Bank AG	Member of the Supervisory Board
Elisabeth Stheeman	
Senior Advisor, Bank of England, Prudential Regulation Authority	
Aareal Bank AG	Member of the Supervisory Board
TLG Immobilien AG	Member of the Supervisory Board
Courno	Senior Advisor
Hans-Dietrich Voigtländer	
Senior Partner of BDG Innovation + Transformation GmbH & Co. KG	
Aareal Bank AG	Member of the Supervisory Board
Prof. Dr Hermann Wagner, Chairman of the Audit Committee	
German Chartered Accountant, tax consultant	
Aareal Bank AG	Member of the Supervisory Board
btu beraterpartner Holding AG	Member of the Supervisory Board
PEH Wertpapier AG	Member of the Supervisory Board
DEMIRE Deutsche Mittelstand Real Estate AG	Chairman of the Supervisory Board
Squadra Immobilien GmbH & Co. KGaA	Member of the Supervisory Board
Beate Wollmann*	
Aareon Deutschland GmbH	
Aareal Bank AG	Member of the Supervisory Board

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

Composition of Supervisory Board's committees

Executive and Nomination Committee	
Marija Korsch	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
York-Detlef Bülow	Deputy Chairman
Richard Peters	
Dr Hans-Werner Rhein	

Technology and Innovation Committee	
Hans-Dietrich Voigtländer	Chairman
Marija Korsch	Deputy Chairman
Thomas Hawel	
Richard Peters	
Elisabeth Stheeman	

Audit Committee	
Prof. Dr Hermann Wagner	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
York-Detlef Bülow	
Marija Korsch	
Richard Peters	
Hans-Dietrich Voigtländer	

Remuneration Control Committee	
Marija Korsch	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
York-Detlef Bülow	Deputy Chairman
Dieter Kirsch	
Hans-Dietrich Voigtländer	

Risk Committee	
Sylvia Seignette	Chairman
Elisabeth Stheeman	Deputy Chairman
Dieter Kirsch	
Marija Korsch	
Dr Hans-Werner Rhein	
Prof. Dr Hermann Wagner	

Committee for Urgent Decisions
Sylvia Seignette
Elisabeth Stheeman
Dieter Kirsch
Marija Korsch
Dr Hans-Werner Rhein
Prof. Dr Hermann Wagner

Management Board

Hermann Josef Merkens, Chairman of the Management Board		
Finance, Participating Interests, Portfolio Management, Regulatory Affairs, Corporate Communications, Investor Relations, Board Office incl. Sustainability, Human Resources, Legal and Audit		
Aareal Estate AG	Chairman of the Supervisory Board	
Aareal Capital Corporation	Member of the Board of Directors	until 8 July 2016
Aareal Capital Corporation	Chairman of the Board of Directors	since 8 July 2016
Aareal First Financial Solutions AG	Member of the Supervisory Board	until 4 March 2016
Aareon AG	Deputy Chairman of the Supervisory Board	
Aareal Beteiligungen AG (former Corealcredit)	Chairman of the Supervisory Board	
CredaRate Solutions GmbH	Member of the Advisory Board	
Westdeutsche ImmobilienBank AG	Chairman of the Supervisory Board	

Dagmar Knopek, Member of the Management Board		
Credit Management, Workout and Operations		
Aareal Bank Asia Limited	Chairman of the Board of Directors	until 29 August 2016
Aareal Capital Corporation	Chairman of the Board of Directors	until 8 July 2016
Aareal Capital Corporation	Member of the Board of Directors	since 8 July 2016
Aareal Capital Corporation	Member of the Board of Directors	until 31 December 2016
Aareon AG	Member of the Supervisory Board	
Westdeutsche ImmobilienBank AG	Member of the Supervisory Board	

Christiane Kunisch-Wolff, Member of the Management Board (since 15 March 2016)		
Risk Controlling and Compliance		
Westdeutsche ImmobilienBank AG	Member of the Supervisory Board	since 4 May 2016

Thomas Ortmanns, Member of the Management Board		
Housing Unit, Treasury, Information Technology and Organisation		
Aareal First Financial Solutions AG	Chairman of the Supervisory Board	
Aareon AG	Chairman of the Supervisory Board	
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Chairman of the Supervisory Board	
HypZert GmbH	Member of the Supervisory Board	
Westdeutsche ImmobilienBank AG	Member of the Supervisory Board	

Christof Winkelmann, Member of the Management Board (since 1 July 2016)		
Sales Units Structured Property Financing		
Aareal Bank Asia Limited	Chairman of the Board of Directors	since 30 August 2016
Aareal Capital Corporation	Member of the Board of Directors	since 1 January 2017
La Sessola Service S.r.l.	Member of the Management Board	
La Sessola S.r.l.	Member of the Management Board	

Offices held by employees of Aareal Bank AG pursuant to section 340a (4) no. 1 of the HGB

Disclosures made include mandates held by employees of Aareal Bank AG in statutory supervisory bodies of large corporations.

Dr Stefan Lange, Bank Director	
Westdeutsche ImmobilienBank AG	Member of the Supervisory Board
Dr Reinhard Grzesik, Bank Director	
Westdeutsche ImmobilienBank AG	Member of the Supervisory Board

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, 28 February 2017

The Management Board

Hermann J. Merkens **Dagmar Knopek** **Christiane Kunisch-Wolff**

Thomas Ortmanns **Christof Winkelmann**

Auditors' Report

We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system and the management report of Aareal Bank AG, Wiesbaden for the business year from 1 January to 31 December 2016. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law are the responsibility of the Company's Board of Managing Directors. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with § (Article) 317 HGB ("Handelsgesetzbuch": "German Commercial Code") and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with (German) principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the Company's Board of Managing Directors, as well as evaluating the overall presentation of the annual financial statements and management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion based on the findings of our audit, the annual financial statements comply with the legal requirements and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with (German) principles of proper accounting. The management report is consistent with the annual financial statements, complies with legal requirements, as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Frankfurt/Main, 1 March 2017

PricewaterhouseCoopers GmbH

Wirtschaftsprüfungsgesellschaft

Stefan Palm	ppa. Lukas Sierleja
Wirtschaftsprüfer	Wirtschaftsprüfer
(German Public Auditor)	(German Public Auditor)

Report of the Supervisory Board of Aareal Bank AG, Wiesbaden

Dear shareholders,

Once again, the financial year 2016 under review was a very eventful one for Aareal Bank – whose activities in a persistently volatile environment were accompanied by historically low interest rates and continued regulatory uncertainty. In this context, Aareal Bank not only generated very good results. The Bank also broke new ground in order to find answers to the issues raised by the fundamental changes associated with digitalisation proceeding at high speed.

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

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

Moreover, the Supervisory Board was informed, in detail, about the ”Aareal 2020 – Adjust. Advance. Achieve.“ programme for the future, which was presented in February 2016. The Supervisory Board supports the related objectives set out by the Management Board. Given an unchanged basic strategic orientation, this development of the strategy aims to protect the Group's strong base in an increasingly demanding environment, and to unlock new revenue potential.

Activities of the Plenary Meeting of the Supervisory Board

Nine plenary meetings of the Supervisory Board were held during the year under review. During the meetings, the members of the Supervisory Board received reports and explanations from the members of the Management Board, and discussed these in detail. One of the focal working and reporting aspects during all scheduled meetings was the approach to be taken by the Bank towards the persistently challenging market environment.

In its discussions, the Supervisory Board also concerned itself with changes to the regulatory framework, in great detail.

Throughout the financial year, in the course of all meetings as well as during the periods between meetings, the Management Board informed the Supervisory Board about economic and market developments and their potential impact on Aareal Bank Group, in a timely, complete and comprehensible manner. This included detailed explanations of the appropriate measures taken in response to the challenges arising from general market developments, in particular the prevailing low interest rate environment.

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

The focal points of the individual meetings are outlined below.

During its meetings in January and February, the Supervisory Board carried out the scheduled reviews of remuneration systems, including a detailed discussion of all related issues concerning the system and amount of remuneration. The Supervisory Board also discussed the establishment of a Chief Risk Officer, as a new Management Board position. As part of this task, based upon a proposal by the Executive and Nomination Committee, the Supervisory Board also discussed and determined the requirements profile for this role. The newly-established function of Chief Risk Officer was filled with the appointment of Ms Christiane Kunisch-Wolff to the Management Board of Aareal Bank. Throughout the appointment process, the Supervisory Board discussed, in great detail, which candidates meet this profile. With Ms Kunisch-Wolff, a renowned expert with relevant qualifications was appointed for this role. The Supervisory Board also debated the Bank’s future dividend policy.

In the March meeting, the Supervisory Board concerned itself in detail with the financial statements and consolidated financial statements presented for the 2015 financial year, and with the auditors’ report. The relevant facts were presented in the Supervisory Board report for the previous year. In addition, the proposal regarding the selection and subsequent appointment of the external auditor for the Annual General Meeting was discussed. This also included the scope and focal points of the audit for the 2016 financial year, as defined by the Supervisory Board. Other issues covered during the March meeting included the preparations for the Annual General Meeting in May 2016. This meeting also discussed the annual reports submitted by Internal Audit and by the Compliance Officer.

During its April meeting, the Supervisory Board resolved on the process for the appointment of Mr Christof Winkelmann to Aareal Bank’s Management Board. Mr Winkelmann was appointed in consideration of his proven market and banking expertise, and his long track record of successful work for Aareal Bank, which make him especially suitable for the position of the Management Board member responsible for Sales units.

The May meeting commenced with a detailed review of the Annual General Meeting of Aareal Bank AG, which preceded the meeting. Furthermore, the Management Board presented its regular reporting on business developments, which the Supervisory Board discussed in great detail.

The meeting in July exclusively comprised an extensive presentation and discussion of Aareal Bank Group’s strategy, during which the Supervisory Board intensely discussed strategic initiatives with the Management Board, passing the necessary resolutions.

Besides receiving regular reports, during its September meeting, the Supervisory Board discussed new rules imposed by an EU Regulation pursuant to which the Supervisory Board Audit Committee will have greater importance from the 2017 financial year onwards. In order to support the Supervisory Board in monitoring the audit of the financial statements – especially with regard to the independence of external auditors, and the services rendered by them – the Audit Committee will in future decide upon the approval of so-called non-audit services provided by the external auditors.

In the December meeting, the Management Board reported on the Group’s corporate planning. The Management Board submitted and explained the corporate planning in detail to the Supervisory Board. Corporate governance issues were discussed as well. The requisite resolutions were passed and implemented. Furthermore, the Supervisory Board adopted the regular Declaration of Compliance, pursuant to section 161 of the German Public Limited Companies Act (Aktiengesetz – ”AktG”), which was subsequently published on the Bank’s website.

In accordance with sections 25c and d of the German Banking Act (Kreditwesengesetz – ”KWG”), the results of the evaluations carried out in November and December 2016 have been discussed in detail by the Supervisory Board during its meeting in March 2017. The Supervisory Board will incorporate these findings into its work.

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

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

To the extent that any Supervisory Board decisions were taken by way of circulation, the related issues were discussed in detail at the subsequent Supervisory Board meeting, including a report by the Management Board on the implementation of such decisions taken previously.

As part of preparing Supervisory Board decisions, a routine examination is carried out as to whether there are any conflicts of interest. No potential conflicts of interest that would need to be considered in the context of decision-making processes were identified during the financial year under review. The members of the Supervisory Board have declared in writing that no conflicts of interest pursuant to section 5.5.2 of the Corporate Governance Code arose during the financial year under review.

In addition to its regular meetings, the Supervisory Board convened for a separate informational meeting, during which auditors Pricewaterhouse-Coopers provided very detailed information on current changes and deliberations in the regulatory and legal framework, as well as on the potential impact of such trends upon Aareal Bank.

Activities of Supervisory Board Committees

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

The Executive and Nomination Committee of the Supervisory Board convened for four scheduled meetings, during which the committee prepared the plenary meetings of the Supervisory Board. During the financial year under review, the Executive and Nomination Committee concerned itself with the establishment of a Chief Risk Officer, as a new Management Board position. As part of this process, the Committee discussed the necessary questions regarding the job description, as well as candidates' required qualifications, in great detail. The appointment process for this position was carried out subsequently, and concluded with the appointment of Ms Kunisch-Wolff. Furthermore, the Committee carried out the appointment process for the position of Management Board member responsible for Sales units, and prepared the corresponding proposals for resolutions to be adopted by the plenary meeting, together with a recommendation to appoint Mr Winkelmann.

Furthermore, the Executive and Nomination Committee concerned itself with the efficiency of the Supervisory Board and its committees, as well as with corporate governance rules; within the scope of a regular dialogue with the Management Board, the Committee informed itself on the strategic development of Aareal Bank Group.

The Risk Committee held four meetings during the year under review. The Management Board submitted detailed reports to the committee, covering all markets in which the Bank is active in the property finance business, as well as supplementary reports regarding the Bank's investments in securities portfolios. The committee members discussed these reports and market views in detail; the committee also concerned itself with the banking and regulatory environment, and dealt with both loans requiring approval and transactions subject to reporting requirements on a regular basis. The committee discussed individual exposures of material importance to the Bank, which were presented and explained by the Management Board. In addition, reports on current developments and related market responses were provided to the committee. Also, detailed reports were given regarding the Bank's liquidity status and management as well as its funding. Risks from existing investments, as well as all additional material risks were also presented.

The committee regularly discussed reports on the Bank's risk situation, which were submitted and explained by the Management Board. Having discussed the contents with the Management Board, these were duly noted and approved by the members of the committee. Besides credit and country risks, the committee concerned itself with market risks, liquidity risks, and operational risks. The committee also concerned itself with Aareal Bank's risk-bearing capacity and capital ratios, as well as the Bank's cooperation with regulators, within the scope of the Single Supervisory Mechanism (SSM) under the auspices of the ECB. The committee also decided on any other transactions requiring the Supervisory Board's approval pursuant to the Company's Memorandum and Articles of Association or the internal rules of procedure.

The Committee for Urgent Decisions is a 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 2016, the Audit Committee received and discussed the preliminary results for the 2015 financial year. During its

March meeting, the committee received the external auditors' report on the 2015 financial year and discussed the results with the auditors in detail. The committee members discussed the contents of the audit reports provided; they formed their own judgement of the audit results on the basis of these reports, and by way of meetings held with the external auditors. In accordance with its duties under the Memorandum and Articles of Association, the Audit Committee also discussed the selection of external auditors and the focal aspects of the audit for 2016 during the same meeting.

During its meeting in May 2016, the Audit Committee considered the contents and further development of sustainability reporting for Aareal Bank Group. In addition, the committee discussed the initial audit for achieving limited assurance for this report, including an examination of selected qualitative and quantitative information in the Sustainability Report 2015 by PwC, the results of which were discussed in the presence of PwC representatives.

In accordance with the requirements of the German Corporate Governance Code, during its meetings in May, August and November 2016, the Audit Committee discussed with the Management Board the quarterly results to be published.

Proceedings at the meetings in August and November also included supplementary topics, such as amendments under the EU Audit Regulation and Directive, according to which external auditors are no longer permitted to provide certain non-audit services. With effect from 1 January 2017, permitted non-audit services to be rendered by the external auditors must be approved by the Audit Committee. Said regulation has extended the Audit Committee's oversight duties in the context of monitoring the Bank's procurement of services from the external audit firm elected by the Annual General Meeting. In order to fulfil these oversight duties in an efficient manner, the Audit Committee adopted a process for approving and monitoring non-audit services rendered by the external auditors during its November meeting. Furthermore, the committee was informed about the review of the Internal Control System, in accordance with legal requirements; it duly acknowledged the report, following discussion. In addition to a report on the audit progress, the Management Board presented and explained the updated Group planning to the committee during its December meeting. The committee also received reports submitted by Internal Audit, and the Compliance Report, requesting and receiving detailed explanations, and duly noting both reports.

During its six meetings, the Remuneration Control Committee discussed issues related to the Bank's remuneration systems and all related matters, fulfilling its original assignment. In addition to topics to be dealt with on a regular basis, the Remuneration Control Committee concerned itself with necessary adjustments of the remuneration systems due to amendments to the German Regulation on Remuneration in Financial Institutions ("Institutsvergütungsverordnung – InstVergV"). Moreover, the Remuneration Control Committee supported the Supervisory Board with all issues related to the remuneration of the Management Board. In particular, the committee provided support for determining the Management Board's targets for the current year, and for assessing target achievement by the Management Board, as a basis for determining variable remuneration for the members of the Management Board for the year 2016. As a rule, support was provided to the Supervisory Board by preparing the corresponding recommended resolutions.

The Technology and Innovation Committee convened for four meetings, during which the committee discussed market trends, technological developments and innovation trends in detail, especially with a view to clients of the Consulting/Services segment. Discussion topics included potential business opportunities arising from the growing digitalisation of business processes, and how Aareal Bank Group could turn such opportunities into benefits for clients. In this connection, the committee also discussed measures in detail which are required for an optimal design of change processes, and which create an innovation-friendly environment. Such topics also include considerations to further develop talent management measures. Another key aspect of regular discussions was how to support the Bank in realigning its banking systems, against the background of numerous new requirements in terms of accounting, regulation, and IT security.

Where members of the Supervisory Board were unable to attend a meeting, they had announced their absence in advance, giving reasons. Attendance of Supervisory Board members at meetings is shown in the table below.

Member of the Supervisory Board	Number of meetings attended/ number of meetings (plenary and committee meetings)
Marija G. Korsch	33 of 33
Prof. Dr Stephan Schüller	24 of 25
York-Detlef Bülow *	23 of 25
Thomas Hawel *	13 of 13
Dieter Kirsch *	18 of 19
Richard Peters	21 of 23
Dr Hans-Werner Rhein	17 of 17
Sylvia Seignette	13 of 13
Elisabeth T. Stheeman	16 of 17
Hans-Dietrich Voigtländer	25 of 25
Prof. Dr Hermann Wagner	19 of 19
Beate Wollmann*	9 of 9

* Employee representive

Financial Statements and Consolidated Financial Statements

The Supervisory Board instructed Pricewaterhouse-Coopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt/Main (from 1 March 2017: PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft), who were elected as auditors by the Annual General Meeting 2016, with the audit of the financial statements and the consolidated financial statements. The external auditors appointed submitted a statement regarding their independence to the Supervisory Board, who duly noted it. The Supervisory Board has no reason to doubt the accuracy of this statement of independence. Fulfilling their duties as commissioned by the Supervisory Board, PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft audited the financial statements prepared in accordance with the German Commercial Code (HGB) and the consolidated financial statements prepared in accordance with IFRSs, as well as the Management Report and the Group Management Report. Based on the results of their audit, PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft issued an unqualified audit opinion for the financial statements and consolidated financial statements.

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

The financial statements and management report of Aareal Bank AG, prepared in accordance with the HGB, and the consolidated financial statements and the Group management report prepared in accordance with IFRSs, and the proposal of the Management Board regarding the appropriation of profit, and the audit reports, were all examined in detail. No objections were raised to the audit results. In its meeting on 23 March 2017, the Supervisory Board approved the results of the audit. The Supervisory Board approved the financial statements and Management Report of Aareal Bank AG, prepared in accordance with the HGB, together with the consolidated financial statements and the Group Management Report prepared in accordance with IFRSs, and thus confirmed the financial statements of Aareal Bank AG. The Supervisory

Board examined and discussed with the Management Board its proposal regarding the appropriation of profit. On the basis of the discussion, the Supervisory Board endorsed the proposal for the appropriation of profit submitted by the Management Board.

Special Transactions

Aareal Bank Group was able to conclude material litigation concerning former Corealcredit Bank, with rulings in the Bank's favour. Even though the resulting non-recurring effect only had a relatively minor impact on the Bank's results after taxes, the conclusion of these proceedings was a positive outcome.

Personnel Matters

At its meeting held on 19 February 2016, the Supervisory Board appointed Ms Christiane Kunisch-Wolff as a member of the Management Board of Aareal Bank, effective 15 March 2016. To date, Ms Kunisch-Wolff was a member of the Management Board of Westdeutsche ImmobilienBank AG, where her responsibilities included accounting and financial reporting as well as anti-money laundering and Compliance. The Supervisory Board is delighted to have won another Management Board member from within the Group, and wishes Ms Kunisch-Wolff every success for her mandate.

In its meeting on 20 April 2016, the Supervisory Board appointed Mr Christof Winkelmann as a member of the Management Board of Aareal Bank, effective 1 July 2016. Mr Winkelmann first worked for Aareal Bank from 2000 to 2006, being responsible for the Bank's hotel financing business. Having worked for another bank, he returned to Aareal Bank in 2008 as Managing Director, Special Property Finance. He has been responsible for the Bank's Special Property Finance business – covering financings for hotels, retail and logistics properties – ever since.

During the same meeting, the Supervisory Board adopted a new distribution of responsibilities amongst the members of the Management Board. Mr Winkelmann assumed responsibility for the Sales units in the Structured Property Financing segment, a position previously held by Ms Dagmar Knopek, with effect from 1 July 2016. Mr Winkelmann is thus particularly responsible for all of the segment's new business activities. Ms Knopek, who has been a member of the Management Board since 2013, assumed the function of Chief Credit Officer on the Management Board on the same date. In her new function, she is responsible for Credit Management (encompassing loan administration and management), Operations, and the Workout portfolio. These duties were previously within the portfolio of Hermann J. Merkens, the Chairman of the Management Board of Aareal Bank AG.

In conclusion, the Supervisory Board would like to thank the Management Board and all of the Group's employees for their strong commitment during the 2016 financial year, which was once again characterised by a challenging environment. That commitment – and strong motivation – from all employees of Aareal Bank Group made the Company's success possible.

Frankfurt, March 2017

For the Supervisory Board

Marija Korsch

Marija Korsch (Chairman)

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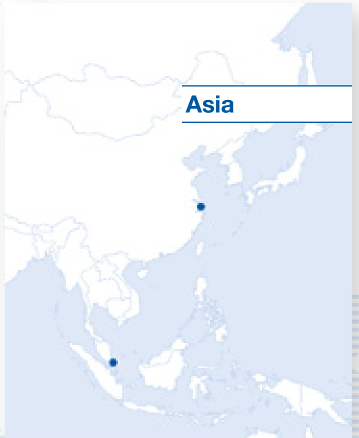
Financial Calendar

11 May 2017	Publication of results as at 31 March 2017
31 May 2017	Annual General Meeting – Kurhaus, Wiesbaden
10 August 2017	Publication of results as at 30 June 2017
14 November 2017	Publication of results as at 30 September 2017

Structured Property Financing

Structured Property Financing

Consulting / Services



Structured Property Financing

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

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

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