ANNUAL REPORT AAREAL BANK GROUP 2006

Aareal Bank

KEY GROUP FIGURES

	01 Jan - 31 Dec 2006	01 Jan - 31 Dec 2005	Change
Consolidated Income Statement	**€ mn**	**€ mn**	**€ mn**
Operating profit	160	-90	250
Group net income / loss after minority interest income	107	-55	162
Indicators			
Cost / income ratio (%) [1]	54.1	59.1	
Earnings per share (€)	2.49	-1.40	
RoE after taxes (%)	10.1	-5.7	

	31 Dec 2006	31 Dec 2005	Change	Change
Portfolio Data	**€ mn**	**€ mn**	**€ mn**	**%**
Property financing	20,682	22,025	-1,343	-6
of which: international	14,289	13,033	1,256	10
Property financing under management [2]	22,771	24,698	-1,927	-8
of which: international	14,289	13,033	1,256	10
Shareholders' equity	1,372	1,241	131	11
Total assets	38,279	39,186	-907	-2
Regulatory Indicators	**%**	**%**		
Core capital ratio (German Banking Act)	8.3 [4]	8.4		
Total capital ratio (German Banking Act)	13.5 [4]	14.5		
Core capital ratio (BIS rules) [3]	7.3 [4]	7.2		
Total capital ratio (BIS rules) [3]	12.1 [4]	12.6		

	31 Dec 2006	31 Dec 2005
Rating		
Fitch Ratings, London		
Long-term	A-	BBB+
Short-term	F2	F2

[1] *only in the Structured Property Financing segment*

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

[3] *The ratios were calculated in accordance with the definitions by the Basel Committee. No agreement regarding the determination of the ratios has been concluded with the German Federal Financial Supervisory Authority (BaFin).*

[4] *after confirmation of Aareal Bank AG's financial statements 2006; the inclusion of retained earnings transferred as part of Aareal Bank AG's liable equity capital as at 31 December 2006 is subject to approval by the Annual General Meeting.*

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Dear shareholders, business associates and Aareal Bank staff

We announced in the 2005 Annual Report that it was our intention to harness all the strengths of Aareal Bank Group, as we embarked upon a strategic review and realignment. This realignment process was oriented specifically around an ambitious six-point programme, with the objective of creating a solid basis to ensure profitable growth in the future.

It is our great pleasure to report that we succeeded in completing the six-point programme ahead of schedule; we even substantially exceeded it in relation to a number of decisive matters. We are delighted to have this opportunity to thank you for the confidence you have placed in our bank.

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

Specifically, which milestones did we achieve in 2006?

1. Sustained growth in new business

We achieved notable success in expanding our business. Since we achieved our original target of approx. € 7 billion for new lending commitments in 2006 at a point during the second half of the year, we raised our forecast to over € 8 billion for the year as a whole. With new lending commitments at year-end totalling approx. € 9.9 billion, we were able to even surpass this new target by a considerable margin. This corresponds to an increase of 39.5 % over the previous year's figure of € 7.1 billion.

We have therefore succeeded in raising the volume of new international business generated by 36.4 %, from € 6.1 billion to € 8.3 billion.

Domestic business was up 58.7 %, from € 1 billion to € 1.6 billion. International business accounted for a good 84 % of all new commitments.

We also achieved even greater diversification of the total property financing portfolio. The German share of 47 % at year-end 2005 was reduced to 37 % as at 31 December 2006. On the other hand, we are expanding the international portfolios in a way that ensures no economic region (except for Germany) accounts for more than 15 % of the overall portfolio.

The expansion of the lending business is matched by activities on the refinancing side. Aareal Bank's first jumbo mortgage bond, issued at the start of 2006, allowed us to develop the bank's refinancing mix and to create a solid base for expanding the business.

2. Reducing the non-performing loan (NPL) portfolio

Our original objective was to scale back the portfolio of non-performing loans from an original volume of € 2,851 million to a residual balance of € 1 billion by 31 December 2006. In fact, the NPL share of the overall portfolio was not only reduced faster, but also to a greater extent than originally planned, down to € 643 million. The NPL inventory at the start of 2005 had been equivalent to a 10.7 % share of the overall portfolio. This had shrunk to less than 2.8 % (€ 643 million) at the end of 2006.

We are particularly proud of a transaction concluded in September 2006, whereby a portfolio of non-performing loans was transferred to Aartemis Credit Management GmbH, which was established for this purpose. The innovative structure allowed us to transfer the economic risk to the buyer at the time of concluding the agreement before the loans were actually transferred to Aartemis Credit Management GmbH.

3. Leveraging the bank's mid-sized corporate structure

We disposed of our restructured subsidiaries and participations that were not in line with our strategy. The objective here has been to make the group a less complex entity, facilitating fast entrepreneurial thinking, whilst at the same time raising profitability. On the other hand, some of the participations that were in line with our strategy were restructured.

The outcome clearly acknowledges a two-segment strategy, comprising the Structured Property Financing and Consulting / Services segments.

In the Structured Property Financing segment, we merged our mortgage bank subsidiary Aareal Hyp AG into Aareal Bank during the first quarter. This had the effect of streamlining parallel structures that had been required by the regulatory legal framework until now.

The Consulting / Services segment principally comprises our activities in the Institutional Housing business. The strategic importance of this business segment is attributable – amongst other things – to the opportunity for achieving positive contributions to results without having to incur credit risk.

Furthermore, more than € 4 billion in stable deposits represent an important component of the refinancing mix that exists independently of the current market situation. These deposits are generated from the automated large-scale payment services business with our customers from the commercial housing sector, for whom we act as lead bank.

Marked structural changes were made in the units of the Consulting / Services segment in order to achieve an appropriate contribution to results.

The new structure is well established. During 2006 we established a product policy that was oriented more towards meeting the customers' requirements, and introduced measures for increasing efficiency; the outcome was such that the Consulting / Services segment already generated a significantly more positive contribution to results in the period under review.

We succeeded in taking two further important steps before the end of the year. Our asset management activities were sold to Schroders, the global asset manager. Furthermore, the Interhotel Group, in which Aareal Bank held a 33% stake, sold its properties alongside associated subsidiaries. Each transaction generated double-digit million cash flows, some of which will accrue during the current year. We have earmarked these funds for targeted investment in our core businesses.

4. Upgrading the organisational structure

To further enhance efficiency, the organisational structure was streamlined, interfaces reduced and lines of communication shortened. A strict cost management programme was also introduced.

We succeeded in optimising all business and administrative areas at the Aareal Bank head office in 2006. We also rearranged the German sales area in the Structured Property Financing segment, so that it now centres on four locations – Berlin, Hamburg, Munich and our head office in Wiesbaden.

Internationally, and where appropriate, we have also aggregated our sales resources in other countries into regional centres (so-called hubs), thus enhancing the efficiency of our distribution network. This has already been realised with the Nordic hub for Scandinavia, located in Stockholm, and the CEE hub in Warsaw for Central and Eastern Europe. In future, New York will act as the hub for North America and Singapore as the hub for the Asia / Pacific region.

5. Emphasising a modern corporate culture

With 16 offices internationally, employing quality staff from 31 different nations, Aareal Bank is well-positioned today to further expand its international presence and to firmly establish itself as a global player. Our employees are a key factor, whose expertise, commitment and customer orientation contribute substantially to the company's success.

We revised the personnel management tools last year, replacing them with a new remuneration, bonus and career structure. Besides the classic career path for executives, specialists can now avail themselves of new career opportunities as well. This offers us greater scope to reward one of the key success factors of the new business model: a highly-specialised and global staff network.

Employees who think and act with the company's interests in mind are an indispensable feature of modern corporate culture. This is reflected in our revised organisational structure – extended powers, tighter management structures and new platforms to facilitate internal dialogue.

Developing a modern corporate culture will remain a priority for us, even after the conclusion of our strategic realignment.

6. Transparency in managing our business

We now manage our business with greater internal as well as external transparency. The popularity of our new business model amongst investors, together with the motivation of our staff, strengthens our understanding of open and transparent corporate communication.

We conducted more than 300 personal discussions with investors and analysts during the 2006 financial year; we also participated in many international conferences. Our policy of openness and transparency has significantly strengthened the confidence in Aareal Bank that is shown by our partners. Market observers, shareholders, representatives of the regulatory bodies and many other interested parties voice their approval of and acknowledge our strategic realignment. This is evident in the performance of our share price and ratings, as well as in the results of various audits.

Internal transparency is equally important, as it promotes staff loyalty and the ability of our employees to act in an enterprising manner.

We come to the welcome conclusion that the simpler, target-oriented structures that have recently come to define Aareal Bank have contributed significantly to enhancing our public profile and to strengthening internal mutual trust.

Conclusion

The success of our strategic realignment can be measured (amongst other ways) by the fact that after two years our company is once again in a position to distribute a dividend to our shareholders. Net income after minority interest amounted to € 107 million, which translated into earnings of € 2.49 per share and a return on equity (RoE) after taxes of 10.1%. We will propose to the Annual General Meeting to distribute a dividend of € 0.50 per share.

The six-point programme met with a positive response, both from our clients and from the capital markets. At this point, we would like to extend sincere thanks to our clients who gave us their full support during this challenging time. Our intensive and open communication on the necessity and initiative of the six-point programme gained the total conviction of our shareholders. We would also like to express our gratitude for the confidence that was shown in the bank and in our share. We would especially like to thank our employees; without their exemplary commitment, we would not have been able to achieve our objectives.

Another welcome outcome of the faster implementation of the strategic review was Fitch Ratings' November 2006 upgrade of Aareal Bank AG's rating from BBB+ to A-.

Outlook: FUTURE 2009

In light of the early completion of the six-point programme after only one-and-a-half years, we can now embark on our growth programme "FUTURE 2009" well ahead of schedule. This programme, which encompasses the entire Aareal Bank Group, targets a return on equity after taxes of 12 - 13 % by the year 2009.

With this strategy, based on market opportunities and growth, we will once again be subject to the discipline of clear objectives and set milestones. FUTURE 2009 defines our vision of growth and how we want to achieve it.

Within the scope of this growth programme, we will aim at a three-dimensional accord to safeguard the legitimate interests and expectations of our investors, clients and employees.

Expansion on the basis of the stakeholder approach

Our products, services and capabilities have proven our business model successful. We will continue to expand our business segment Structured Property Financing into Europe, North America and Asia/Pacific to serve our clients' needs in these regions.

In the Consulting/Services segment, we will be a reliable partner, supporting our clients in a changing environment.

We are in a people business. Our employees are the key to our success and that of our customers. Therefore, it is vital to continue to attract entrepreneurial professionals.

We set ourselves ambitious goals to meet capital markets' expectations. Our targets and performance will be transparently communicated.

We are focusing on organic growth. This means that we can and want to achieve commercial strength on the basis of our own strengths and ability. Our new corporate structure provides the necessary requirements: acquisitions or mergers with partners are therefore not a prerequisite for achieving our goals.

Yours sincerely

The Management Board

Dr. Schumacher   Kickum   Merkens

Ortmanns   Schörnig

CORPORATE GOVERNANCE

CORPORATE

CORPORATE GOVERNANCE

The German Corporate Governance Code was subject again to amendments in 2006. These amendments serve to enhance the management and supervision of exchange-listed companies.

The implementation of the German Corporate Governance Code, as amended on 12 June 2006, within the framework of Aareal Bank AG's Corporate Governance Code

Aareal Bank implemented in full (with the exception of individual points) the changes that were incorporated in the German Corporate Governance Code (the "Code"), as amended on 12 June 2006. These points will be outlined below and the reasons for the exceptions explained. The instances where the company refrains from implementing the changes apply mainly to recommendations that cannot be easily harmonised with the specific structure of the company.

In the section on the cooperation between the Management Board and the Supervisory Board, item 3.8 of the Code recommends that a deductible be agreed where a company takes out D&O insurance cover. Aareal Bank has taken out a D&O liability insurance policy for members of the Management Board and the Supervisory Board that does not provide for a deductible. Responsible action is an integral obligation for all members of a company's executive bodies. For this reason, the members of the company's executive bodies believe that it does not require a deductible. Item 4.2.2 in the section on the composition and remuneration of the Management Board also recommends that upon proposal by the Board, the plenary meeting of the Supervisory Board deals with the contracts for the members of the Management Board and advises on the structure of the remuneration system for the Management Board as well as reviewing it on a regular basis.

In its meeting on 23 May 2006, Aareal Bank's Supervisory Board passed on all issues related to the remuneration of the Management Board to the Executive Committee for independent assessment and handling. This is due to the abolishment of the separate Human Resources Committee as of this date. The procedure of delegating this duty to a committee has stood the test of time. The Executive Committee advises on a regular basis on the determination and structure of the emoluments paid to the members of the Management Board and reports to the plenary meeting of the Supervisory Board on its deliberations in this respect.

Particular importance was attached – within the scope of reducing the size of the Supervisory Board – to the selection of Supervisory Board members to be appointed to the committees. The banking expertise and international experience of the committee members was important to the selection process. Item 5.4.2 in the section on the composition and remuneration of the Supervisory Board recommends that the members of the Supervisory Board do not exercise directorships or advisory tasks for important competitors of the company. In view of the due care that was taken by the 2006 Annual General Meeting in selecting the members of the Supervisory Board, this recommendation was complied with in the best possible way. This also applies to the successor to Dr. Nolting, who retired from the Supervisory Board of Aareal Bank after having assumed the position of Chairman of the Management Board of Allgemeine Hypothekenbank Rheinboden AG.

Aareal Bank AG was unable to adhere to the recommendation of the Code to elect Supervisory Board members at varied dates. The reason for this was that historically, all terms of office end on a single termination date. The recommendation could not be adhered to without breaching the principle of equal treatment of all candidates. Furthermore, grading the terms of office would represent an unnecessary increase in the bank's administrative expenditure.

The regulations laid down in item 7.1.3 in the section on accounting practises in the Code refer to the breakdown of the remuneration as of page 146.

Management Board

The Management Board is responsible for managing the company. In doing so, it is obliged to act in the best interests of the company and undertakes to increase its sustainable enterprise value. The Management Board ensures that all provisions of law are complied with, and endeavours to achieve their compliance throughout Group companies. The Management Board develops company strategy, coordinates it with the Supervisory Board, and ensures its implementation. It ensures appropriate risk management and risk controlling throughout the company. The Management Board cooperates trustfully with Aareal Bank's other executive bodies, and with employee representatives.

There were no conflicts of interest affecting members of the Management Board within the meaning of Aareal Bank's Corporate Governance Code in the 2006 financial year.

The Supervisory Board

The task of the Supervisory Board is to advise regularly, and to supervise the Management Board in the management of the company. It is involved in decision-making that is of fundamental importance to the company, and cooperates closely and on the basis of trust with the Management Board.

The members of the Supervisory Board and their functions in the Supervisory Board's committees are listed on page 17. The Supervisory Board reports on its duties and the events of the 2006 financial year in its report on page 168 of this Annual Report. The members of the Supervisory Board have stated that there were no conflicts of interest during the financial year under review.

As was stated above, Dr. Nolting retired from his office to avoid conflicts of interest. The Supervisory Board reviews the efficiency of its own activities on a regular basis. The following considerations in particular are examined:

- meetings (contents, duration, results);
- information provided to the Supervisory Board by the Management Board;
- composition of the Supervisory Board; and
- specific topics relevant to the committees.

The results serve to further improve the work carried out by the Supervisory Board as well as enhancing the cooperation between the Supervisory Board and the Management Board.

D = Chairman
Dpty. C = Deputy Chairman

	Plenary meeting	Executive Committee	Accounts and Audit Committee	Credit and Market Risk Committee	including: Committee for Urgent Decisions
Hans W. Reich	X (C)	X (C)	X	X (C)	X (C)
Erwin Flieger	X (Dpty. C)	X (Dpty. C)		X	X
Christian Graf von Bassewitz	X		X	X	X
Manfred Behrens	X				
Dr. Herbert Lohneiß	X			X (Dpty. C)	X
Joachim Neupel	X		X (C)	X	X
Prof. Dr. Stephan Schüller	X	X	X (Dpty. C)		
Wolf R. Thiel	X	X			
York-Detlef Bülow	X (Dpty. C)	X (Dpty. C)	X		
Tamara Birke	X			X	
Thomas Hawel	X				
Helmut Wagner	X				

The analysis showed that the Supervisory Board largely works efficiently, and that there is potential for improvement only in certain areas.

The Supervisory Board has created committees for its work. Responsibility for individual duties has been delegated to these committees.

The committees and their duties are outlined in this Annual Report in the Supervisory Board report, and the positions are occupied as set out below.

Remuneration system for the Supervisory Board

A resolution was adopted by the Annual General Meeting in 2006 to reduce the number of members in the Supervisory Board and to adjust its remuneration system accordingly. In the financial year 2006, those members that were re-elected to the Supervisory Board in 2006 will be remunerated on a pro-rata basis in accordance with the old remuneration system for the period until the Annual General Meeting, and pro-rata on the basis of the new remuneration system for the period thereafter.

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

	Fixed remuneration Total	Variable remuneration Total	Total remuneration
Hans W. Reich	107,050.60	8,827.49	115,878.09
Christian Graf v. Bassewitz	56,249.69	3,447.69	59,697.38
York-Detlef Bülow	56,525.51	4,344.33	60,869.84
Tamara Birke	29,270.67	3,447.69	32,718.36
Manfred Behrens	22,278.44	3,447.69	25,726.14
Dr. Richard Brantner (until 23 May 2006)	28,605.60	1,654.43	30,260.03
Prof. Dr. Johann Eekhoff (until 23 May 2006)	8,294.00	1,654.43	9,948.43
Wolfgang Fauter (until 23 May 2006)	11,611.60	1,654.43	13,266.03
Erwin Flieger	48,231.51	4,344.33	52,575.84
Lutz Freitag (until 23 May 2006)	8,294.00	1,654.43	9,948.43
Thomas Hawel (since 23 May 2006)	13,984.44	1,793.26	15,777.71
Dr. Friedrich-Adolf Jahn (until 23 May 2006)	8,294.00	1,654.43	9,948.43
Ralf Kupka (until 23 May 2006)	11,611.60	1,654.43	13,266.03
Dr. Peter Lammerskitten (until 23 May 2006)	18,490.40	1,654.43	20,144.83
Jacques Lebhar [1] (until 23 May 2006)	4,887.03	896.73	5,783.75
Dr. Herbert Lohneiß (since 24 November 2006)	3,351.11	305.76	3,656.88
Joachim Neupel (since 23 May 2006)	34,961.11	3,586.53	38,547.64
Dr. Claus Nolting (since 23 May 2006 until 21 August 2006)	8,506.67	727.22	9,233.89
Kurt Pfeiffelmann (until 23 May 2006)	11,611.60	1,654.43	13,266.03
Prof. Dr. Stephan Schüller (since 23 May 2006)	27,968.89	1,793.26	29,762.15
Klaus-Peter Sell (until 23 May 2006)	11,611.60	1,654.43	13,266.03
Wolf R. Thiel	36,485.87	3,447.69	39,933.56
Prof. Dr. Dr. h.c. mult. Hans Tietmeyer (until 23 May 2006)	8,294.00	1,654.43	9,948.43
Helmut Wagner (since 23 May 2006)	13,984.44	1,793.26	15,777.71
Reiner Wahl (until 23 May 2006)	11,611.60	1,654.43	13,266.03
Dr. Jürgen Westphal (until 23 May 2006)	11,611.60	1,654.43	13,266.03
Anja Wölbert (until 23 May 2006)	8,294.00	1,654.43	9,948.43
	621,971.58	**63,710.55**	**685,682.13**

All details on the variable remuneration component assume a dividend payment of € 0.50 per share entitled to dividend payments.

[1] after deduction of 30 % withholding tax for Supervisory Board members (section 50a (1) and 50a (2) of the German Income Tax Act) and 5.5 % solidarity surcharge

comprises a short-term and a long-term component.

The fixed remuneration is € 20,000 p.a. for each Supervisory Board member. The Chairman of the Supervisory Board shall receive twice the amount, while the deputy shall receive one and a half times as much as a normal member. The fixed remuneration is increased by € 10,000 p.a. for any Supervisory Board committee member (with the exception of the Committee for Urgent Decisions, which is a part of the Credit and Market Risk Committee).

The fixed remuneration is increased instead by € 20,000 p.a. for Chairmanship of a Supervisory Board committee (also with the exception of the Committee for Urgent Decisions, being a part of the Credit and Market Risk Committee).

The fixed remuneration component of a Supervisory Board member, including the remuneration for the Chairmanship of a Supervisory Board committee, forms the basis for assessing the performance-related remuneration.The performance-related remuneration only comes into effect if a dividend is paid for the financial year in question that exceeds at least € 0.20 per share.

The short-term performance-related remuneration currently amounts to 12.5 % of the individual assessment basis for each full € 50 million of the consolidated net income attributable to shareholders of Aareal Bank AG as reported in the Group income statement. However, it may not exceed 50 % of the individual assessment basis.

The long-term performance-related remuneration of a Supervisory Board member amounts to 12.5 % of the individual assessment basis for each 10 % increase in the consolidated net income attributable to shareholders of Aareal Bank AG (as reported in the consolidated income statement) over the unweighted average of the consolidated net income attributable to shareholders of Aareal Bank AG for the three previous full financial years. The long-term profit-oriented remuneration is not paid if the average value is negative. On this basis, the members of the Supervisory Board are not entitled to a long-term performance-related remuneration for the 2006 financial year. The long-term performance-related remuneration is capped at 50 % of the individual assessment basis, so that the aggregate variable remuneration may amount to maximum 100% of the fixed remuneration component.

Transactions with related parties

The bank also concludes transactions with related parties. These transactions are presented on page 146 of the Notes to the Financial Statements in this Annual Report.

Trade date	Name	Status	Type	Quantity	Price per share	Volume
30 June 2006	Christian Graf von Bassewitz	Supervisory Board	Purchase	1,000	29.50	29,500
29 June 2006	Christian Graf von Bassewitz	Supervisory Board	Purchase	1,000	29.24	29,240
21 June 2006	Christian Graf von Bassewitz	Supervisory Board	Purchase	2,000	29.76	59,520
26 May 2006	Thomas Ortmanns	Management Board	Purchase	300	33.28	9,984
03 April 2006	Christof M. Schörnig	Management Board	Sale	1,798	38.85	69,848
21 March 2006	Christof M. Schörnig	Management Board	Sale	2,308	38.27	88,332
20 March 2006	Christof M. Schörnig	Management Board	Sale	2,000	38.60	77,200

Purchase or sale of the company's shares

The table above indicates the transactions carried out in 2006 by members of the company's executive bodies at the following terms. These transactions were published subject to the reporting requirements of the German Securities Trading Act (WpHG) in the category "Director's Dealings" on Aareal Bank AG's website.

Accounting policies

The Aareal Bank Group accounts are prepared in accordance with International Accounting Standards (IAS) / International Financial Reporting Standards (IFRS). The single-entity financial statements of Aareal Bank AG are prepared in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – HGB). The Management Board prepares the financial statements of Aareal Bank AG and the consolidated financial statements. The Supervisory Board approves them and thus confirms the financial statements of Aareal Bank AG. The financial statements are audited by PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, which was appointed by the Annual General Meeting as auditors for the financial year 2006.

Relationship to shareholders

The General Meeting of Aareal Bank AG is held once a year. At this Annual General Meeting, the shareholders decide, in particular, on the formal approval for the members of the Supervisory Board and Management Board for the financial year under review, on the appropriation of any net retained profit, amendments to the Memorandum and Articles of Association, and authorisations on capital adjustments. The Annual General Meeting also elects the auditor for the company.

The company's shareholders may submit statements or proposals in writing, by fax or e-mail, to the company or may request to speak at the Annual General Meeting. The shareholders may also submit counter or supplemental motions to the agenda items at the Annual General Meeting so that they participate in structuring and influencing the meeting. At the Annual General Meeting, the Management Board or Supervisory Board shall comment on or answer the contributions made by shareholders.

Communication

Aareal Bank AG's policy of communication is oriented towards the interests of all stakeholders. It publishes details on the financial position and performance quaterly.

This published information is elaborated on by the Management Board in press conferences and analysts' meetings, and thus communicated to the interested public. The company publishes any information which may impact its share price, in the form of ad-hoc disclosures. This information is also published on the bank's website. Aareal Bank is striving to exploit in a targeted manner the possibilities offered by modern communications channels, particularly the internet.

The company's realignment programme reflects the importance of open and transparent communication to Aareal Bank AG.

Declaration of Compliance with section 161 of the German Stock Corporation Act (AktG)

The Management Board and Supervisory Board of Aareal Bank AG declare, in accordance with section 161 of the AktG, that:

"Aareal Bank AG has complied with the recommendations of the Government Commission "German Corporate Governance Code" (as amended on 02 June 2005 and, with effect from 12 June 2006, as amended on that date) since the last Declaration of Compliance was issued in December 2005; in each case, except for the recommendations mentioned below:

Pursuant to section 3.8 of the German Corporate Governance Code, a suitable deductible shall be agreed if the company takes out a D&O (directors and officers' liability insurance) policy for the Management Board and Supervisory Board.

For the members of the Management Board and Supervisory Board, there is a directors' and officers' liability insurance policy without a deductible. Since it goes without saying that all members of Aareal Bank's Management Board and Supervisory Board have a duty to act responsibly, no deductible is required.

Pursuant to section 4.2.2 of the Code the full Supervisory Board shall discuss and regularly review the structure of the Management Board compensation system at the proposal of the committee dealing with Management Board contracts.

The Supervisory Board of Aareal Bank AG has transferred responsibility for matters relating to the renumeration of the Management Board to its Executive Committee, which independently resolves upon and deals with them. This procedure has proven to be successful over many years of practice. The Executive Committee discusses the structure of the system of compensation, regularly examines it and determines the amount of compensation for members of the Management Board. It reports to the full Supervisory Board on the discussion and examination of the system of compensation.

In the coming fiscal year, Aareal Bank AG will continue to comply with the recommendations of the German Corporate Governance Code (as amended on 12 June 2006) except with respect to sections 3.8 and 4.2.2 as set out above.

Furthermore, Aareal Bank AG adopted its own Corporate Governance Code as early as 1999. The bank's Code has been adapted to incorporate amendments to the German Corporate Governance Code; it goes far beyond the recommendation of the Government Commission."

For further details on the Corporate Governance Principles of Aareal Bank AG, please refer to our website: http://www.aareal-bank.com/servlet/PB/menu/1002243_l2/index.html

Wiesbaden, December 2006

The Management Board

Dr. Schumacher Kickum Merkens

Ortmanns Schörnig

The Supervisory Board

Hans W. Reich (Chairman)

GOVERNANCE

OUR EMPLOYEES

OUR EMPLOYEES

Aareal Bank Group's workforce averaged approximately 2,712 staff during 2006. This represents a drop of 505 staff over the figure of 3,217 for the previous year, equating to a reduction of 15.7 %. This development was marked by the Group's strategic realignment. Amongst other measures, two subsidiaries were successfully disposed of: Aareal Hypotheken-Management GmbH and Aareal Hypotheken Vermittlungsgesellschaft mbH.

Average staff numbers at Aareal Bank AG were down from 1,206 in 2005 to 1,145 during 2006.

On account of the targeted streamlining of the organisational structures in the Consulting/Services segment, the average staffing level here was reduced by 255 to 1,540.

We always endeavour to handle the necessary organisational restructuring of the Group in as socially responsible a manner as possible.

BEWERT, the unit which employed the bank's property experts, was incorporated into its own company – Aareal Valuation GmbH – at the start of 2006, with 28 members of staff transferring to the new entity.

The sale of non-performing loans (NPL) will lead to a consolidation of staffing levels in the Workout unit in the medium term.

In parallel to these consolidating moves, we also strengthened our employee base in order to invest in new markets and products. This involved mainly our international locations, but is also reflected in our trainees who have gone through our international trainee programme, and specialists for our Wiesbaden-based head office. The global focus of our bank is evident in the international composition of our staff.

Appraisal and Target Setting System

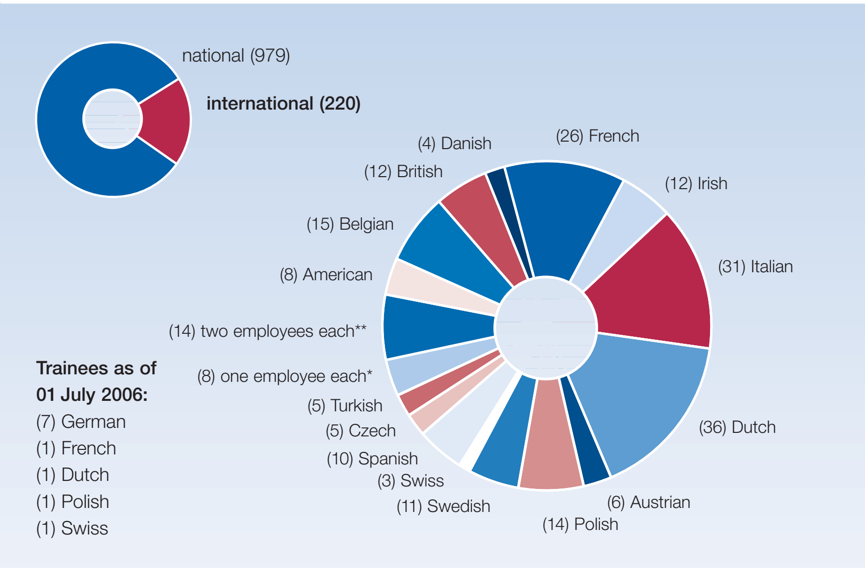
Aareal Bank AG

As we announced in our last annual report, we introduced a new remuneration, appraisal and target agreement system in the bank that was initially implemented at management level. Following in-depth preparation and information events conducted, the system is being introduced for all members of staff as of 2007.

This should improve the culture of dialogue fostered in our bank, and achieve greater transparency with regard to objectives. It will also enhance staff loyalty, so as to further promote their commitment to the bank.

The variable compensation component for the bank's executive staff was extended within the scope of an agreement reached with the bank's representative committee of executive staff, to include an equity-based long-term component, the so-called "virtual shares". This means that a part of bonus payments will be converted into virtual shares, and disbursed in three equal parts over the three subsequent years after the

Aareal Bank's international employee structure



** from: Bulgaria, Japan, Yugoslavia, Canada, Mexico, Portugal, Romania, Ukraine*

*** from: China, Finland, Greece, Croatia, Morocco, Russia, Singapore*

variable compensation component has been determined. The amount of the payment is derived from the relevant share price.

Aareon AG

The appraisal and target setting system already introduced at Aareon AG has meanwhile become established as an integral part of staff management.

Since 2006, it also comprises a variable salary share for all staff and serves as a valuable addition to the balanced scorecard system already in place for executive staff.

Further education

Training is a significant core element of our personnel development. Our objective is to establish a virtual corporate university, based on the concept of the Aareal Academy. The Aareal Academy should be based on a four-pillar structure in future. The employees will attend internal seminars and workshops where their training will be practical and relevant to their existing or future areas of responsibility. There is also the possibility of participation – in a targeted manner – in external seminars on selected topics. Additionally, we are in the process of enhancing our cooperation with two top internationally-renowned universities.

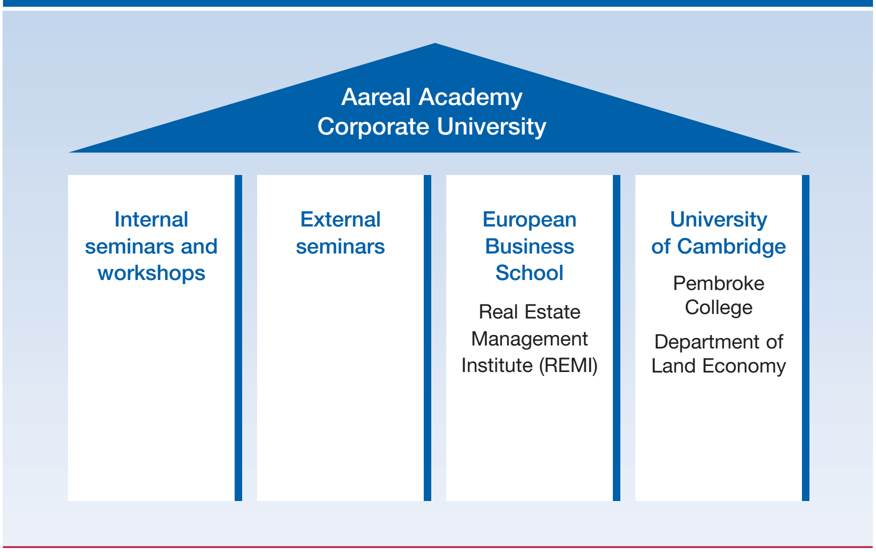
We extended our longstanding cooperation with the Real Estate Management Institute (REMI) of the European Business School (ebs); the REMI has meanwhile relocated to Wiesbaden. Aareal Bank will endow the Aareal Foundation Chair for Property Investment and Financing for the next five years. This will guarantee that Aareal Bank representatives are involved in the international network and in the executive bodies of ebs, a highly-reputed business school.

The holder of the chair, Prof. Dr. Rottke, for his part will participate in Aareal Bank events and will become involved in arranging in-house seminars.

Conducting joint research projects facilitates an efficient exchange of theoretical and practical knowledge. Furthermore, Aareal Bank staff will participate in property-related executive programmes this year.

We also plan to expand another important cooperation we have undertaken with the Department of Land Economy at Pembroke College, Cambridge University.

A new trainee programme was set up in the 2006 financial year under the auspices of the Aareal Academy. The programme is defined by a much greater degree of practical relevance, and deals with the candidates' individual objectives in depth.



The four pillars of Aareal Academy

The Annual Management Meeting – a conference for all Aareal Bank executives – was held for the first time in March 2006. Amongst the focal points of the agenda were workshops on the topics of management, corporate culture and personnel development. One of the outcomes has been Aareal Bank's new management guidelines, which reflect the modern management philosophy practices in the bank. Further evidence of the bank's international activities can be seen in the inclusion of additional languages (such as Chinese) into the regular intensive language courses offered.

Thanks and appreciation

The Management Board would like to express its sincere thanks to the staff of Aareal Bank Group, for their high level of commitment in the day-to-day business and for their tremendous assistance within the scope of realigning the Group.

It would also like to thank the members of the Works Council and the representative committee of executive staff for their constructive cooperation at all times.

THE AAREAL BANK SHARE

THE AAREAL BANK SHARE

In the 2006 financial year, Aareal Bank Group concentrated with great success on implementing the six-point programme. Accordingly, one of the major aspects of our investor relations activities during the period under review was to communicate this process to our shareholders, and to the market. The performance of the Aareal Bank share reflected the expectations of our investors with regard to the success of our strategic realignment.

The publication in November 2005 of the strategic consequences we had drawn from the credit portfolio audit was liberating; we had finally put past events behind us. As of this point in time, investors looked at the successfully-managed turnaround, and took their investment decisions accordingly.

The Aareal Bank share also performed well during the course of 2006, initially matching the performance of other entities operating in the property sector. Additionally, the general euphoria surrounding German property stimulated our share price, especially at the start of the year. In April it reached € 40.33, the highest closing price since it was listed.

The favourable performance of our share since the strategic realignment not only reflects the high level of confidence that investors place in our management team, but in the bank as a whole.

The confidence in the Management Board and the Investor Relations team was reflected in the many investor discussions held. Mutual trust was further enhanced through transparency, topicality and the setting of concrete goals. The focal point was on the implementation of our six-point programme. The consistent realignment of our Structured Property Financing segment, together with the sharpened focus of the Consulting/Services segment, met with great approval.

History

The Aareal Bank share has been listed as a separate entity – following the split of the former DePfa Group – since 17 June 2002 and has been included into the MDAX® since 23 September 2002.

Moreover, since 01 January 2003, Aareal Bank has been included in the Prime Standard segment of the Frankfurt Stock Exchange. Companies listed in the Prime Standard segment need to comply with international transparency requirements, over and above the requirements of Official Trading or the General Standard segment. Maintaining a high level of transparency vis-à-vis all investors is an integral part of our strategic positioning as an international property finance house, and as a global player on the capital market.

Key data

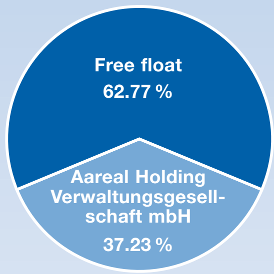
The following table provides an overview of the key data of the Aareal Bank share:

Key data	2006	2005
Share price (€) [1]		
Year-end price	35.27	32.07
High	40.33	32.64
Low	29.15	22.36
Book value per share (€)	26.38	23.32
Dividend per share (€)	0.50 [3]	–
Earnings per share (€)	2.49	-1.40
Price/earnings ratio [2]	14.16	–
Dividend yield (%) [2]	1.4	–
Market capitalisation (€ mn) [2]	1,508	1,371

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

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

Shareholder structure



Aareal Holding Verwaltungsgesellschaft mbH

8.94 %	Bayerische Beamten-Lebensversicherung a.G.
8.94 %	Schweizerische Lebensversicherungs- und Rentenanstalt
6.68 %	Versorgungsanstalt des Bundes und der Länder
6.06 %	Bankhaus Lampe KG
5.25 %	Deutscher Ring Gruppe
1.36 %	Condor Lebensversicherungs-AG

Shareholder structure

Aareal Holding Verwaltungsgesellschaft mbH holds a 37.23 % stake in the 42,755,159 notional no-par value bearer shares ("bearer unit shares") of Aareal Bank AG; the remaining 62.77 % are in free float.

Share performance

In the period between 30 December 2005 and year-end 2006, the Aareal Bank share rose by 10 % to € 35.27.

Compared with the share price of € 17.95 at the time of listing (17 June 2002), this equates to a 96.5 % performance at the end of the 2006 financial year (excluding dividends), or an annualised performance of 16.1 %. This share price performance represents an extremely profitable return on capital for those investors holding our share as a long-term investment. The DAX was up by 47.4 % in the same period, which corresponds to an annual increase of around 8.9 %.

In the 2006 financial year, the share price fluctuated between an annual low of € 29.15 on 28 June 2006 and a high of € 40.33 on 20 April 2006.

The weighted average of the closing prices in 2006 increased by 26.5 % over the previous year, from € 27.00 to € 34.16.

This performance was also attributable to the publication of the outcome of the credit portfolio audit in November 2005, and the subsequent realignment of the Aareal Bank Group.

Relative performance of the Aareal Bank share price (%)

The advantageous development seen at year-end 2006 also continued into the new financial year 2007, with the share trading at € 38.39 on 20 February 2007.

Aareal Bank coverage and investor relations activities

The Aareal Bank share was covered by the research departments of 21 investment banks in 2006; at year-end, 14 banking sector analysts recommended our share as a "buy" or "outperformer", with a further six rating it as "hold" or "market performer". Only one bank assessed the share as a "sell".

We met with more than 300 institutional investors (funds, pension funds, hedge funds etc.) during the financial year under review. Our presence at a large number of roadshows, conferences and round tables was always met with a positive response. Constructive dialogue held with existing as well as with potential new shareholders represents a core element of our investor relations strategy.

The positive capital market response – which is reflected in the rising share price – is as welcome to our shareholders as it is to us.

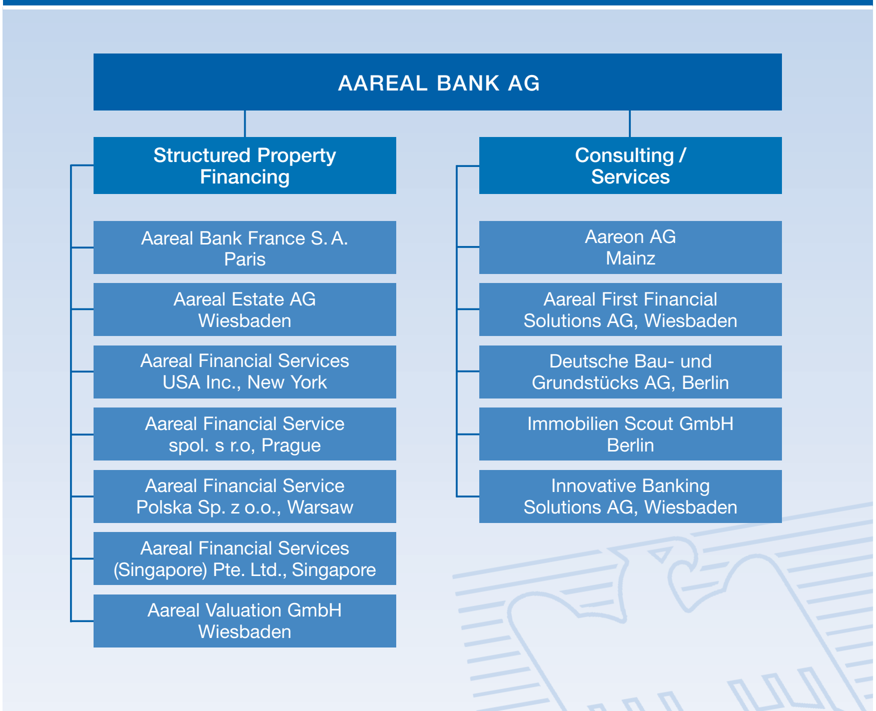
GROUP MANAGEMENT REPORT

GROUP MANAG

GROUP MANAGEMENT REPORT

The financial year 2006 was both very challenging and very successful for Aareal Bank Group. The operative implementation of the strategic realignment, which was set out in a six-point programme, was concluded ahead of schedule. The systematic and risk-oriented expansion of new business, the continued reduction of our NPL portfolio and consistent focus on our core expertise contributed in particular to the significant improvement in the bank's economic position. The positive outcome was reflected amongst other things, in the restoration of the bank's ability to pay a dividend for 2006, and Fitch Rating's upgrade of our bank rating to A-.

New Company Structure of Aareal Bank



Business and environment

Corporate structure and business activities

Aareal Bank Group is one of the leading international specialist property banks. Its parent company is Aareal Bank AG, a commercial bank with a licence to issue German asset-covered bonds (Pfandbriefe), whose head office is located in Wiesbaden, Germany.

Aareal Bank's business model, which was revised and realigned in 2006, is made up of two segments:

I. Structured Property Financing

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

Aareal Bank has more than 15 years experience in domestic and international commercial property finance. We focus in particular on a portfolio that is broadly diversified by region and by types of property. We provide property financing solutions in over 25 countries. We can call upon an established network of regional market experts and industry specialists to offer financing solutions tailored to meet our customers' requirements in all target markets.

Aareal Bank has established itself as an active issuer on the capital market, where it issues traditional as well as structured securities to cater for a broad investor base. Transactions are issued in liquid currencies as private placements with individual issuing features or as benchmark bonds.

2. Consulting / Services

The Consulting / Services division offers the institutional housing sector a comprehensive range of services for managing residential property portfolios and processing payment flows.

The bank cooperates with its subsidiary Aareal First Financial Solutions AG in the payments and deposit-taking business, to offer our commercial housing sector clients a highly-automated mass payments system that is integrated into their administrative processes. The payments business generates customer deposits, which contribute to the bank's short-term refinancing mix.

The IT system consultancy and related advisory services of this segment are represented by Aareon AG. It is recognised as the leading IT consultancy and systems house for the institutional housing sector, with a market share of approximately 60 %. In 2006, Aareon adjusted to the change in the market environment by adopting a differentiated product strategy suited to match market sub-segments and customer requirements.

Disposal of Property Asset Management

A decision was reached during the financial year under review that Property Asset Management no longer represented a core business activity of Aareal Bank Group. For this reason, Aareal Bank ceased its asset management activities in December 2006 with the sale of Aareal Asset Management GmbH and its subsidiaries. These were all part of the former Property Asset Management segment.

Company management

Aareal Bank Group is managed on the basis of various economic indicators.

The Structured Property Financing segment uses mainly operating profit, RoE and the cost / income ratio.

The indicators used in the management of the Consulting / Services segment depend on the characteristics of the individual subsidiaries, using EBIT and EBIT margin, for example, or operating profit on a segment level.

Strategic realignment

The basis for the strategic realignment of Aareal Bank up to the end of 2006 was set out in a clearly-defined six-point programme:

1. Sustained growth in new business

Commercial property financing is Aareal Bank's key source of income.

Hence, the main objectives of the realignment were to expand and further diversify new lending commitments and extend the existing client base. Expanding the refinancing base through jumbo Pfandbriefe and improving Aareal Bank's issuer rating also played a central role.

2. Reducing the non-performing loan (NPL) portfolio

Another key issue of the realignment was the consistent and speedy reduction of Aareal Bank's non-performing loan portfolio. This realignment was not only concluded earlier than planned during the financial year under review; it also extended to a greater degree than originally envisaged.

3. Leveraging the bank's mid-sized corporate structure

Aareal Bank's mid-sized corporate structure represents one of its competitive advantages. In order to take even greater advantage of this strength, the complex investment portfolio was reviewed to assess its compatibility with Aareal Bank's core expertise. Non-core investments were sold and Aareal Bank's segments realigned.

4. Upgrading the organisational structure

The organisational structure was streamlined, interfaces reduced and lines of communication shortened – all with a view to further enhancing efficiency. A strict cost management programme was also introduced.

5. Emphasising a modern corporate culture

The expansion of the corporate structure also represented a key building block in the realignment process. Binding management guidelines combined with clearly defined personal expertise and management tools, together with transparency in the performance assessment are all prerequisites for open and intelligent management. This impacts on the employees' corporate identification and hence on the ability to implement necessary changes.

6. Transparency in managing our business

Open external communication strengthens the level of confidence shown in the Group, while open internal communication creates the basis for confidence and for staff to identify with the bank. It impacts favourably on their motivation. A key issue of the realignment therefore was to create a level of transparency that exceeds the objectives and planning of Aareal Bank.

Macroeconomic and industry-specific environment

2006 was defined by historically low interest rates worldwide. Nevertheless, this was not reflected in a uniform economic trend. The US once again commanded pole position in the economic cycle as the driver of global economic growth. The Federal Reserve Bank (Fed) has gradually increased the Fed Funds rate (starting as long ago as mid-2004) from a historical low of 1% to 5.25% by mid-2006.

The step-by-step approach with which the central banks reacted to less volatile macroeconomic data reduced the uncertainty in relation to short-term interest rates and contributed generally to low yields, lower yield volatility and flat yield curves.

Global economic growth was approx. 5.1% in the year under review. The growth rates of approx. 3.5% in the US and of approx. 3% in Europe are somewhat lower than the global average; they also lag considerably behind the growth rates in China (approx. 10%) or India (approx. 8%). However, given the historical record price of oil and various other commodities in 2006, and in view of the slightly higher interest rates, this growth can still be described as being robust.

Global commercial property markets

This positive trend is also reflected in the commercial property markets. These are defined by higher liquidity, and at the same time by a short supply of attractive investment properties in terms of quality. Accordingly, the prices for such properties have risen considerably in the year under review.

Demand was supported by higher – but still relatively low – interest rates, that continued to provide investors with access to cost-effective borrowing. Pension funds are also substantially increasing the ratio of property relative to their overall investments, thus channelling liquidity into the sector.

Other asset managers, such as private equity funds and fund management companies have also increased their share of property investments. This is accompanied by a strategy of internationalisation in the property business that matches the business model of Aareal Bank.

German institutional housing sector

The structural change in the German property management sector remained intact during 2006. International investors acquired further residential portfolios, which led to increasing internationalisation of the supplier structure on the German property market.

High service and maintenance costs remained a challenge for the property management companies. While net rents (exclusive of heating) in Germany rose by only 7 % from 2000 to 2005, operating costs rose by 53 % during the same period. The demands on property management to counteract this effect are rising continuously in the commercial housing sector.

Group profitability

Operating income of € 160 million exceeded our target for the 2006 financial year.

Net interest income of € 389 million in the 2006 financial year was down 7.2 % on the previous year. This is due above all to lower risk-weighted assets, as a result of the accelerated reduction of exposures no longer in line with our strategy.

Loan loss provisioning of € 89 million corresponds to the forecasted target corridor of € 80-90 million.

Net commission income of € 145 million is lower than last year's figure of € 163 million; however, this figure still included the subsidiaries that have since been sold within the course of the adjustment of our investment portfolio.

Net trading income of € 13 million was largely attributable to the valuation of standalone derivatives, and expenditure for credit derivatives used for portfolio hedging.

The result from non-trading assets of € 66 million is largely down to the realisation of securities from the available-for-sale portfolio, and from the deconsolidation of subsidiaries. The valuation of properties held as financial investments posted a loss of € 12 million.

Administrative expenditure fell substantially by 9.6 % to € 356 million. This clearly reflects the successes of our realignment.

After taking into account net other operating income and expenses of € -8 million, operating income amounted to € 160 million in 2006.

The utilisation of a tax liability in the fourth quarter (discounted corporation tax credit from previous years) resulted in a total income tax expense of € 36 million in 2006.

Current income of € 1 million from the now-sold Aareal Asset Management GmbH and its subsidiaries is included in operating income, under results from discontinued operations.

After minority interest of € 18 million, Group net income stands at € 107 million. This is equivalent to a net return on equity of 10.1 %, and earnings per share of € 2.49.

Segment reporting

Structured Property Financing

Business development

In the 2006 financial year, we further extended our international presence in property financing, and successfully implemented our new location concept. Where appropriate, we have aggregated our sales resources across borders, thus enhancing the efficiency of our distribution network. The development and implementation of a new distribution strategy for the German market, especially through the appointment of key staff to strategically important positions, has led to a significant improvement in efficiency.

The aggregate volume of our new loan commitments was increased substantially during the 2006 financial year – by more than 40 %, from € 7.1 billion to € 9.9 billion, with international business accounting for roughly 84 %.

Scandinavia

We observed stable to slightly higher rental levels and rising property prices last year in Scandinavia. This is due to the high demand still evident from international investors for commercial property in the region. Besides Sweden and Denmark, Finland has also now established itself as a target market for international investors. Interest in Norway on the other hand is still relatively minor.

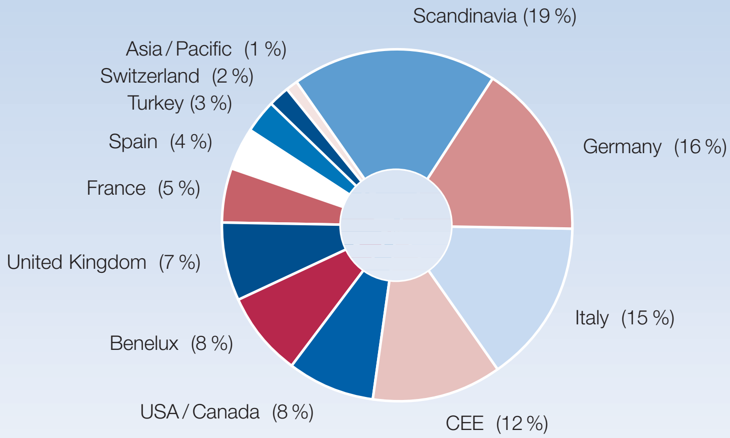
There is a trend for investors to view Scandinavia as a cross-border economic region. By implementing our Nordic hub in Stockholm, we have been able to anticipate this trend early on. New loan commitments have accordingly grown to more than € 1.9 billion.

Germany

The German market is focused mainly on the regions of Hamburg, Berlin, Cologne-Dusseldorf, Rhine-Main, Rhine-Neckar, Stuttgart and Munich. The long period of stagnation led to a sharp drop in rents and to high vacancy levels on the market for office property. The situation varies greatly from region to region. International investors have been very active for some years now. Whilst interest was initially centred on residential property portfolios, this trend has now extended to include all property types. This surge in demand, combined with numerous property sales by the public sector, has led to continuous turnover growth in the property market as a whole.

We are optimally positioned in Germany, with our four offices in Berlin, Hamburg, Munich and Wiesbaden. Here in Europe's largest economy, we generated the second-highest volume of new loan commitments

New business by region in 2006 (%)



(after Scandinavia) of € 1.6 billion in 2006; this equates to an increase of almost 60 % over the previous year.

Italy

Our offices in Rome and Milan provide optimum cover of the important property regions in Italy for domestic and national customers. Investment yields have declined in recent years in keeping with the trend in other European markets. Italy continues to attract international investors, however.

Vacancy rates are low to moderate.

Similar to last year, our good market position in Italy allowed us to achieve a high volume of new commitments in the year under review. At € 1.5 billion, Italy accounted for approx. 15 % of our new business.

Central and Eastern European Countries (CEE)

We have observed high turnover in office space and declining vacancy ratios, combined with stable rents, in the property markets of Poland, Slovakia and the Czech Republic. The return on property is converging increasingly towards that achieved in the other EU states.

Russia's property market is concentrated on the greater Moscow region and to a lesser extent on St. Petersburg. High demand and the scarcity of all types of modern properties has driven up rents. Vacancy rates are low. In terms of the volume of new rentals, Moscow is one of Europe's most active property locations.

We have achieved good market penetration in CEE, particularly in Poland, and substantially increased the volume of new loan commitments in the previous financial year to a total of € 1.2 billion.

Benelux

At just under € 0.8 billion, the volume of new business in the Benelux region is also strong. Overall, the Benelux countries are equally defined by stable rents and return on investments.

United Kingdom

Since the year 2000, initial yields in the United Kingdom have continued to decline on stable to slightly rising rents, especially in London and its top locations. The dynamic environment has attracted a large number of international investors to this market. During 2006, we increased our new loan commitments in this region by approx. 20 % over the previous year, to at least € 0.7 billion.

France and Spain

In France and Spain, shopping centres are particularly important due to the comparatively high level of consumer demand. Overall, rents are stable in these two markets with a tendency towards slightly lower returns on investment.

We committed to new financings of approx. € 0.5 and 0.4 billion in France and Spain respectively.

North America (NAFTA states)

We are also active in the world's largest property market. There is a trend towards falling vacancy rates in the US inner-city market for office property. Demand for office space has risen considerably in the major urban areas, and the construction of new office properties in selected local markets is on the increase at the same time. Investment yields in first-class locations are at historical lows. On the other hand, the demand for apartments in condominium ownerships, especially for expensive allocator projects, is easing somewhat. Vacancies in existing residential properties vary according to region, but in general they are low.

Occupancy rates in the hotel market are rising; the national average daily room rate is also higher.

The property market in Canada is characterised by very stable prices for residential property. We have also detected a rising presence of international investors in this market.

International investors are showing sporadic interest in Mexico. In the financial year under review, we provided support to existing customers in financing two resort hotels in the Gulf of Mexico.

At a good € 0.8 billion, the volume of new business in North America is on par with the previous year.

Asia / Pacific region

Direct investment in Asia by international investors continues to rise, with Japan and China accounting for more than 50 % of the flow.

During 2006, we started to expand our presence as a provider of property finance in the Asia / Pacific region, generating a good

€ 0.1 billion in new business. We provided financing solutions for an office property in China, a logistics property in Japan and resort hotels in Macao and the Maldives.

Pooling the resources of industry specialists nationwide

We combine our regional expertise with the knowledge of our industry specialists into an established network, providing financing for hotels, logistics and shopping centres. This enables us to support our clients with specialists from these sectors and propose tailor-made financing packages, in addition to our experience in office and residential property.

Network of regional market experts and sector specialists

Shopping centres

Aareal Bank further expanded its activities in retail property finance during 2006, focusing particularly on financing properties in the CEE markets and in Turkey. In co-operation with the decentralised country units, the bank generated approximately € 1.9 billion in new business.

Interest by international investors in retail property is still very strong. Falling returns on investment in almost all markets were seen at a primary as well as a secondary level. Retail sales and rents for top-class properties remain stable or are rising slightly. Besides the classic shopping centres, investors are also focussing on alternative investment products, such as retail parks and outlet centres.

Hotels

During the period under review, we concluded approximately € 1.4 billion of new business in hotel financing in 15 different countries.

The number of investors discovering this property segment has risen sharply, resulting in falling returns in most of the markets.

However, occupancy rates have risen further in almost all sub-markets and room rates were increased almost universally.

Logistics properties

Global economic growth is promoting the demand for logistics services and space. In addition to the traditional locations, we are also watching markets with development potential for logistics infrastructures for example, Russia, China or the CEE countries. We provide structured financing solutions for logistics properties in North America, Europe and Asia. Emphasis is on the growth regions in Central, Eastern and Southeast Europe (incl. Turkey and the Russian Federation), the core Western European markets and the Asian distribution hub.

During the 2006 financial year, our new logistics property financings amounted to almost € 1 billion.

Segment result

Net interest income in the Structured Property Financing segment amounted to € 340 million in the 2006 financial year. This equates to a decline of 11.2 % compared with the previous year, which is attributable mainly to the reduction of the German portfolio share no longer in line with our strategy. Net loan loss provisioning stands at € 89 million and therefore corresponds to the forecasted target corridor of € 80-90 million for 2006.

Net commission income in the financial year under review rose from € 27 million to € 33 million. We successfully reduced administrative expenses by 7.9 % against the 2005 financial year, to € 199 million. This was largely due to the cost-cutting measures taken, such as process optimisation, the project portfolio and the location strategy.

On balance, Structured Property Financing generated income before taxes of € 139 million, compared with losses of € 75 million the year before.

Consulting / Services

Institutional housing sector

IT systems business and consulting (Aareon AG)

Owing to a changing environment in the property management sector, the 2006 financial year was clearly marked by a forward-looking strategic realignment of Aareon, which aims to provide a product strategy designed to meet the customers' requirements, growth in profitability and a consequent strengthening in Group profitability.

In order to achieve this objective, revenues are set to increase by improving the level of service provided to existing customers and acquiring new customers at the same time. Various cost-cutting measures – such as exploiting Group synergies and efficiency improvement measures – were also implemented. The realignment of the product range and the advanced migration of the Blue Eagle system will lead to higher profitability.

The changes in the property management sector are increasingly heightening the heterogeneous demands placed by customers on an IT system. Aareon reacts to this situation with a differentiated product strategy.

The new multi-product strategy provides various software solutions to meet the customers' complex requirements:

- **Blue Eagle**, the SAP-based premium product;

- **GES**, the tried-and-tested ERP system;

- the in-house solution **WohnData**; and

- **Wodis**, the solution for SMEs.

Product life cycles of legacy systems GES ERP and WohnData were extended in the course of the new strategy. The premium solution – Blue Eagle – is particularly suitable for companies with complex and individual requirements of an IT system.

Aareon's software services are complemented by product line integrated services, which include the integrated payments service and the interest-based services platform Mareon.

The subject of rising ancillary rental costs currently dominates the property management sector. This challenge is forcing the property management companies to take innovative measures. Processes must be organised in such a way that is both cost-efficient as well as service-oriented in relation to the tenants.

In June, Aareon therefore agreed to enter into a strategic partnership with Techem AG, Eschborn. Within the scope of this partnership, the companies exchanged the business areas Aareon Energiemanagement and Techem IT Services GmbH. The former Techem IT Services GmbH was integrated in October in the Aareon group as Aareon Wodis GmbH. This allowed Aareon to include the Wodis software solution in its portfolio, acquiring roughly 350 new customers as a result.

All in all, approx. 6.3 million rental units were being managed in Germany through the Aareon ERP systems as at year-end 2006.

In view of the changes in market requirements, the organisational structure was aligned to match products in November. This had the effect of optimising the management structure and organisational units. These changes resulted in approximately 100 staff reductions during 2006.

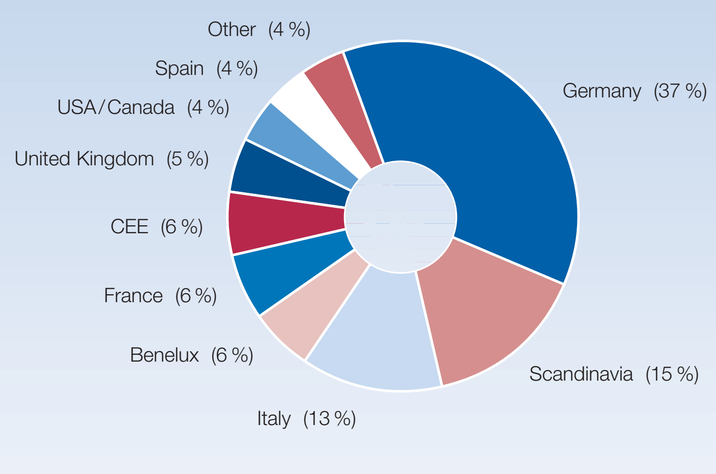
Payments and deposit-taking

In the 2006 financial year, we successfully concentrated on our core systems in the payments business alongside a customer-oriented review of services to be rendered.

We also further increased our sales activities in this area of business, having redefined its interface to the bank's back office. This led to staff reductions, as well as achieving a considerable reduction in the use of external resources.

The initial successes of the measures are already evident in the acquisition of new customers and rising deposits. On a monthly average, deposits were around € 4.4 billion in 2006.

Property financing portfolio by region as at 31 December 2006 (%)



Segment result

The segment result of Consulting / Services in the 2006 financial year is characterised mainly by the strategic realignment.

Net commission income in the financial year totalled € 167 million. The previous year's figure of € 177 million still included around € 20 million in net commission income from two subsidiaries, Aareal Hypotheken-Management GmbH (AHM) and Aareal Hypotheken Vermittlungs GmbH (AHV), which were sold in the meantime.

Results from non-trading assets of € 14 million include € 11 million of gains realised upon the exchange transaction concluded with Techem AG.

Administrative expenditure was also reduced by approx. € 20 million from the sale of the aforementioned subsidiaries AHM and AHV. Administrative expenditure was reduced in the year under review by a total of € 22 million to € 164 million, although this figure already includes (to a large extent) the costs incurred for the restructuring of Aareon.

Overall, the Consulting / Services segment generated operating profit of € 21 million in the 2006 financial year, after incurring a loss of € 7 million the year before.

Financial situation

Total assets

Aareal Bank's consolidated total assets as at 31 December 2006 amounted to € 38.3 billion, after € 39.2 billion as at 31 December 2005.

Financial situation

Property financing portfolio

The volume of Aareal Bank's property financing under Management stood at € 22.8 billion as at year-end 2006. This equates to a fall of 7.8 % compared with 31 December 2005, attributable to two highly contrasting factors, which are described below.

We increased the volume of international financings by 9.6 % in 2006, thus further enhancing the regional diversification of the overall portfolio.

On the other hand, we targeted a further reduction of the share of our German portfolio no longer in line with our strategy; this was achieved in particular through the successful conclusion of two NPL transactions. The German property financing portfolio was reduced by a total of 27.3 % to € 8.5 billion. Germany thus accounts for only 37 % of the overall portfolio, down from 47 % as at 31 December 2005.

Of the overall loan portfolio held by Aareal Bank, € 16.1 billion was attributable to commercial property finance and € 6.7 billion to residential housing finance as at 31 December 2006.

Portfolio management and exit strategies

Our Credit Treasury team uses syndicated loans and securitisations to manage our property financing portfolio.

As part of our exit strategy for non-performing loans, during the year under review we concentrated on the structuring and sale of NPL portfolios.

In the year ahead, we will expand the active management of our loan portfolio by setting up a separate unit.

Reducing the NPL portfolio

Following our debut with two successful true sale transactions in 2005, we sold a third portfolio of non-performing loans at the start of 2006. The total volume of this third transaction was € 345 million including interest and fees of € 80 million.

We sold our fourth, and to date, largest NPL portfolio in September 2006 – with an aggregate volume of approx. € 1.4 billion, including interest and fees. Our target to reduce the NPL to below € 1 billion by the end of 2006 was therefore already exceeded before year-end. These portfolio transactions and individual workout processes enabled us to reduce the NPL portfolio from € 2,085 million as at 31 December 2005 to approx. € 643 million.

Synthetic securitisation and syndication

As at 31 December 2006, the volume of Aareal Bank's financing solutions placed in the market via securitisations amounted to € 4.5 billion, compared with € 6.6 billion as at 31 December 2005.

We syndicated lending volume in excess of just under € 400 million during the period under review.

Refinancing

Refinancing structure

Aareal Bank refinances its lending activities on the capital market mainly in medium-term maturities, which it complements with long-term measures. It refinances its money market activities through customer deposits and interbank transactions.

Aareal Bank benefits particularly from the new German Pfandbrief Act (Pfandbriefgesetz), and increasingly uses asset-covered bonds to refinance its international loan portfolio. In the medium term, it will increasingly exploit the possibilities of the new German Pfandbrief Act to boost the share of Pfandbriefe in its refinancing mix. The cover assets pool of Aareal mortgage bonds is broadly diversified, including properties from 15 countries. Pfandbrief issues are therefore an important instrument for Aareal Bank Group in its efforts to explore a new range of investors, and to reduce its refinancing costs. New investors, especially in Europe, are attracted to asset-covered bonds, in particular jumbo Pfandbriefe owing to their liquidity and quality.

Aareal Bank is an active issuer of uncovered promissory note loans, registered bonds and bearer instruments.

Aareal Bank's MTN programme is an internationally recognised documentation framework for securities issues. Sized at € 10 billion, the MTN programme allows drawings in subordinate, uncovered debt securities, as well as in mortgage bonds and public-sector covered securities, in all the required currencies and structures.

Settlement of payment transactions for commercial housing clients generates residual current account balances and term deposits of over € 1 billion or over € 3 billion respectively on a monthly average. The volume has been stable and rising slightly over recent years.

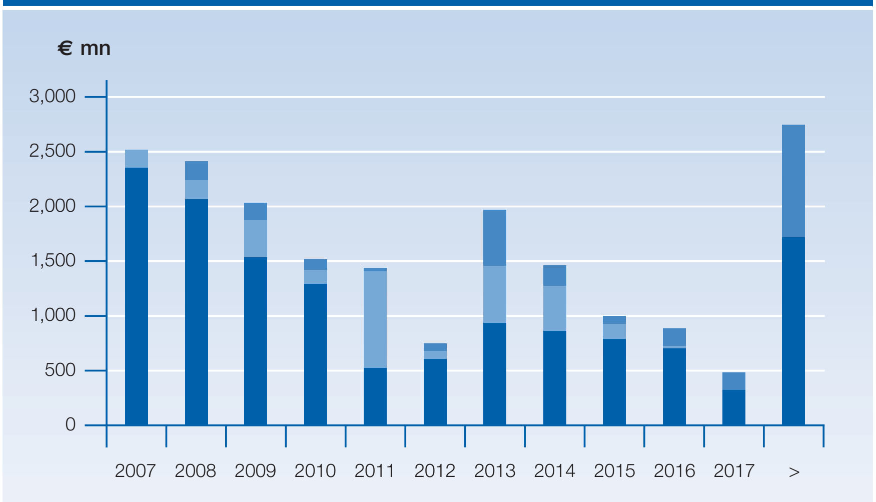
A € 5 to 10 billion portfolio of liquid, high-quality securities serves as the liquidity reserve, thus facilitating the generation of large-volume short-term liquidity, depending on the situation.

New issues

Aareal Bank successfully expanded refinancing activities on the capital markets, having expanded its investor base both nationally and internationally.

It raised approx. € 4.6 billion in long-term funds in 2006 (including Aareal Bank's debut € 1 billion jumbo mortgage Pfandbrief and € 275 million in public bearer bonds). The majority of private placements (more than € 2.8 million) were issued in the form of registered securities, including promissory note loans and registered mortgage bonds. Furthermore, approximately € 500 million in bearer bonds (mainly MTNs) were placed on the capital markets.

Maturity structure of the long-term refinancing mix as at 31 Dec 2006



We managed to further reduce funding costs, for example, by expanding the share of Pfandbriefe and demand-oriented, structured interest rate products in the funding mix.

The increasing degree of internationalisation in Aareal Bank's capital market activities is obvious. The international share of 55 % of allocated orders for the successful debut jumbo Pfandbrief issue were attributable to investors from 13 different countries. We also target new investor groups through Pfandbrief issues denominated in the currencies of our cover assets pool, which is diversified internationally. Aareal Bank issued Pfandbriefe denominated in US dollars and Danish kroner within the scope of private placements during the year as a whole. Following an extensive roadshow in Scandinavia, we successfully issued a debut Aareal Bank benchmark Pfandbrief in Swedish kroner.

Regulatory indicators

Upon confirmation of the financial statements, Aareal Bank Group's liable capital in accordance with section 10a of the German Banking Act totalled € 2,436 million, of which core capital accounted for € 1,471 million. The capital ratios according to the German Banking Act (Grundsatz I) stood at 8.3 % (after 8.4 % on 31 December 2005) for the core capital ratio and at 13.5 % (14.5 %) for the total capital ratio. Aareal Bank Group's risk-weighted assets according to the German Banking Act amounted to € 18,044 million. This figure includes € 225 million in assets exposed to market risk.

When measured according to Bank for International Settlements (BIS) rules, the core capital ratio (upon confirmation of the financial statements) was 7.3 % (31 December 2005: 7.2 %) and the total capital ratio 12.1 % (12.6 %), based on core (tier 1) capital of € 1,406 million, and risk-weighted assets of € 19,477 million (including € 225 million in assets exposed to market risk).

Report on material events after the reporting date

An agreement was reached with DEPFA Deutsche Pfandbriefbank AG (DEPFA) at the start of 2007 with regard to offsetting the effects arising from the completed tax audit of a subsidiary. This applies to a participation transferred to Aareal Bank within the scope of the split of the former DePfa Group, and will be recognised in 2007 when some conditions precedent that have to be met exclusively by Aareal Bank have been fulfilled.

Outlook

Interhotel Group, in which Aareal Bank holds a beneficial interest of approx. 33 %, has concluded an agreement to sell its properties held in subsidiaries, together with related operating SPVs. From this, Aareal Bank expects total income in the double-digit million euro range, which it will recognise – upon realisation of profit by Interhotel Group – in its IFRS consolidated financial statements for 2007.

Development of the environment

In view of the high degree of liquidity on the markets, we can expect a positive economic climate and a favourable investment climate again in 2007. The five leading central banks believe that we can expect a positive growth trend for the global economy in 2007 for the fifth consecutive year.

This assessment is in line with the expectations of the International Monetary Fund (IMF), which is forecasting growth of 4.9 % for 2007.

International property markets

We are forecasting that property prices will at least remain stable. The risk of a setback in property prices will be countered by continually placing the sustained cash flow stability of the charged properties at the core of our lending decisions and our credit monitoring.

We expect rents in **Scandinavia** to remain constant or to rise slightly in the short- to medium-term.

We are forecasting higher sales growth on the German property market and believe **Germany** is about to enter a phase of higher rents, albeit in individual market segments rather than across the board.

Rents should be stable in **Italy** this year. The change announced in the taxation framework is fuelling uncertainty among international investors and will tend to lead to higher rental yields, so that property prices could come under slight pressure.

We are forecasting stable to slightly rising rents in **CEE** for Poland, the Czech Republic and Slovakia. We also expect the yield differential relative to Western European countries to remain unchanged until the EU accession states have been largely integrated and have introduced the euro as their currency.

The **North American market** should continue to attract large numbers of international investors; rents and property prices should remain stable or rise slightly. We are planning to substantially increase business volumes in this region over the next three years.

Based on our belief that the environment in the **Asia / Pacific region** should develop favourably in the long term, we want to step up our commitment in a visible and targeted manner, above all in China and Japan, within the framework of our growth strategy.

Corporate development

The successful conclusion of our realignment has created a solid base for our operations. Aareal Bank Group's core objective for the next three years is profitable growth within our Structured Property Financing and Consulting / Services segments.

We plan to substantially develop our new business in the Structured Property Financing segment over the next three financial years, whilst maintaining the current risk / return ratios. We are also expecting fewer high early repayments in our loan portfolio in the years ahead. We are forecasting overall organic portfolio growth to average at 8 - 10 % per annum up to 2009, on slightly rising average maturities.

We will counter the risk of greater competitive pressure – and a decline in the portfolio through continued high early repayments – by targeting investments in particular market units in North America and Asia. This represents a part of our growth strategy for the next three years, which we have designed to immediately follow the six-point programme. We will establish a loan portfolio management unit to meet the higher requirements these investments place on the management of our loan portfolio.

The realignment strategy initiated in the period under review should be followed by a significant increase in the income generated by the Consulting / Services segment. Targeted cost-cutting measures will make a significant contribution here. On the other hand, we plan to contribute € 40 - 50 million to Aareal Bank's profit before taxes as early as the 2008 financial year through Aareon's product portfolio – which is differentiated to meet the individual requirements of our customers and the associated rising volume of deposits.

This forecast is reflected appropriately in the business risks. We are confident that we can achieve this goal.

This comprehensive growth strategy is geared towards gradually increasing the operating profit and net RoE of the Aareal Bank Group during the period up to 2009. Within this context, Aareal Bank Group aims to achieve net RoE of between 12 % and 13 % by the year 2009.

Risk report

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 success factor in a competitive environment. Besides this purely economic motivation for a state-of-the-art risk management system, regulatory requirements have been increasing as well. It was against this background that we continued to develop our risk management system, allocating significant resources, during the financial year under review.

Areas of responsibility for risk management and monitoring

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

The diagram shown on the following page provides an overview of the responsibilities assigned to the respective organisational units.

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. When monitoring

Areas of responsibility for risk management and monitoring			
Overall responsibility: Management Board and Supervisory Board of Aareal Bank AG			
Type of risk		Risk management	Risk monitoring
Market price risks		Treasury; Dispo Committee	Risk Controlling
Liquidity risks		Treasury	Risk Controlling
Credit risks	Property Finance Individual exposures	Credit Management	Risk Controlling, Credit Office
	Property Finance Portfolio risks	Credit Management, Credit Office	Risk Controlling
	Transactions with financial institutions	Treasury; Counterparty and Country Limit Committee	Risk Controlling
	Country risks	Treasury, Credit Management, Counterparty and Country Limit Committee	Risk Controlling
Operational risks		Process owners	Risk Controlling
Specific risk exposures subsidiaries		Corporate Development	Risk Controlling, Corporate Development, Controlling bodies
Process-independent monitoring: Internal Audit			

the risks generally associated with banking business, the bank does not differentiate between the individual subsidiaries having incurred these risks.

Since the risks the Consulting / Services segment is exposed to differ profoundly from those of the banking business, specific risk monitoring methods have been developed and deployed to suit the relevant risk exposure at the respective subsidiary.

In addition, risk monitoring for these subsidiaries is carried out via the relevant control bodies and the Investment Risk Control unit, which was further developed during the financial year under review.

Risk situation at the Aareal Bank Group

The table on page 52 summarises our risk profile on the basis of regulatory requirements and economic risk capital allocation.

Risk situation and risk management at the Aareal Bank Group

The business policy set by the Management Board, and approved by the Supervisory Board, provides the conceptual framework

Risk situation at the Aareal Bank Group	31 Dec 2006	31 Dec 2005
Key figures calculated in accordance with the German Banking Act (KWG)	**€ mn**	**€ mn**
Core capital ratio (Tier 1)	8.3 % [2]	8.4 %
Risk-weighted assets	17,819	16,152
Credit equivalent amount from market risks	225	138
Total risk exposure	**18,044**	**16,290**
Tier 1 capital	1,471	1,363
Liable capital	2,436	2,359
Core capital ratio according to BIS rules [1]	**7.3 % [2]**	**7.2 %**
Risk capital	**€ mn**	**€ mn**
Credit risks	674	606
Market risks	86	88
Operational risks	61	64
Other risks / risk buffers	231	204
Aggregate risk capital allocation	**1,052**	**962**

[1] The ratio was calculated in accordance with the definitions by the Basel Committee. No agreement regarding the determination of the ratios has been concluded with the German Federal Financial Supervisory Authority (BaFin).

[2] After confirmation of Aareal Bank AG's financial statements 2006; the inclusion of retained earnings transferred as part of Aareal Bank AG's liable equity capital as at 31 December 2006 is subject to approval by the Annual General Meeting.

for risk management. Taking this as a basis, and strictly considering the bank's risk-bearing capacity, we have formulated detailed strategies for managing the various types of risk, which are designed to ensure risks are dealt with consciously and professionally. Accordingly, these strategies include general policies, to ensure a uniform understanding of risks across all parts of the bank, and to provide a cross-sectional, binding framework applicable to all departments. In line with the overall business strategy, risk strategies are revised at least once a year, and are approved by the Management Board.

Risk-bearing capacity and risk limits

The bank's ability to carry and sustain risk – which is defined by the amount of aggregate risk cover – is a core determining factor governing the structure of its risk management system. Aggregate risk cover is defined as the core capital (tier 1 capital) in accordance with the BIS definition, plus the budgeted net income before taxes. We have deliberately opted for a very conservative definition of aggregate risk cover; the calculation does not include additional funds such as supplementary and subordinated capital, and existing reserves. The aggregate risk cover is updated at least once a year, and additionally in the event of significant changes occurring.

We have thus implemented a system based upon limits that are differentiated according to the type of risk, with limits set in a way so as to ensure Aareal Bank's ability to bear risk at any time. We employ a limit system incorporating two harmonised perspectives: on the one hand, limits determined according to the value-at-risk method limit the risk for the individual risk categories. On the other hand, we use a system of nominal limits in the lending business (e.g. country limits, counterparty limits, construction phase limits) and for market price risk (e.g. stress limits).

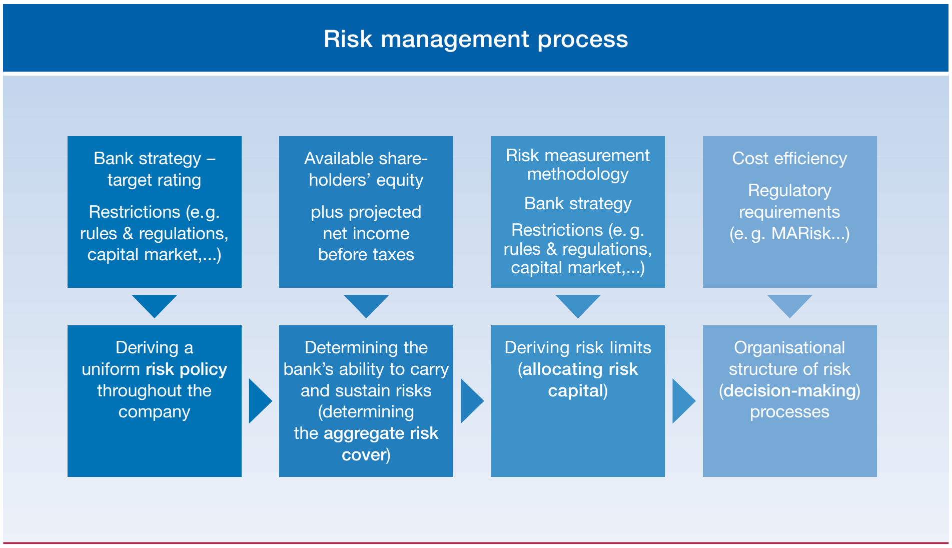
The chart below illustrates the relationship.

Ongoing development during the financial year under review

We continued to develop and refine our risk management methodology and procedures, in a targeted manner, during the financial year under review. Specific measures included implementing the Minimum Requirements for Risk Management, and the Investment Risk Control unit.

Implementing MARisk

The German Federal Financial Supervisory Authority ("BaFin") published Minimum Requirements for Risk Management ("MARisk") at the end of 2005. Designed to replace the former Minimum Requirements for the Credit Business of Credit Institutions ("MaK"),



Minimum Requirements for the Trading Activities of Credit Institutions ("MaH") and Minimum Requirements for Specifications of the Internal Audit of Credit Institutions ("MaIR"), MARisk have introduced certain additional requirements for banks' internal management and control processes. Such additional requirements, which include regulations governing the risk-bearing capacity, and regarding the management of liquidity risk and operational risks, have become mandatory for all banks subject to the German Banking Act since 01 January 2007. We implemented the MARisk, including the newly-introduced requirements, during the year 2006, within the scope of a major internal project.

Investment Risk Control

Aareal Bank Group's risk exposure is 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, which we include in our centralised risk management system through an Investment Risk Control concept. For this purpose, Investment Control conducts regular audits of all relevant Group entities, reviewing and assessing their risk situation in detail. The results are submitted to the Management Board of Aareal Bank AG, within the framework of ongoing risk reporting.

The following chapters of this Risk Report offer a detailed explanation of the types of risk that are relevant to Aareal Bank's business.

1. Structured Property Financing

1.1 Credit Risks

1.1.1 Credit Risks in the Property Finance Business

Credit risks in Aareal Bank Group's property finance business are related to a deterioration in the borrower's credit quality, a loss in the value of collateral, or risks upon disposal of the financed property. Credit risk materialises where a financing partner's economic situation deteriorates, or where this partner cannot meet its contractual obligations fully or in time. Collateralisation risks result from the threat of a loss in value of collateral, which can occur through property-specific or market-induced factors. The financed property can be subject to risks arising during completion, renting and / or sale.

Risk management on an individual transaction level

Risk management in Aareal Bank's lending business analyses, monitors and manages the risks involved during the completion phase of the financed property, as well as the medium- and long-term risks arising from a deterioration in credit quality or loss in collateral value. Every financing transaction is based on planning agreed upon in advance. The bank is compensated for this imputed risk, measured according to the planned financing structure, with an appropriate pricing premium.

Risk management recognises and evaluates negative deviations from the plan, allowing it to minimise the potential risks by taking appropriate countermeasures. The differentiated early warning systems and management tools employed by the bank are specifically designed for the particular features of the commercial property lending business.

Early warning system and management tools employed in the completion phase of the financed property

Risk management during the completion phase is aimed at making risks transparent and manageable.

In particular, this requires the continuous monitoring of risks, and quantifying them using rating procedures. Accordingly, the rating system is a key tool for supporting the lending decision (as discussed below).

Moreover, we ensure that disbursement is made after the agreed collateral is pledged, after fulfilment of further conditions for payment, and according to construction progress. Periodic disbursement checks are carried out for this purpose.

The new rating procedure as an early warning system and management tool

During the financial year under review, the bank made extensive use of the new rating procedure (implemented in 2005), which is geared towards the specific requirements of Basel II. The key elements of this rating procedure are outlined below.

The property rating evaluates property-specific indicators and qualitative aspects. As the fundamental basis of property rating, the future ability to cover interest and principal payments is determined as part of cash flow planning (identifying cash flow surpluses or shortfalls) and, if applicable, the risk associated with the completion and/or marketability of the properties financed. In addition to these quantitative data, qualitative aspects are also taken into consideration, in particular the projection regarding future cash flow developments.

The corporate rating evaluates adequate ratios (particularly regarding profitability and financial situation) on the basis of the last financial statements as well as qualitative aspects regarding the company, such as its internal structures, sales capability and the quality of its management. The new rating methodology also includes variations for borrowers from property-specific industries as well as for other companies.

The impact of the property rating / corporate rating on the final rating is always determined on the basis of the share of the relevant company's investments financed by the bank, and detailed information available on the company's assets. If available, the rating also takes into account an assessment of the group background and any special factors reflecting certain specific features of the company or the financing.

In addition, the collateral provided has an impact on the rating result, with the collateral being evaluated with regard to its individual value (and absence of impairment) and estimated fluctuations in that value (e.g. as a result of property cycles), using different criteria (such as property location / type).

Early warning system and management tools employed during the loan term

To monitor the credit quality of its financing counterparties (such as borrowers or guarantors), the bank employs standardised tools such as periodic monitoring, ratings, portfolio reporting, etc. during the entire term of the loan. The results of these checks are taken into account in the rating. If the credit rating is downgraded, the bank routinely implements measures to either maintain risks at an acceptable level, or to reduce them.

Collateral is checked for impairment on a regular basis, in line with applicable provisions, and the rating adjusted in the event of significant changes.

Lending exposure is also subject to a continuous IT-based monitoring process (depending on a classification in terms of risk and size), which is conducted in regular intervals, to report on and manage any major changes involving the exposures. The rating is also checked and adjusted if necessary on an annual basis. In the event of major market fluctuations, portfolios or sub-portfolios are monitored independent of their individual risk content.

Handling of exposures identified as subject to higher risk exposure by the early warning system

Depending on their risk content, loans identified by the bank's early warning system as being subject to higher risk exposures are classified either as ”on watch“ or ”risk prevention“.

”On watch“ exposures are loans in regard to which a deterioration of the risk indicators is still within a reasonable range from a risk perspective, i.e. no sustained risk exposure is foreseeable and the loans remain under observation. The ”risk prevention“ category contains exposures having a sustained risk that are subject to close supervision.

In the event of a restructuring of loans, or of recovery procedures, any further handling of the exposures in question is transferred to the Workout unit. For all loans identified as high risk, the monitoring frequency is tightened accordingly. The IT-based allocation enables continuous portfolio monitoring.

Collateralisation

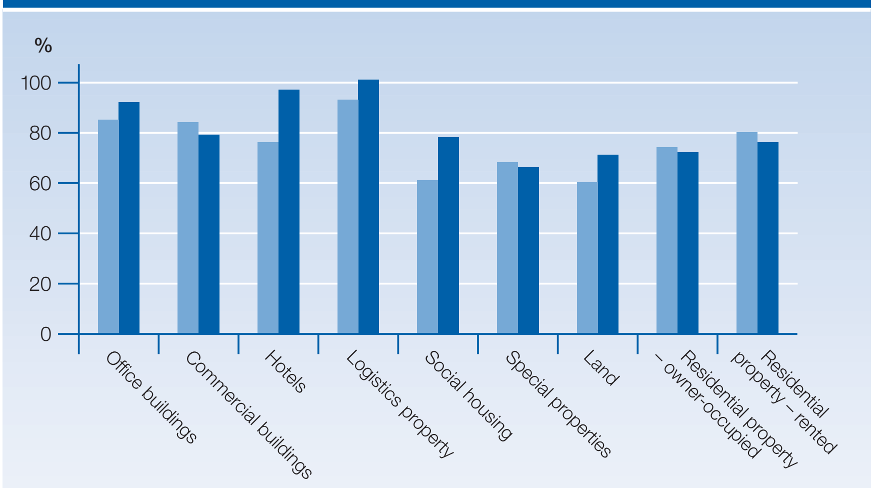
Over the last three years, the volume-weighted loan-to-value ratio for the entire property portfolio (performing loans) was between 77 % and 78 % of the mortgage lending value for German business, and between 73 % and 83 % for international business.

Risk provisioning

Using guidelines that are applicable to the property finance business throughout the Group, the bank calculates the potential risk of default for individual cases and sets aside appropriate specific loan loss provisions. Particular consideration is given to the change in property prices in different sub-markets and the market value adjusted to the current financial position. Value adjustments recognised at a Group portfolio level are determined using historical default data. The risk parameters used for calculation are primarily based on the average loan-to-value ratio of the Group's property financing portfolio, which is determined at regular intervals.

Following the split of the former DePfa Group, DEPFA Deutsche Pfandbriefbank AG relinquished legal responsibility, to a certain extent, for the future performance of the property finance business to Aareal Bank AG. In cases where Aareal Bank has not already assumed liability for property loans, it is responsible for the management thereof under the Agency Agreement entered into.

Loan-to-value ratio (volume-weighted, based on lending value), by property category



Risk management from a portfolio perspective

We understand credit risk management as the identification, measurement and subsequent management of risks at a portfolio level. The bank continued to expand and refine its risk management toolkit during the period under review. Specifically, this included implementing procedures to determine risk parameters introduced within the Basel II framework: PD (probability of default) and LGD (loss given default).

Since 2001, one of the main tools for managing credit risk arising from the property finance business has been the analytical credit risk model used in the bank. Based on this model, the bank's decision-makers are informed on a quarterly basis of the performance of large-sized property finance exposures and of their risk content. Utilising this model means we have already met most of the requirements of the Basel Committee on the identification, assessment, monitoring and management of credit risk concentrations.

The evaluation of portfolio risks on a value-at-risk (VaR) basis differentiates between expected and unexpected loss. Expected loss reflects the average loss that is anticipated for a one-year period on the basis of the historical data. Unexpected loss, which is also referred to as credit value-at-risk ("CVaR") states the amount of economic equity capital that must be available to cover losses over and above the expected loss.

Besides the EAD (exposure at default), LGD and PD parameters, correlation effects within the sub-portfolios that arise from the portfolio composition are also taken into account through determining so-called "sectors" when calculating the portfolio risk. Allocating financing solutions to the same sector reflects joint economic dependencies.

The ratio between unexpected and expected loss is used as a key variable for the risk content of individual segments within the portfolio. Individual segments can be compared on the basis of this variable. We use confidence levels of 99.90 %, 99.95 % and 99.99 % to calculate the CVaR.

The main risk contributors can be identified by determining the extent to which each individual financing transaction contributes to the VaR of the portfolio under observation. The impact of the main risk contributors on the overall portfolio risks is determined by analysing the concentration risk.

Furthermore, the portfolio assessed is analysed by type of property finance and by country, which can identify risk concentrations in individual markets. Additionally, the hypothetical elimination of the main risk contributors permits a simulation of their impact on the portfolio as a whole.

The effects of a more volatile economy are examined using a stress test. For this purpose, the volatilities of the probabilities of default are intensified and the loss ratios of the financings are increased. During a further stress test, the ratings of the financings contained in the portfolio are downgraded by one notch.

The changes to the portfolio structure and to the VaR that arise during a given observation period are illustrated in a separate analysis.

1.1.2 Counterparty Risks of Financial Institutions

We define counterparty risk in relation to financial institutions as the potential losses in value or foregone profit, which may occur through unexpected default or deterioration of the credit quality of trading counterparties with whom the bank has entered into securities transactions, money market, interest rate or currency derivatives, as well as securities repurchase transactions.

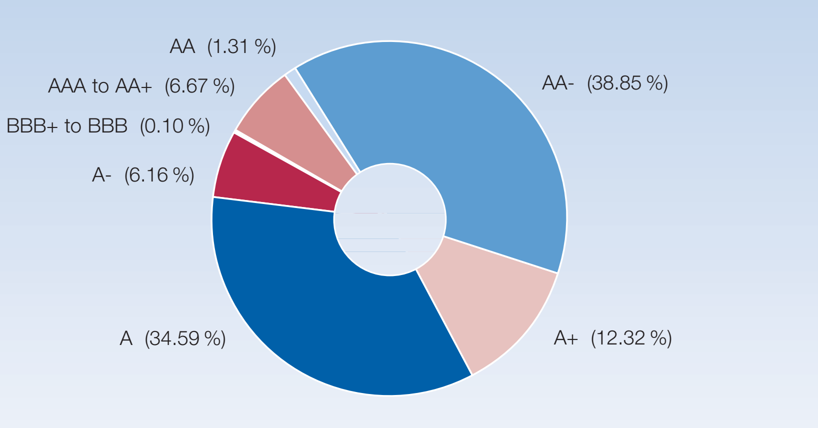
The individual credit quality assessment of the bank's counterparties is particularly important to the approval, monitoring and management process. An internal rating process is therefore employed for financial institution counterparties. This process, which complies with the requirements set out by the Basel II accord (IRB approach), allows all financial institutions to be reliably classified in internal rating classes, taking into consideration both quantitative and qualitative data. The internal ratings can be compared with those of the external agencies by means of the default probability associated with the rating classes.

The choice of counterparty in trading with financial institutions generally remains geared towards names with first-class ratings.

The graph below illustrates the classification of counterparties in internal rating classes, according to the volume of business.

Counterparty-specific credit exposure risk is monitored through a limit system applicable throughout the bank that is directly linked to the Treasury front office system, and which provides real-time information on limits and limit utilisation. Internal ratings are used to determine counterparty limits in the Treasury business. All limits are subject to an annual review process. Should a counterparty's internal rating deteriorate during the course of a year, the limit will be reviewed and, if necessary, reduced. In addition to the overall counterparty limit, Aareal Bank's limit system provides for separate sub-limits for replacement risks, the risks associated with outstanding delivery, covered bonds (Pfandbriefe) and guaranteed as well as non-guaranteed securities.

Classification of counterparties by internal rating class (weighted by business volume, in %)



Limit compliance is monitored through the Risk Controlling unit, which submits regular reports on limit utilisation, internal rating changes, and any breaches of limits to the Management Board. Furthermore, a multi-stage procedure of escalation ensures that infringements of limits are reduced in good time.

Existing netting master agreements and collateral agreements are taken into account when determining the credit risk exposure related to derivatives. In this way, counterparty risk is adequately captured, whilst reducing both the level of required capital cover and the utilisation of the bank's internal counterparty limits.

Counterparty risk in interbank trading at a portfolio level is monitored and managed using a credit risk model, from which both the expected and unexpected loss is derived (credit value at risk or "CVaR"). This model also incorporates concentration and diversification effects. CVaR corresponds to the maximum amount by which the actual loss can exceed the anticipated loss for a given confidence interval.

CVaR limits are defined in line with the analysis of the bank's capability to carry and sustain risk. The Risk Controlling unit is responsible for monitoring compliance with trading limits for financial institutions, and for reporting regularly to the Management Board.

1.1.3 Country Risks

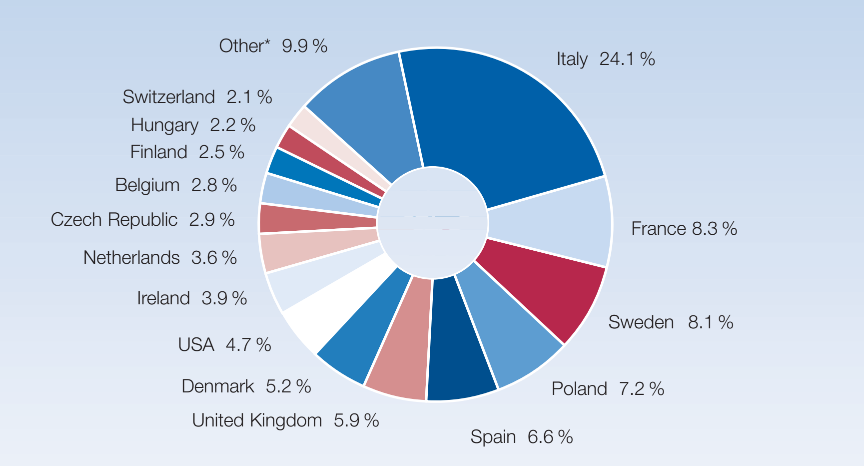
When defining country risk, in addition to the risk of sovereign default or default of state entities, Aareal Bank also considers the risk that a counterparty could become unable to meet its payment obligations as a result of government action, despite being willing and able to pay, due to restrictions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

With the main focus of the business being on the member states of the European Union and North America, exposure is concentrated in countries with very low risk potential. Geographical diversification and the avoidance of concentration risks are therefore of greater importance to us, from the bank's overall perspective, than the observation of transfer risks. The system for managing country risk, utilised within the overall management of the bank, was designed in such a way that it takes both criteria into consideration.

For financings in countries being subject to latent transfer risks, Aareal Bank has taken out transfer risk insurance.

Country risk management is conducted by various units within the bank. The Counterparty and Country Limit Committee carries out a risk assessment of the relevant coun-

Breakdown of country exposure – international business (%)



** Country exposure of less than 2 %*

tries, grades them in country risk groups, and conducts an annual review in terms of country rating. The limits are set by the Management Board. The Risk Controlling unit is responsible for the continuous monitoring of country limits and for reporting on limit utilisation.

In addition to monitoring the bank's international exposure, internal limit monitoring reports utilisations for the bank's domestic business, broken down by Federal states (Länder).

The adjacent chart illustrates the risk exposure by country in the bank's international business, at year-end. It reflects the exposure of the property lending business, as well as the activities of Treasury.

1.2 Market Risks

Market price risk is broadly defined as the threat of losses due to changes in market parameters. Aareal Bank's market price risk exposure predominantly comprises interest rate risks, whilst currency risks are largely eliminated through hedges. Risk exposure from equities and similar holdings hold lesser importance, whereas commodity and other price risks are irrelevant for the bank's business. Hence, the primary market price risk exposures are related to the following risk parameters: interest rates, equity prices, exchange rates, and implied volatilities.

All relevant parameters are covered by our management and monitoring tools. Aareal Bank Group's market risks are managed by Treasury and monitored daily by the Risk Controlling unit.

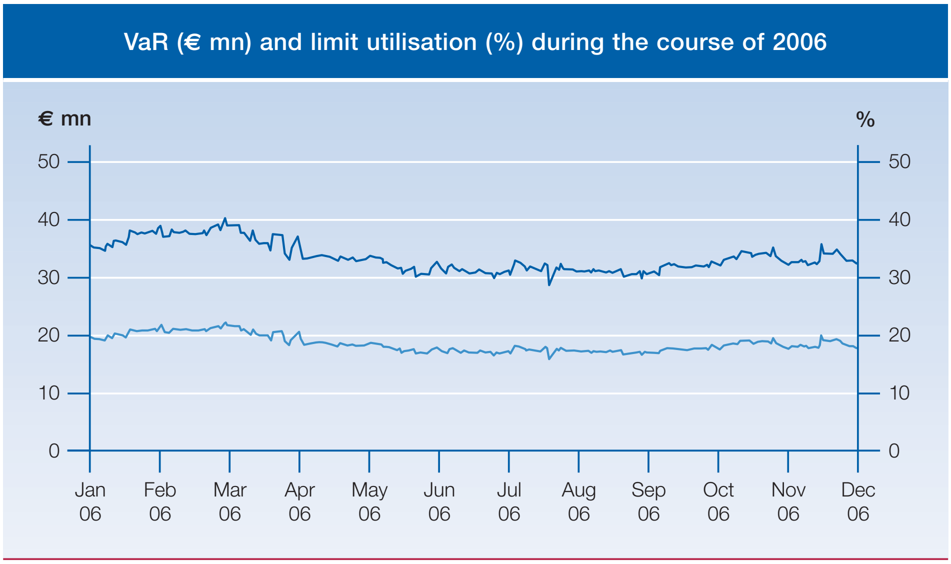
Up-to-date reporting to management on the Group's risk profile provides the basis for all short-, medium- and long-term investment decisions.

Risk Controlling uses a variety of methods and tools to quantify and analyse market price risks.

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

Aggregate VaR – Aareal Bank Group

Risk limit utilisation



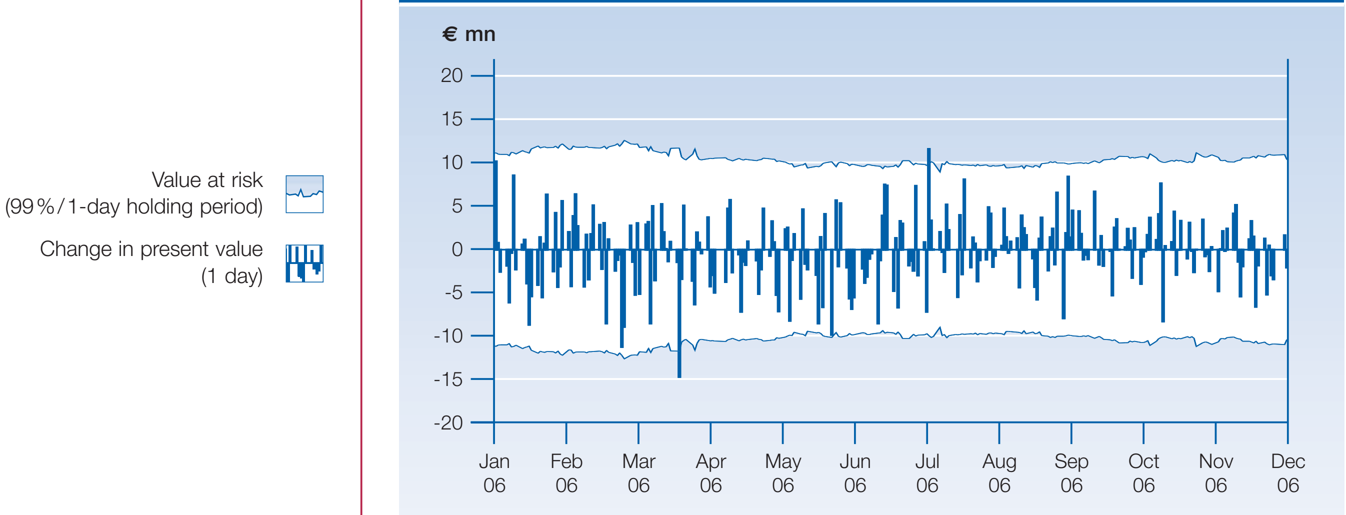
financial transactions. This absolute amount, expressed in euros, indicates the potential loss incurred before counter-measures take effect. Since this is a statistical approach, the forecast for the potential loss that may be incurred within a specific period of time is for a given confidence interval only.

A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. Determined on a daily basis for the Group and all its operating units, it takes into account the correlation between the individual types of risk. The statistical parameters used in the VaR model are calculated on the basis of an in-house data pool over a period of 250 days. The loss potential is determined applying a 99 % confidence interval and a ten-day holding period. 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.

The highest VaR figure recorded for the 99 % confidence level and a 10-day holding period in the financial year 2006 was € 40.2 million on the 2nd of March. The low of € 28.6 million was recorded on 21 July.

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

Present values and 1-day VaR during the course of 2006 (€ mn)



(known as "clean backtesting"). In line with the selected confidence level of 95 %, only a small number of events are expected to break out of the VaR projection (< 5 for a 250-day period). The number of negative outliers was always lower than 1 during 2006, affirming the high forecasting quality of the VaR model we use.

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

Aareal Bank calculates present value fluctuations both on the basis of real extreme market movements over recent years (German reunification, Asian crisis, 11 September 2001, etc.), and also using simulated market movements (parallel shifts, structural changes, steepening of the yield curve). This analysis requires that all positions are revalued fully on the basis of these market scenarios. Within the scope of weekly and monthly reporting, the resulting impact on present value is compared to a special stress limit. No breach of set limits occurred during 2006.

An additional instrument used to quantify interest rate risk exposure is the calculation of interest rate sensitivity, expressed by the

”delta“ parameter. The first step to determine this parameter requires calculating the present values of all asset and equity / liability items on the balance sheet. In a second step, the interest rates of yield curves used for this calculation are subjected to a one basis point parallel shift up (a method known as the ”key rate method“). Delta is the present value of the profit or loss resulting from this yield curve change.

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.

Being authorised to maintain a trading book, Aareal Bank AG is in a position to assign transactions to the trading portfolio as defined for the purposes of the capital ratio according to the German Banking Act (Grundsatz I). Given the small number of transactions and low volumes concluded during 2006, trading book risks played a negligible role in the overall risk scenario.

During the 2006 financial year, the processes employed proved to be able to quantify the risks arising from market price fluctuations in a timely and accurate manner. In addition, new products were quickly and fully integrated into the monitoring processes.

1.3 Operational Risks

The bank defines operational risks (OR), in accordance with the Basel II accord, as the threat of losses caused by inappropriate internal procedures, human resources and systems (or their failure), or through external events. This definition also includes legal risks. In contrast, strategic, reputational and systematic risks are not included.

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 proactive approach. Within this context, management is therefore supported effectively by appropriately controlling the relevant operational risks, in line with the type and extent of the legal regulations as well as with the bank’s risk profile.

Efforts to comply with the requirements for controlling OR were concluded during 2006: major subsidiaries were integrated into the OR control system, training measures successfully delivered throughout the Group, and an overall reporting system, covering all instruments used to control operational risks, was established.

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.

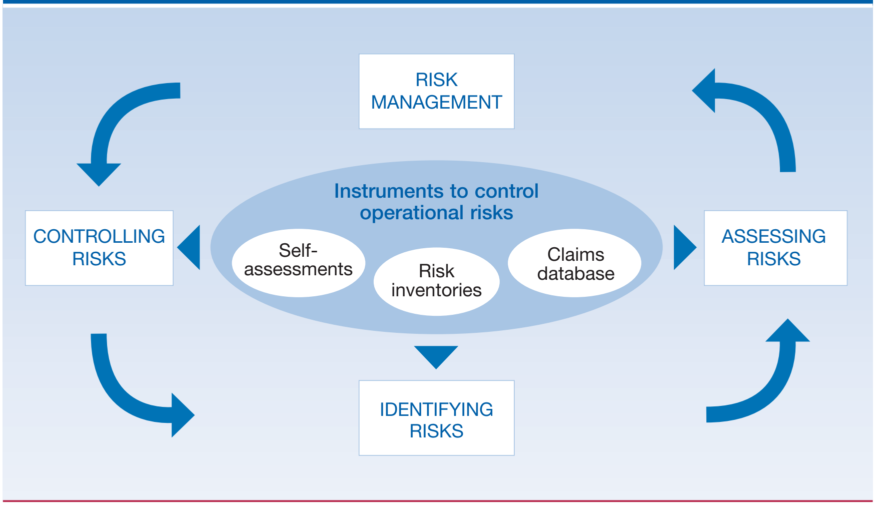
- A loss database, in which relevant operational risk cases are reported, and in which they can be monitored until they are officially closed.

By means of this control toolkit, decentralised data capture as well as centralised and timely compilation of relevant information are ensured. This information provides the basis on which (among other things) measures for preventing / reducing operational risks are implemented. The responsibility for implementing these measures rests with the respective departments.

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. The loss database did not show any losses involving significant monetary damages during the financial year under review.

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 a control circuit which leads to risk identification, evaluation, and management – through to risk control.

Management of operational risks



1.4 Liquidity Risks

Liquidity risk in the narrower sense is defined as the risk that current or future payment obligations cannot be met on time. Aareal Bank's liquidity risk management system is designed to ensure that the bank has sufficient cash and cash equivalents to honour its payment obligations at any future point in time. The risk management and monitoring processes have been designed to cover refinancing and market liquidity risks in addition to liquidity risk in the narrower sense. Treasury is responsible for managing liquidity risks, whilst Risk Controlling ensures the continuous monitoring.

We have developed a cash flow forecast, tracking cash flows from all balance sheet items and derivatives, on a daily basis, over a three-month period forward. 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 a ten-year cash flow profile. We use statistical modelling to incorporate the cash flow profile of products without a fixed contractual lifetime.

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

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.

Moreover, we employ stress tests and scenario analyses to assess the impact of sudden stress events onto the bank's liquidity situation. The scenarios used, which are evaluated on the basis of the liquidity run-off profile, include the failure to roll over the full amount of funding resources, a full-sized rollover of loans and advances to customers, or price mark-downs affecting the liquidity stock.

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

2. Consulting / Services

The Consulting / Services segment mainly comprises IT Services and Consulting, and deposit-taking businesses.

The business focus of IT Services and Consulting is on developing and operating standard software solutions for the commercial housing industry. Advisory services offered in conjunction with this are designed to fulfil specific customer requirements, where products need to be tailored to customers' needs. Key elements of this division are the group subsidiaries Aareon AG and Aareal First Financial Solutions AG. Aareal Bank AG's Institutional Housing Business is responsible for the distribution of banking products. In addition, Aareal Bank AG holds a 30.49 % stake in an internet-based market place (ImmobilienScout GmbH), through which users can rent, buy and sell apartments and houses.

The major risks associated with this segment are described below, using the Group subsidiaries Aareon AG and Aareal First Financial Solutions AG as examples.

Aareon AG

Aareon AG's main risk groups are market, organisational, process, software development, project, finance, and technical risks, which are often interrelated.

Aareon has embarked upon a strategic realignment to respond to structural changes affecting the property management sector. The core element of this initiative is a new strategy encompassing four products: alongside Blue Eagle, Aareon's premium product, the company now offers its customers the opportunity to extend their usage of GES and WohnData, Aareon's tried-and-tested solutions. Aareon also acquired Techem IT Services GmbH, subsequently renamed Aareon Wodis GmbH, whose Wodis software solution designed for medium-sized businesses has complemented Aareon's product portfolio. The company is thus in a position to offer suitable, "future-proof" software solutions to existing and potential customers of all sizes.

Aareon believes that the new four-product strategy has minimised its risk exposure, thanks to reduced dependency of revenues and profits upon a single product, which still requires further development. The strategy was vindicated by a subsequent customer move to extend their usage agreements for existing systems.

These strategic changes involve the risk that the company structure is no longer in line with its new strategic orientation. Aareon counters this risk by introducing a new structural organisation oriented upon product lines. At the same time, internal communications have been intensified to contain any risks which might arise as a result of staff having difficulties with restructuring measures implemented. All the steps taken are designed to ensure optimum customer service.

One of the key aspects of Aareon's business is the continuous development of IT-based solutions offered. Blue Eagle is the most recently developed software generation. The risk arising from developing software is in the potential inability to complete such developments within budgeted costs, with the required quality, and within the timeframe anticipated by the market. Recognising this risk, development work is generally executed within the scope of a process model that is employed throughout the organisation (Aareon Project Management), and which meets internationally accepted standards on the uniform and professional approach to the project process. This process model reduces software development risks. Control and management bodies specifically established to contain other residual risks inherent in the ongoing development of Blue Eagle remain in place; members of the Management Board have assumed personal responsibility in these bodies.

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

Risks arising from the rollout of Blue Eagle into international markets are managed by adapting the software to the requirements of the respective local markets, in a controlled process that is coordinated with the respective local SAP Group entities. To further reduce risks, new markets are first explored through pilot projects with selected customers. The overall volume of investments earmarked for adapting Blue Eagle to various national markets is kept low.

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

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

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

Aareal First Financial Solutions AG

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

We minimised the software development risk in linking ERP systems from different sectors to the existing BK 01® solution by extending the successful co-operation with the German SAP entity for the property business (SAPRE). No new cooperation partnerships were entered into. Development partnerships that do not comply with the defined quality attributes (licensing process) and standard interfaces will not be extended, or will be terminated.

As the ongoing development of the BK@1 software solution (as the successor to the ZKF tool underlying BK 01® solutions) is based on Release 4.01 that is already in production, it does not involve any material risks.

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

Software development risks for the legacy account maintenance system, ZKF, and its successor BK@1 have been reduced significantly through linking GES, Aareon's ERP system, to BK@1. Assuming successful project delivery, it will be possible to terminate ZKF operations at an earlier stage, thus reducing the duration of parallel operation of both systems.

The Management Board applies a standardised project risk management methodology, whereby risks are assessed monthly on a qualitative level, in order to identify any risks at an early stage and take appropriate counter-measures.

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

The market risk regarding utilisation of BK 01® solutions was mitigated by developing interfaces to third-party systems, such as SAP or platforms developed by other software providers to the commercial housing sector, alongside connectivity to Aareon's systems. The process of expanding the coverage of BK 01® to include the utility sector is being expedited. There are currently no plans to explore other sectors.

The copyrighting of BK 01® products serves to reduce market risks. The company already successfully enforced claims resulting from breaches of copyright, and violations of competition law.

CONTENTS II

The tables may contain rounding errors of +/– one unit (€, %, etc.).

CONSOLIDATED FINANCIAL STATEMENTS

FINANCIAL

CONSOLIDATED INCOME STATEMENT
OF AAREAL BANK GROUP

	Note	01 Jan - 31 Dec 2006	01 Jan - 31 Dec 2005
		€ mn	**Mio. €**
Interest income		1,603	1,587
Interest expenses		1,214	1,168
Net interest income	24	**389**	**419**
Provision for loan losses	25	89	273
Net interest income after net loan loss provisions		**300**	**146**
Commission income		228	244
Commission expenditure		83	81
Net commission income	26	**145**	**163**
Net result on hedge accounting	27	9	2
Net trading income	28	13	-25
Results from non-trading assets	29	66	46
Results from investments accounted for at equity		4	-13
Results from investment property	30	-13	-9
Administrative expenses	31	356	394
Net other operating income / expenses	32	-8	-6
Amortisation of goodwill	33	0	0
Operating profit from continuing operations		**160**	**-90**
Income taxes	34	36	-52
Results from discontinued operations	35	1	2
Consolidated net income / loss		**125**	**-36**
Allocation of results			
Consolidated net income / loss attributable to minority interests		18	19
Consolidated net income / loss attributable to shareholders of Aareal Bank AG		107	-55
Appropriation of profits			
Consolidated net income / loss		125	-36
Consolidated net income / loss attributable to minority interests		18	19
Withdrawals from retained earnings		0	55
Consolidated distributable profit		**107**	**0**
		€	**€**
Earnings per share	36	**2.49**	**-1.40**
Diluted earnings per share	36	**2.49**	**-1.40**

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

CONSOLIDATED INCOME STATEMENT

(QUARTERLY DEVELOPMENT)

	01 Oct - 31 Dec 2006	01 Jul - 30 Sep 2006	01 Apr - 30 Jun 2006	01 Jan - 31 Mar 2006	01 Oct - 31 Dec 2005
	€ mn	€ mn	€ mn	€ mn	€ mn
Interest income	417	403	399	384	379
Interest expenses	325	306	297	286	282
Net interest income	**92**	**97**	**102**	**98**	**97**
Provision for loan losses	23	22	22	22	24
Net interest income after net loan loss provisions	**69**	**75**	**80**	**76**	**73**
Commission income	52	55	64	57	70
Commission expenditure	18	20	23	22	23
Net commission income	**34**	**35**	**41**	**35**	**47**
Net result on hedge accounting	3	4	3	-1	0
Net trading income	7	5	-4	5	-11
Results from non-trading assets	27	15	13	11	20
Results from investments accounted for at equity	0	1	0	3	-11
Results from investment property	-12	0	-1	0	2
Administrative expenses	88	89	91	88	101
Net other operating income / expenses	-2	-3	-1	-2	7
Amortisation of goodwill	0	0	0	0	0
Operating profit from continuing operations	**38**	**43**	**40**	**39**	**26**
Income taxes	1	17	9	9	5
Results from discontinued operations	1	0	0	0	3
Consolidated net income / loss	**38**	**26**	**31**	**30**	**24**
Allocation of results					
Consolidated net income / loss attributable to minority interests	4	4	5	5	4
Consolidated net income / loss attributable to shareholders of Aareal Bank AG	34	22	26	25	20

CONSOLIDATED BALANCE SHEET

OF AAREAL BANK GROUP

	Note	31 Dec 2006	31 Dec 2005
Assets		**€ mn**	**€ mn**
Cash funds	37	1,331	1,494
Loans and advances to banks	38	2,691	1,581
Loans and advances to customers	39	23,341	25,148
Provision for loan losses	40	-333	-1,140
Positive market value of derivative hedges	41	883	1,131
Trading assets	42	726	616
Non-current assets held for sale and discontinued operations	43	215	208
Non-trading assets	44	8,510	9,115
Investments accounted for at equity	45	120	160
Investment property	46	10	89
Intangible assets	47	84	70
Property and equipment	48	93	93
Income tax assets	49	42	11
Deferred tax assets	50	175	169
Other assets	51	391	441
Total		**38,279**	**39,186**
Shareholders' equity and liabilities		**€ mn**	**€ mn**
Liabilities to banks	52	5,212	7,855
Liabilities to customers	53	21,346	18,899
Certificated liabilities	54	7,078	7,549
Negative market value of derivative hedges	55	974	1,183
Trading liabilities	56	157	207
Obligations from disposal groups and discontinued operations	57	3	19
Provisions	58	286	274
Income tax liabilities	59	14	25
Deferred tax liabilities	60	128	74
Other liabilities		318	300
Subordinated equity	61	1,391	1,560
Shareholders' equity	62		
Subscribed capital		128	128
Capital reserves		511	511
Retained earnings		314	344
Reserves from transactions under common control		-18	-42
Revaluation surplus		86	56
Minority interest		244	244
Consolidated distributable profit		107	0
Total shareholders' equity		1,372	1,241
Total		**38,279**	**39,186**

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY *

	Subscribed capital	Capital reserves	Retained earnings	Reserves from transactions under common control	Revaluation surplus: AfS measurement reserves	Revaluation surplus: Hedging reserves	Revaluation surplus: Currency translation reserves	Minority interest	Consolidated distributable profit	Consolidated shareholders' equity
	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn
Consolidated shareholders' equity as at 01 Jan 2006	**128**	**511**	**344**	**-42**	**63**	**-6**	**-1**	**244**	**0**	**1,241**
Gains and losses recognised directly in equity					47	7	0			54
Net reduction in unrealised income upon the sale of available-for-sale securities					-13					-13
Measurement results from cash flow hedges, reclassified and included in the income statement										0
Changes in tax effects					-8	-3				-11
Net result of items recognised directly in equity					**26**	**4**	**0**			**30**
Consolidated net income / loss									125	125
Total income					**26**	**4**	**0**		**125**	**155**
Capital increase										0
Withdrawal from retained earnings										0
Effects from transactions under common control			-24	24						0
Consolidated net income / loss attributable to minority interests									-18	-18
Changes in minority interest										0
Changes in reporting entity structure, and other changes			-6							-6
Consolidated shareholders' equity as at 31 Dec 2006	**128**	**511**	**314**	**-18**	**89**	**-2**	**-1**	**244**	**107**	**1,372**

** See note (62) in the Notes to the Consolidated Financial Statements for explanations on the consolidated shareholders' equity*

	Subscribed capital	Capital reserves	Retained earnings	Reserves from transactions under common control	Revaluation surplus			Minority interest	Consolidated distributable profit	Consolidated shareholders' equity
					AfS measurement reserves	Hedging reserves	Currency translation reserves			
	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn	€ mn
Consolidated shareholders' equity as at 01 Jan 2005	**117**	**422**	**421**	**-39**	**16**	**-9**	**-1**	**242**	**0**	**1,169**
Gains and losses recognised directly in equity					63	6				69
Net reduction in unrealised income upon the sale of available-for-sale securities					-11					-11
Changes in tax effects					-5	-3				-8
Net result of items recognised directly in equity					**47**	**3**				**50**
Consolidated net income / loss									-36	-36
Total income					**47**	**3**			**-36**	**14**
Capital increase	11	89								100
Withdrawal from retained earnings			-55						55	0
Effects from transactions under common control				-3						-3
Consolidated net income / loss attributable to minority interests									-19	-19
Net changes in minority interest								2		2
Changes in reporting entity structure, and other changes			-22							-22
Consolidated shareholders' equity as at 31 Dec 2005	**128**	**511**	**344**	**-42**	**63**	**-6**	**-1**	**244**	**0**	**1,241**

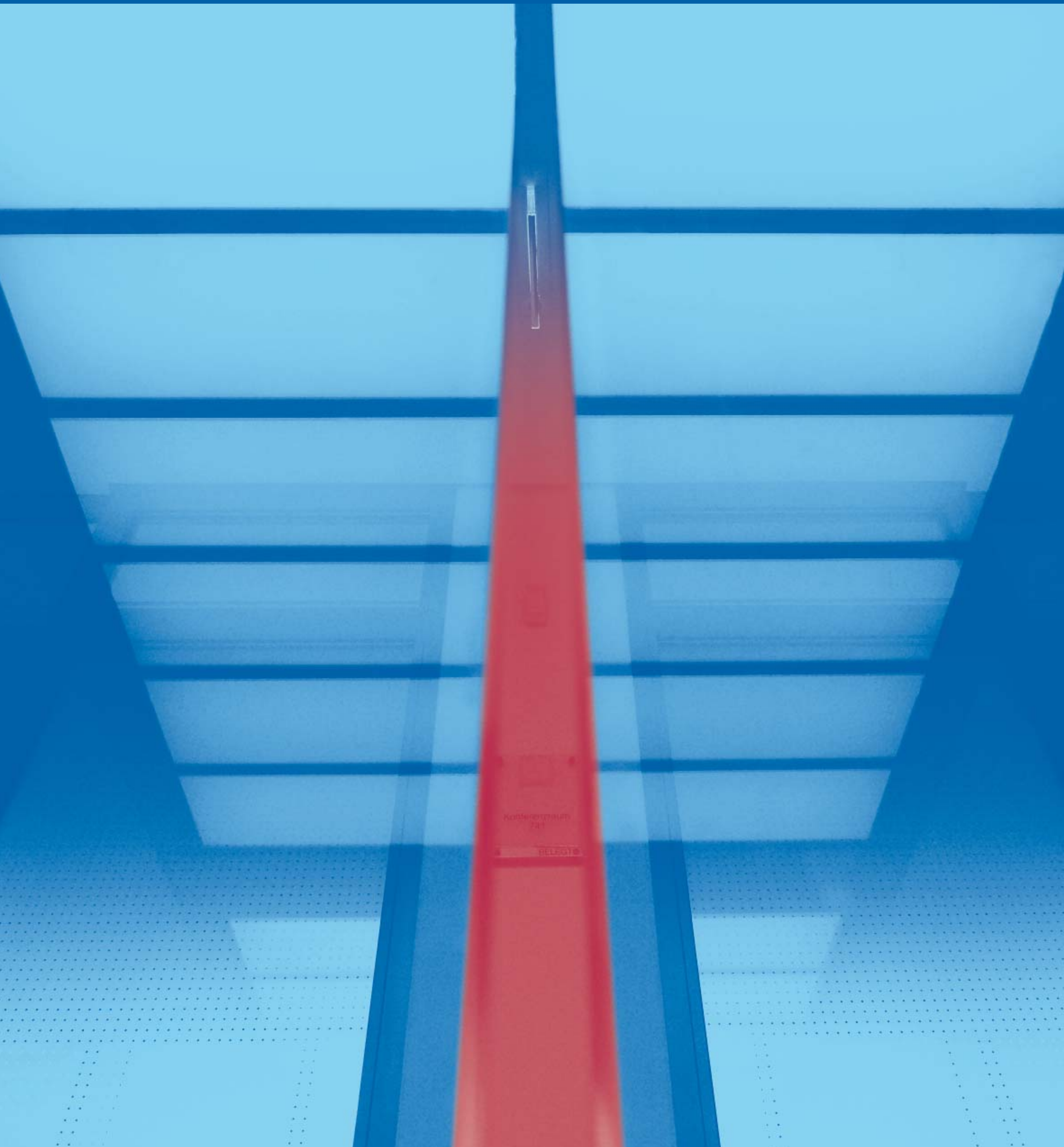
CONSOLIDATED STATEMENT OF CASH FLOWS*

	Cash flow from continuing operations 01 Jan - 31 Dec 2006	Cash flow of discontinued operations 01 Jan - 31 Dec 2006	Total Cash flow 01 Jan - 31 Dec 2006	Total Cash flow 01 Jan - 31 Dec 2005
	€ mn	€ mn	€ mn	€ mn
Consolidated net income / loss	**124**	**1**	**125**	**-36**
Amortisation, depreciation, write-downs and additions on claims	88		88	255
Net new loan loss provisions / (release of provisions)	5		5	20
Depreciation of (write-backs to) fixed assets	37	0	37	43
Other non-cash changes	-126	1	-125	-317
Profits (loss) on the disposal of fixed assets	-69	-1	-70	-59
Other adjustments	-125	4	-121	-303
Subtotal	**-66**	**5**	**-61**	**-397**
Changes in loans and advances to banks	-1.112	-1	-1.113	-184
Changes in loans and advances to customers	617	0	617	-279
Changes in trading assets	-3	0	-3	0
Changes in other assets from operating activities	260	-5	255	234
Changes in liabilities to banks	-2.441	7	-2.434	-344
Changes in liabilities to customers	3.030	0	3.030	3.202
Changes in certificated liabilities	-439		-439	-2.516
Changes in trading liabilities	-2		-2	
Changes in other liabilities from operating activities	-324	-3	-327	-386
Income taxes paid	5	0	5	1
Interest received	1.645	0	1.645	1.567
Interest paid	-1.517	0	-1.517	-1.396
Dividends received	0		0	0
Cash flow from operating activities	**-347**	**3**	**-344**	**-497**

** See note (73) for explanations on the Consolidated Statement of cash flows*

	Cash flow from continuing operations 01 Jan - 31 Dec 2006	Cash flow of discontinued operations 01 Jan - 31 Dec 2006	Total Cash flow 01 Jan - 31 Dec 2006	Total Cash flow 01 Jan - 31 Dec 2005
	€ mn	**€ mn**	**€ mn**	**€ mn**
Proceeds from the disposal of non-trading assets and investments accounted for at equity	1.780	4	1.784	2.680
Payments for the acquisition of non-trading assets and investments accounted for at equity	-1.380	-3	-1.383	-1.959
Proceeds from the disposal of property and equipment and investment property	12	1	13	15
Payments for the acquisition of property and equipment and investment property	-42	-8	-50	-29
Effects of changes in reporting entity structure	0		0	0
Changes due to other investing activities	0		0	0
Cash flow from investing activities	**370**	**-6**	**364**	**707**
Proceeds from capital increase	0		0	100
Dividends paid	-5	5	0	0
Changes in subordinated equity	-165		-165	94
Changes due to other financing activities	-17	-1	-18	-17
Cash flow from financing activities	**-187**	**4**	**-183**	**177**
Cash and cash equivalents at the end of the previous period	**1.494**	**0**	**1.494**	**1.107**
Cash flow from operating activities	-347	3	-344	-497
Cash flow from investing activities	370	-6	364	707
Cash flow from financing activities	-187	4	-183	177
Cash and cash equivalents at the end of the period under review	**1.330**	**1**	**1.331**	**1.494**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS



(A) BASIS OF ACCOUNTING

Legal framework and reporting entity structure

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

As a listed public limited company, Aareal Bank AG has prepared its consolidated financial statements for the financial year ended on 31 December 2006 in accordance with International Financial Reporting Standards (IFRS) applicable within the European Union (EU), in connection with the provisions pursuant to section 315a (1) of the German Commercial Code (Handelsgesetzbuch – "HGB").

The consolidated financial statements were approved for publication on 21 March 2007.

All subsidiaries and joint ventures of Aareal Bank AG have been included in the consolidated financial statements as at 31 December 2006. Companies over which Aareal Bank AG exercises a significant influence ("associated companies") are consolidated at equity.

Within the context of the realignment of Aareal Bank Group, a number of changes to the reporting entity structure occurred in the financial year 2006. Amongst other things, Aareal Bank AG sold its shareholding in Aareal Hypotheken-Management GmbH, Mannheim, with effect from 01 January 2006. In addition, Aareal Bank AG's shareholding in Aareal Immobilien Management AG, Wiesbaden, was sold with effect from 30 June 2006. On 14 December 2006, the Aareal Bank Group sold its asset management activities with effect from 31 December 2006. Therefore, the companies concerned are no longer consolidated as at the balance sheet date.

In particular, within the scope of mergers within the Aareal Bank Group executed in 2006, Aareal Hyp AG was integrated into Aareal Bank AG with retrospective effect from 01 January 2006.

Changes in the reporting entity structure compared to the previous year had no material consequences for the presentation of the financial position and performance of the Group, except for the sale of the asset management activities as set out in more detail in note (9).

An overview of material subsidiaries as at 31 December 2006 (quoting their country of domicile and the percentage of voting rights held) is given in section (J) "List of Shareholdings" of this annual report. The full list of shareholdings has been published in the electronic Federal Gazette and is available to the public.

Accounting policies

(1) Accounting standards

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

Information is presented in accordance with the principle of materiality.

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

Income and expense are recognised on an accrual basis.

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

(2) Currency translation

Individual line items in the financial statements of each Group entity are measured on the basis of the currency of the primary economic environment in which the respective entity operates ("functional currency").

The consolidated financial statements are prepared in euro, being both the functional and the reporting currency.

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

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

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

(3) Consolidation

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

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

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

First-time consolidation of entities is accounted for, applying the purchase method, in accordance with IFRS 3, whereby remeasured amounts (including hidden reserves and hidden encumbrances) must be used when recognising assets and liabilities of an entity to be consolidated. Any excess of acquisition cost over the Group's interest in the fair value of net assets is recognised as goodwill. Any negative goodwill determined during this comparison is immediately charged against income.

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

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

(4) Changes in accounting policies

The following financial reporting standards and interpretations were applied for the first time in the financial year 2006:

- IFRIC 4, 9, 10
- Amendments to IAS 39 and IFRS 4

In the financial year 2006, the following financial reporting standards (IAS / IFRS) and interpretations (SICs and IFRICs) were published by the IASB and adopted by the EU Commission:

- IFRS 7
- IFRIC 8, 9
- Amendments to IAS 1 and IAS 21

The Aareal Bank Group has not exercised the option for early recognition of the provisions applicable as from 01 January 2007.

The first-time adoption of these new or amended standards and interpretations in 2007 is not expected to have any material consequences for the presentation of the financial position and performance of the Group.

Specific accounting policies

(5) Definition and classification of financial instruments

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

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

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

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

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

- At fair value through profit or loss;
- Held to maturity;
- Loans and receivables; or
- Available for sale.

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

- Held for trading, and
- Designated at fair value.

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

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

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

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

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

The ”available for sale“ category comprises all financial assets which cannot be classified under any of the preceding categories. Upon first-time recognition, financial instruments classified as ”available for sale“ are also recognised at fair value (including transaction costs which can be directly attributed); they are subsequently measured at fair value, with results recognised in equity.

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

Amounts exceeding amortised cost, as well as write-backs of equity instruments, are always recognised directly in equity in the revaluation surplus.

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

- at fair value through profit or loss;
- other liabilities.

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

All financial liabilities not designated "at fair value through profit or loss" are classified as "other liabilities". Upon first-time recognition, financial liabilities classified as "other liabilities" are recognised at cost (less transaction costs), and subsequently measured at amortised cost.

(6) Loans and advances to customers

Loans and advances to customers are classified under the (measurement) category of loans and receivables.

Interest income on lending is deferred over the term of the loan, with accrued interest claims disclosed under loans and advances to customers.

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

(7) Risk provisioning

Risk provisioning comprises specific provisions as well as value adjustments on the receivables portfolio.

Where it is probable that the recoverable amount falls below the book value of a loan or an advance, specific loan loss provisions are recorded. This is the case when it is probable (due to observable criteria) that not all interest and principal payments can be made as contractually agreed.

The estimated recoverable amount is determined on the basis of the present values of expected future cash flows from the asset (taking into account the pledged collateral). Cash flows determined in this way are discounted over the estimated marketing period. Collateral is largely provided in the form of land charges or mortgages; these are measured in line with the measurement of investment properties as described in note (13).

Value adjustments recognised at a Group portfolio level are determined using historical default data for the Aareal Bank Group. The risk parameters used for calculation are primarily based on the average loan-to-value ratio of the Group's property financing portfolio, which is determined at regular intervals.

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

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

(8) Trading assets and trading liabilities

Trading assets of the Aareal Bank Group comprise positive market values of derivative financial instruments which are not part of balance sheet hedges (stand-alone derivatives), and securities held for short-term sale. The trading liabilities include negative market values from stand-alone derivatives.

Financial instruments disclosed under these items are classified under the measurement category "at fair value through profit or loss". Measurement results, or realised gains or losses on trading assets or liabilities are reflected in net trading income, together with interest on stand-alone derivatives. Interest on foreign exchange forwards entered into for funding purposes are included in net interest income.

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

On 14 December 2006, the Aareal Bank Group sold its asset management activities. The purpose of the asset management activities is the launch and distribution of property funds. The companies sold within the scope of this transaction include Aareal Asset Management GmbH, Wiesbaden, as well as its direct and indirect shareholdings. The companies sold were previously included in the Property Asset Management segment. The sale of the asset management activities is classified as the discontinuance of an operation in accordance with IFRS 5 due to their significance to the Group so far.

In order to show the consequences of this sale on the Group's financial performance, the net result of this discontinued operation is excluded from operating profit; it is reported separately in the consolidated income statement, and also in segment reporting.

The contents of this item are described in section (E) Segment Reporting. In addition, the net cash flows attributable to operating activities, investing activities, and financing activities of the discontinued operation are shown separately from the other cash flows in the consolidated cash flow statement. Any prior year results have been adjusted accordingly.

In the financial year 2007, the Group plans to sell further shareholdings and properties. The composition of these assets classified as "held for sale" in accordance with IFRS 5 and disposal groups still reported in the balance sheet as at 31 December 2006 is explained in more detail in notes (43) and (57).

(10) Hedge accounting

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

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

Hedge accounting is based on clean fair values.

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

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

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

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

(11) Investments accounted for at equity

Investments in associates included in this item are recognised at cost when the significant influence arises, and subsequently carried at amortised cost, particularly including the share of results of operations in income.

(12) Non-trading assets

Non-trading assets of the Aareal Bank Group include securities in the form of bonds or other debt securities, equities, and fund units. In addition, this item includes investments in companies over which Aareal Bank AG does not exercise economic control or other significant influence.

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

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

The bonds and other debt securities reported in non-trading assets are allocated to the measurement categories "available for sale" or "loans and receivables" in accordance with IAS 39. The remaining securities and equity investments are classified as "available for sale".

(13) Investment property

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

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

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

(14) Leases

In line with IAS 17, leases where a material part of the risks and rewards incidental to ownership of the leased assets remains with the lessor are classified as operating leases. Where substantially all risks and rewards are transferred to the lessee, the lease is classified as a finance lease. The provisions of IFRIC 4 were complied with as regards the application of IAS 17.

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

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

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

(15) Intangible assets

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

All research costs for proprietary software are directly recognised as expenditure. Development costs are capitalised from the time when the software development can be regarded as completed from a technical perspective, and several other conditions are fulfilled. They are amortised on a straight-line basis, using an estimated economic life of between five and ten years.

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

Where there are indications of impairment of intangible assets (as set out in IAS 36) at the reporting date, and the recoverable amount is lower than the carrying amount of the asset concerned, the asset is written down against income, to the estimated recoverable amount.

If it is impossible to estimate the recoverable amount for a specific asset, the recoverable amount of the cash-generating unit that the asset belongs to must be determined. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The Aareal Bank Group generally defines individual Group companies as cash-generating units. The recoverable amount of an asset or a cash-generating unit is the higher of fair value and value in use. (Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset or cash-generating unit.)

(16) Property and equipment

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

Land and buildings reported under property and equipment are depreciated on a straight-line basis, over a period of 50 years.

Other property and equipment items are initially depreciated using the declining-balance method, subsequently reverting to straight-line depreciation, applying the following periods:

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

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

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

(17) Deferred taxes

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

Deferred tax assets are created on losses carried forward for tax purposes, provided that tax laws allow for the use of existing tax loss carry forwards within the next five years after the reporting date. Existing deferred tax assets must be reviewed for impairment on a regular basis.

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

(18) Liabilities

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

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

(19) Provisions

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

(20) Pension obligations

Aareal Bank Group maintains various defined benefit plans as defined in IAS 19. For the purpose of reporting pension obligations, IAS 19 makes a distinction between defined contribution plans and defined benefit plans.

Under defined contribution plans, an enterprise pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

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

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

Provisions for pensions and similar obligations under defined benefit plans are determined in accordance with IAS 19 on the basis of the projected unit credit method. Projected economic and demographic developments, as well as salary and career trends, must be applied to the calculations of the provisions. The discounting factor used to determine the present value of the obligation is based on the capital market rate of corporate bonds with impeccable credit rating at the reporting date. Calculating the amount of the provisions in the Aareal Bank Group is based on mathematical expertise drawn up on the basis of standard procedures set by the Aareal Bank Group.

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

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

(21) Shareholders' equity and minority interest

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

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

(22) Reserves from transactions under common control

The split of the DEPFA Group, which was completed during the financial year 2002, resulted in the transfer of various property financing portfolios, various participations and several properties from DEPFA Deutsche Pfandbriefbank AG to Aareal Bank Group. In turn, some participations previously held by Aareal Bank AG were transferred to DEPFA Deutsche Pfandbriefbank AG.

Moreover, Aareal Bank provided individual maximum default guarantees for individual loans within the property finance portfolio of DEPFA Deutsche Pfandbriefbank AG.

The transfer of said assets was decided upon whilst Aareal Bank still belonged to the DEPFA Group; it was still ongoing during the 2006 financial year.

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

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

(23) Share-based payments

The Aareal Bank Group currently maintains two share-based payment plans in accordance with IFRS 2. Please refer to note (77) for a more detailed description.

A provision for obligations under the two remuneration programmes has been recognised against administrative expenses, in the amount of the fair value of the relevant obligation at the reporting date. In order to determine the fair values of the Aareal Bank share for the two remuneration models of the Aareal Bank Group for employees and members of the Management Board, historical data related to share price development and volatility is used. The share price development data in the year under review is intended to be used for the calculation of the historical 1-year volatility, which amounts to approx. 25 %. The average share price on the basis of the daily closing rates for the year 2006 amounts to € 34.15. In addition, the model assumes a standardised normal distribution of the future share prices around a median. The resulting weighted average share price at the relevant future payment date will be discounted at a risk-free interest rate, as is the expected future dividend. The euro swap curve for the five-year period ended 2006, as published by Bloomberg as at 29 December 2006, is used as the risk-free interest rate curve. Interim terms are determined by linear interpolation. The calculation of the expected future dividends is based on a payout ratio of 25 % for subsequent years.

(B) NOTES TO THE CONSOLIDATED INCOME STATEMENT

(24) Net interest income

	01 Jan-31 Dec 2006 € mn	01 Jan-31 Dec 2005 € mn
Interest income from		
Property loans	862	842
Public-sector loans	81	81
Other lending and money market operations	329	323
Fixed-income securities and debt register claims	319	333
Dividends received	10	8
Other interest income	2	0
Total interest income	**1,603**	**1,587**
Interest expenses for		
Bonds issued	428	400
Borrowed funds	361	318
Subordinated equity	79	84
Term deposits taken	222	224
Overnight deposits taken	102	77
Other banking transactions	22	65
Total interest expenses	**1,214**	**1,168**
Total	**389**	**419**

(25) Provision for loan losses

	01 Jan-31 Dec 2006 € mn	01 Jan-31 Dec 2005 € mn
Additions	151	316
Amounts released	107	93
Direct write-offs	49	52
Payments on loans previously written off	4	2
Total	**89**	**273**

(26) Net commission income

	01 Jan-31 Dec 2006 € mn	01 Jan-31 Dec 2005 € mn
Commission income from banking transactions	57	52
Commission expenses from banking transactions	27	18
Commission income from Consulting / Services	140	158
Commission expenses from Consulting / Services	42	46
Other commission income	31	34
Other commission expenses	14	17
Total	**145**	**163**

Commission income and expenses from banking transactions mainly include commissions from the property lending business and securitisation transactions. Commission from Consulting / Services primarily includes comission for IT services.

(27) Net result on hedge accounting

The total result from hedging instruments and their related underlying instruments of € 9 million (2005: € 2 million) largely includes the effects from the measurement of fair value hedges.

The total amount of risk-induced changes to fair value was determined using recognised measurement methods, based on current market parameters.

(28) Net trading income

	01 Jan-31 Dec 2006 € mn	01 Jan-31 Dec 2005 € mn
Results from derivative financial instruments	9	-23
Currency translation	1	-2
Net income / expenses from other positions held for trading	3	0
Total	**13**	**-25**

Net trading income includes € 12 million (2005: € -14 million) in fair value changes determined using recognised measurement models, based on current market parameters. See note (63) regarding the measurement methods used.

(29) Results from non-trading assets

	01 Jan-31 Dec 2006 € mn	01 Jan-31 Dec 2005 € mn
Results from securities sales	29	43
Results from the measurement of securities	0	0
Results from the disposal of participating interests	38	3
Results from the measurement of participating interests	-1	0
Total	**66**	**46**

(30) Results from investment property

	01 Jan-31 Dec 2006 € mn	01 Jan-31 Dec 2005 € mn
Rental income	7	11
Expenses for the operation of properties rented out	3	4
Expenses for the operation of properties not rented out	0	0
Results from the measurement of properties	-14	-16
Results from the sale of properties	-3	0
Total	**-13**	**-9**

(31) Administrative expenses

	01 Jan-31 Dec 2006 € mn	01 Jan-31 Dec 2005 € mn
Staff expenses	228	246
of which: for pensions	17	12
Other administrative expenses	105	122
Depreciation and amortisation of property and equipment and intangible assets	23	26
Total	**356**	**394**

Administrative expenses include research and development costs in the amount of € 2 million (2005: € 6 million).

Other administrative expenses for the financial year 2006 include the fees paid to the auditors of the consolidated financial statements, as set out in the following table:

	01 Jan-31 Dec 2006 € mn	01 Jan-31 Dec 2005 € mn
Auditing fees	2	4
Other audit or valuation services	0	0
Tax advisory services	0	0
Other services	2	0
Total	**4**	**4**

(32) Net other operating income / expenses

	01 Jan-31 Dec 2006 € mn	01 Jan-31 Dec 2005 € mn
Income from the sale of properties	12	10
Income from the release of provisions	10	10
Rental income	15	19
Income from goods and services	2	1
Miscellaneous	32	42
Total other operating income	**71**	**82**
Expenses for foreclosed assets and other properties	24	40
Expenses for services used	1	1
Write-downs on trade receivables	5	4
Expenses for other taxes	2	2
Miscellaneous	47	41
Total other operating expenses	**79**	**88**
Total	**-8**	**-6**

Miscellaneous other operating expenses include research and development costs of € 4 million (2005: € 4 million) which could not be capitalised.

(33) Amortisation of goodwill

Amortisation of goodwill in accordance with IAS 36 was nil in the financial year 2006 (2005: € 0 million).

(34) Income taxes

	01 Jan-31 Dec 2006 € mn	01 Jan-31 Dec 2005 € mn
Current income taxes	-3	25
Deferred taxes	39	-77
Total	**36**	**-52**

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

	01 Jan-31 Dec 2006 € mn	01 Jan-31 Dec 2005 € mn
Income before income taxes	160	-88
Applicable tax rate	39,8 %	39,8 %
Calculated income taxes	64	-35
Reconciliation to reported income taxes		
Corporate income tax credit	-19	–
Effect of different tax rates in other countries	-1	-7
Tax-free income	-19	-9
Non-deductible expenses	2	1
Taxes for previous years	-3	-5
Changes in tax rates for deferred taxes	–	1
Third party interests	7	8
Provisions for deferred taxes	6	-5
Trade income tax	0	0
Other differences	-1	-1
Reported income taxes	**36**	**-52**

The tax rate used for German Group companies was 39.8 % (2005: 39.8 %). Companies subject to corporation tax only were charged a tax rate of 26.4 % (2005: 26.4 %).

(35) Results from discontinued operations

The breakdown of the result from discontinued operations is described in section (E) Segment Reporting.

(36) Earnings per share

	01 Jan-31 Dec 2006	01 Jan-31 Dec 2005
Consolidated net income / loss attributable to equity holders of Aareal Bank AG (€ mn)	107	-55
Average number of shares outstanding	42,755,159	39,464,663
Earnings per share (€)	**2.49**	**-1.40**

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

Earnings per share are attributable to continuing operations (€ 2.48 per share; 2005: € -1.45 per share) and to discontinued operations (€ 0.01 per shares; 2005: € 0.05 per share).

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

(C) NOTES TO THE CONSOLIDATED BALANCE SHEET

(37) Cash funds

	31 Dec 2006 € mn	31 Dec 2005 € mn
Cash on hand	1	1
Balances with central banks	1,330	1,493
Total	**1,331**	**1,494**

No public sector debt instruments and bills of exchange eligible for refinancing at central banks were held at the balance sheet date.

(38) Loans and advances to banks

	31 Dec 2006 € mn	31 Dec 2005 € mn
Term deposits and current account balances	659	826
Public-sector loans	354	422
Other receivables	1,678	333
Total	**2,691**	**1,581**

The following regional breakdown applies to loans and advances to banks:

	31 Dec 2006 € mn	31 Dec 2005 € mn
Germany	2,345	685
International	346	896

(39) Loans and advances to customers

	31.12.2006 € mn	31.12.2005 € mn
Property loans	20,682	22,025
Public-sector loans	1,735	1,682
Other receivables	924	1,441
Total	**23,341**	**25,148**

Additional property loans were transferred to Aareal Bank Group during the financial year 2006, as a result of the split of the former DEPFA Group.

Moreover, Aareal Bank is obliged to gradually assume the remaining property loans on the books of DEPFA Deutsche Pfandbriefbank AG as at 31 December 2006 in the event of certain contractually agreed conditions.

The following regional breakdown applies to loans and advances to customers:

	31 Dec 2006 € mn	31 Dec 2005 € mn
Germany	9,045	12,001
International	14,296	13,147

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

Property finance under management in an aggregate volume of € 4,493 million (2005: € 6,661 million) has thus been hedged using synthetic securitisation techniques. Synthetic securitisation does not result in a derecognition of the receivables concerned.

These synthetic securitisations included interest sub-participation agreements for the First Loss Pieces sold in an aggregate amount of € 138 million (2005: € 166 million), as well as the assumption of first losses up to € 21 million (2005: € 21 million).

(40) Risk provisioning

	Specific loan loss provisions		Valuation allowances at a portfolio level		Total	
	2006 € mn	2005 € mn	2006 € mn	2005 € mn	2006 € mn	2005 € mn
Position as at 01 January	**1,113**	**1,354**	**27**	**24**	**1,140**	**1,378**
Additions / transfers	127	278	2	3	129	281
Drawdowns	846	438			846	438
Amounts released	90	76			90	76
Effect of changes in reporting entity structure		-5			0	-5
Balance at 31 December	**304**	**1,113**	**29**	**27**	**333**	**1,140**

Provision for loan losses is entirely related to loans and advances to customers. This item is classified as ”loans and receivables“ in accordance with IAS 39.

The drawdowns of specific loan loss provisions amounting to € 846 million mainly result from the sale of two non-performing loan portfolios (NPL) in 2006. The loans were sold through true-sale transactions to an investor operating in the German NPL market.

(41) Positive market values of derivative hedges

	31 Dec 2006 € mn	31 Dec 2005 € mn
Positive market values of fair value hedges	388	737
Positive market values of cash flow hedges	2	2
Pro rata interest receivable	493	392
Total	**883**	**1,131**

(42) Trading assets

	31 Dec 2006 € mn	31 Dec 2005 € mn
Debt and other fixed-income securities	498	336
of which: Public-sector issuers	–	–
Positive market values of standalone derivatives	225	279
Other assets held for trading	3	1
Total	**726**	**616**

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

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

Aareal Bank AG intends to sell individual fund investments as well as several properties in the financial year 2007.

The assets involved in these transactions were classified as held for sale on 31 December 2006, and accounted for in accordance with IFRS 5. The resulting measurement led to a negative effect of € 3 million, which was expensed and reported in net other operating income / expenses. The assets are broken down into the following main groups:

	31 Dec 2006 € mn	31 Dec 2005 € mn
Property	190	133
Intangible assets	–	10
Other assets	25	65
Total	**215**	**208**

(44) Non-trading assets

	31 Dec 2006 € mn	31 Dec 2005 € mn
Debt securities and other fixed-income securities		
Bonds and debentures of public-sector issuers	5,844	6,116
Bonds and debentures of other issuers	2,183	2,641
Money market instruments from public-sector issuers	0	1
Equities and other non-fixed income securities	478	345
Interests in affiliated companies	–	–
Other investments	5	12
Total	**8,510**	**9,115**

Carrying amounts of negotiable non-trading assets:

	Listed		Unlisted	
	2006 € mn	2005 € mn	2006 € mn	2005 € mn
Debt and other fixed-income securities	7,029	7,461	998	997
Equities and other non-fixed income securities (available for sale)	226	234	112	–
Total	**7,255**	**7,695**	**1,110**	**997**

(45) Investments accounted for at equity

There were no unrecognised pro-rata losses incurred from companies accounted for at equity during the financial year (2005: € 0 million). There were no accumulated, unrecognised losses at the reporting date (2005: € 0 million). The share of the Aareal Bank Group in gains and losses of associates taken into account in 2006 totalled € 3 million (2005: € 3 million). Material companies accounted for at equity had total assets of € 503 million (2005: € 843 million) and total liabilities of € 69 million (2005: € 159 million). At-equity accounting was based on the most recent available financial statements prepared under local GAAP.

(46) Investment property

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

	2006 € mn	2005 € mn
Carrying amount as at 01 January	**89**	**177**
Additions	0	3
Disposals	3	8
Effect of changes in reporting entity structure		5
Effect of classification as held for sale (in accordance with IFRS 5)	-62	-72
Net losses from fair value measurement	14	16
Carrying amount as at 31 December	**10**	**89**

(47) Intangible assets

	31 Dec 2006 € mn	31 Dec 2005 € mn
Goodwill	32	22
Software developed in-house	37	39
Other intangible assets	15	9
Total	**84**	**70**

The amount shown for software developed in-house includes € 16 million (2005: € 19 million) for the electronic payments system BK@1; the software is amortised over a remaining term of eight years. The same item also includes € 7 million (2005: € 5 million) for the property management software suite Blue Eagle; the software is amortised over an average remaining term of eight years.

Intangible assets developed as follows:

	2006				2005			
	Software developed in-house € mn	Goodwill € mn	Other intangible assets € mn	Total € mn	Software developed in-house € mn	Goodwill € mn	Other intangible assets € mn	Total € mn
Cost								
Balance at 01 January	**57**	**90**	**30**	**177**	**51**	**90**	**31**	**172**
Additions	6	10	11	27	17		2	19
Transfers				0				0
Disposals	6	9	6	21	3		1	4
Effects of changes in reporting entity structure				0				0
Effect of non-current assets held for sale and disposal groups				0	-8		-2	-10
Balance at 31 December	**57**	**91**	**35**	**183**	**57**	**90**	**30**	**177**
Depreciation and amortisation								
Balance at 01 January	**18**	**68**	**21**	**107**	**11**	**68**	**16**	**95**
Depreciation and amortisation	7		4	11	7		5	12
of which: write-downs				0				0
Measurement changes not recognised in income				0				0
Write-ups				0				0
Transfers				0				0
Disposals	5	9	5	19				0
Effects of changes in reporting entity structure				0				0
Effect of non-current assets held for sale and disposal groups				0				0
Balance at 31 December	**20**	**59**	**20**	**99**	**18**	**68**	**21**	**107**
Carrying amount as at 01 January	**39**	**22**	**9**	**70**	**40**	**22**	**15**	**77**
Carrying amount as at 31 December	**37**	**32**	**15**	**84**	**39**	**22**	**9**	**70**

(48) Property and equipment

	31 Dec 2006 € mn	31 Dec 2005 € mn
Land and buildings and construction in progress	77	74
Office furniture and equipment	16	19
Total	**93**	**93**

Property and equipment:

	2006				2005			
	Land and buildings € mn	Office furniture and equipment € mn	Construction in progress € mn	Total € mn	Land and buildings € mn	Office furniture and equipment € mn	Construction in progress € mn	Total € mn
Cost								
Balance at 01 January	**79**	**92**	**9**	**180**	**83**	**89**	**14**	**186**
Additions	2	8	6	16		8		8
Transfers				0		4	-3	1
Disposals	4	18	9	31	4	8	2	14
Effect of changes in reporting entity structure				0				0
Effect of non-current assets held for sale and disposal groups				0		-1		-1
Balance at 31 December	**77**	**82**	**6**	**165**	**79**	**92**	**9**	**180**
Depreciation and amortisation								
Balance at 01 January	**6**	**73**	**8**	**87**	**9**	**68**	**5**	**82**
Depreciation and amortisation	2	9		11	1	10	3	14
of which: write-downs				0			3	3
Measurement changes not recognised in income				0				0
Write-ups				0				0
Transfers				0		2		2
Disposals	2	16	8	26	4	7		11
Effect of changes in reporting entity structure				0				0
Effect of non-current assets held for sale and disposal groups				0				0
Balance at 31 December	**6**	**66**	**0**	**72**	**6**	**73**	**8**	**87**
Carrying amount as at 01 January	**73**	**19**	**1**	**93**	**74**	**21**	**9**	**104**
Carrying amount as at 31 December	**71**	**16**	**6**	**93**	**73**	**19**	**1**	**93**

(49) Income tax assets

Income tax assets of € 42 million as at 31 December 2006 (2005: € 11 million) include € 24 million (2005: € 4 million) expected to be realised after a period exceeding twelve months.

(50) Deferred tax assets

When recognising deferred taxes, claims and liabilities arising vis-à-vis the same tax authority which may be netted and paid in one amount were offset in the amount of € 1,414 million (2005: € 955 million).

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

	31 Dec 2006 € mn	31 Dec 2005 € mn
Loans and advances to banks / to customers	300	177
Trading assets and trading liabilities	31	22
Non-trading assets	221	140
Intangible assets	3	1
Liabilities to banks / to customers, and certificated liabilities	604	309
Provisions	29	47
Tax loss carryforwards	112	140
Other	289	288
Deferred tax assets	**1,589**	**1,124**

Deferred tax assets not recognised totalled € 28 million (2005: € 40 million).

Deferred tax assets as at 31 December 2006 include € 112 million (2005: € 149 million) expected to be realised after a period exceeding twelve months.

(51) Other assets

	31 Dec 2006 € mn	31 Dec 2005 € mn
Properties held for sale	16	180
Trade receivables	128	107
Other	247	154
Total	**391**	**441**

(52) Liabilities to banks

	31 Dec 2006 € mn	31 Dec 2005 € mn
Payable on demand	557	653
Term deposits	1,116	1,466
Promissory note loans borrowed	2,124	2,009
Liabilities from securities repurchase transactions	1,004	3,112
Registered mortgage bonds	340	295
Other	71	320
Total	**5,212**	**7,855**

(53) Liabilities to customers

	31 Dec 2006 € mn	31 Dec 2005 € mn
Payable on demand	5,129	4,635
Term deposits	4,578	4,199
Promissory note loans borrowed	7,784	6,271
Registered mortgage bonds	3,819	3,544
Other	36	250
Total	**21,346**	**18,899**

(54) Certificated liabilities

	31 Dec 2006 € mn	31 Dec 2005 € mn
Medium-term notes	2,151	3,200
Bearer mortgage bonds	1,830	489
Other debt securities	3,097	3,860
Total	**7,078**	**7,549**

New issues of certificated liabilities during 2006 totalled € 1,826 million (2005: € 376 million). The amounts reported include accrued interest.

(55) Negative market values of derivative hedges

	31 Dec 2006 € mn	31 Dec 2005 € mn
Negative market values of fair value hedges	592	856
Negative market values of cash flow hedges	3	9
Pro rata interest payable	379	318
Total	**974**	**1,183**

(56) Trading liabilities

Trading liabilities of € 157 million (2005: € 207 million) was attributable exclusively to negative market values of standalone derivatives, which are primarily used to hedge the economic credit and interest rate risk exposure.

(57) Obligations from disposal groups and discontinued operations

Obligations from disposal groups and discontinued operations relate to the following main categories:

	31 Dec 2006 € mn	31 Dec 2005 € mn
Deferred tax liabilities	–	3
Provisions	2	1
Other liabilities	1	15
Total	**3**	**19**

(58) Provisions

	31 Dec 2006 € mn	31 Dec 2005 € mn
Provisions for pensions and similar obligations	103	96
Other provisions	183	178
Total	**286**	**274**

Provisions for pensions and similar obligations

The provisions for pensions result mainly from retirement benefit plans maintained at Aareal Bank AG and Aareon AG.

There are currently five different retirement benefit plans within Aareal Bank AG, of which four plans have been closed (and no longer admit employees). All of these plans are defined benefit plans (as defined in IAS 19), under which the bank guarantees the amount of benefits to beneficiaries, subject to certain conditions. The various types of benefits are backed by reinsurance cover to a certain extent; some are funded. Depending on the type of retirement plan, the amount of benefits depends on various factors, including eligible salary, period of employment, benefits from the statutory pension insurance fund as well as on returns generated where external funding is involved.

There are currently six different retirement benefit plans within Aareon AG. All plans have been closed, and no longer admit employees. These plans are also defined benefit plans, as defined in IAS 19. Depending on the type of retirement plan, the amount of benefits also depends on various factors, including eligible salary, period of employment, benefits from the statutory pension insurance fund as well as on benefits from direct insurance plans.

The determination of the amount of provisions for pensions is based on the following actuarial assumptions:

	31 Dec 2006	31 Dec 2005
Calculation method	Projected unit credit method	Projected unit credit method
Calculation basis	Actuarial tables 2005 G issued by K. Heubeck	Actuarial tables 2005 G issued by K. Heubeck
Actuarial assumptions (%)		
Interest rate used for valuation	4.50	4.25
Development of salaries	2.25	2.25
Career development	0.00 to 1.00	1.00
Pension increase	2.00	3.00
Rate of inflation	2.00	2.00
Staff turnover rate	3.00 to 4.00	3.20

Pension liabilities developed as follows in the 2006 financial year:

	2006 € mn	2005 € mn
Present value of pension liabilities as at 01 January	**136**	**112**
Unrecognised actuarial gains / losses as at 01 January	-40	-20
Reported provision for pensions as at 01 January	**96**	**92**
Service cost	4	3
Interest expenses	6	5
Recognised actuarial gains / (losses)	2	1
Other additions and transfers	0	0
Pension payments made	5	5
Reported provision for pensions as at 31 December	**103**	**96**
Unrecognised actuarial gains / losses as at 31 December	33	40
Present value of pension liabilities as at 31 December	**136**	**136**

The present value of pension obligations developed as follows:

	31 Dec 2005 € mn	31 Dec 2004 € mn	31 Dec 2003 € mn	31 Dec 2002 € mn
Present value of pension liabilities	136	112	93	87

Expenses incurred under pension obligations during the financial year are shown in administrative expenses. € 8 million of pension obligations as at 31 December 2006 are fully funded, and € 9 million in related assets are carried on the consolidated balance sheet. The related fund assets amounted to € 9 million as at 31 December 2006, and were reported under investment securities. Provisions for pensions carried at 31 December 2006 include € 98 million (2005: € 91 million) expected to be realised after a period exceeding twelve months.

Other provisions

Other provisions developed as follows:

	Restructuring provisions € mn	Provisions for staff costs and other administrative costs € mn	Provisions in the lending business € mn	Other provisions € mn	Total € mn
Carrying amount as at 01 Jan 2006	**4**	**68**	**69**	**37**	**178**
Additions	5	50	22	31	108
Charge-offs	0	36	15	11	62
Amounts released	0	5	17	5	27
Effect of changes in reporting entity structure		0		-13	-13
Reclassifications	-4	-1		4	-1
Carrying amount as at 31 Dec 2006	**5**	**76**	**59**	**43**	**183**

	Restructuring provisions € mn	Provisions for staff costs and other administrative costs € mn	Provisions in the lending business € mn	Other provisions € mn	Total € mn
Carrying amount as at 01 Jan 2005	**5**	**51**	**70**	**50**	**176**
Additions		55	37	17	109
Charge-offs	1	26	21	29	77
Amounts released		6	17	4	27
Effect of changes in reporting entity structure				-1	-1
Reclassifications		-6		4	-2
Carrying amount as at 31 Dec 2005	**4**	**68**	**69**	**37**	**178**

Provisions for staff costs and other administrative costs include provisions set aside for bonuses, partial retirement, and for anniversary bonuses.

€ 51 million (2005: € 53 million) in provisions related to the capital guarantees for DEPFA Deutsche Pfandbriefbank AG was recognised as at the balance sheet date.

Other provisions include provisions for the costs of preparing the financial statements, and for interest rate guarantees related to the property loan portfolio held by DEPFA Deutsche Pfandbriefbank AG. The item also includes a provision for an indemnification agreement entered into upon the sale of a subsidiary.

Provisions existing at the reporting date are expected to be realised within a twelve-month period following the reporting date, with the exception of provisions for the lending business and restructuring provisions.

(59) Income tax liabilities

Income tax liabilities of € 14 million as at 31 December 2006 (2005: € 25 million) include € 12 million (2005: € 18 million) expected to be realised after a period exceeding twelve months.

(60) Deferred tax liabilities

When recognising deferred taxes, claims and liabilities arising vis-à-vis the same tax authority which may be netted and paid in one amount were offset in the amount of € 1,414 million (2005: € 955 million).

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

	31 Dec 2006 € mn	31 Dec 2005 € mn
Loans and advances to banks / to customers	331	242
Trading assets and trading liabilities	97	87
Non-trading assets	447	321
Intangible assets	14	17
Liabilities to banks / to customers, and certificated liabilities	304	30
Provisions	21	23
Other	328	309
Deferred tax liabilities	**1,542**	**1,029**

€ 26 million (2005: € 15 million) in deferred taxes on measurement differences between the tax balance sheet and the consolidated accounts was directly recognised in the revaluation surplus. Deferred tax liabilities as at 31 December 2006 include € 51 million (2005: € 56 million) expected to be realised after a period exceeding twelve months.

(61) Subordinated equity

	31 Dec 2006 € mn	31 Dec 2005 € mn
Subordinated liabilities	667	726
Profit-participation certificates	504	600
Contributions by silent partners	220	234
Total	**1,391**	**1,560**

Subordinated liabilities

In the event of liquidation or insolvency, subordinated liabilities must be repaid only after all other creditors have been satisfied. No early repayment obligation will arise for the issuer under any circumstances.

Interest was paid on subordinated liabilities at an average rate of 5.06 % (2005: 4.82 %). € 34 million (2005: € 34 million) in interest expenses was incurred with respect to subordinated liabilities.

In the financial year 2002, Aareal Bank AG raised € 227.0 million in subordinated capital from Aareal Property Services B.V., Amsterdam, due on 31 December 2026, of which € 23 million were provided to Aareal Bank France S.A., Paris, and € 47 million to Aareal Hyp AG, Wiesbaden. The bank has an initial right to terminate on 31 December 2006; the creditors do not have any early termination rights. Aareal Capital Funding LLC has assumed all obligations of Aareal Property Services B.V. under subordinated capital issues as at 31 December 2005. Upon the merger of Aareal Hyp AG into Aareal Bank AG, effective at 01 January 2006, the share in subordinated capital of Aareal Hyp AG was transferred to Aareal Bank AG. Given the changed transaction structure, the Aareal Bank AG now has € 250 million in subordinated equity from Aareal Capital Funding LLC, Delaware, USA, at its disposal, of which it, in turn, made a partial amount available to Aareal Bank France S.A. (€ 23 million). The bank's attributable share of € 227 million exceeds 10 % of the aggregate nominal value of all subordinated liabilities and bears an interest of 7,135 %.

As at the balance sheet date, the bank had no knowledge of any further individual items exceeding 10 % of total subordinated liabilities.

Profit-participation certificates

Profit-participation certificates issued comply with the provisions of section 10 (5) of the German Banking Act (Kreditwesengesetz – ”KWG“) and include the profit-participation certificates issued by Aareal Bank AG as shown in the following table.

Pursuant to the terms and conditions of issue, holders of profit-participation certificates have a claim on interest payments which takes precedence over the profit entitlements of shareholders. Where a distribution during the term of the profit-participation certificates would cause a net loss, said interest claim would be reduced, creating a claim for backpayment during the term of the certificates at the same time.

Repayment takes place at the nominal amount (subject to any loss sharing), on the day after the Annual General Meeting passing resolutions regarding the relevant financial year. The profit-participation certificates evidence creditors' rights; they do not grant any share in the liquidation proceeds.

Issuer	Year of issue	Type	Nominal amount (€ mn)	Issue currency	Coupon (%)	Maturity date
Aareal Bank AG	1996	Registered securities	10	DEM	6.80	31 Dec 2007
Aareal Bank AG	2002	Bearer securities	250	EUR	6.375 - 6.75	31 Dec 2011
Aareal Bank AG	2002	Registered securities	60	EUR	7.01 - 7.22	31 Dec 2012
Aareal Bank AG	2003	Bearer securities	60	EUR	6.125	31 Dec 2013
Aareal Bank AG	2003	Registered securities	25	EUR	6.08 - 6.12	31 Dec 2013
Aareal Bank AG	2003	Registered securities	5	EUR	6.31	31 Dec 2017
Aareal Bank AG	2004	Registered securities	17	EUR	5.47 - 5.75	31 Dec 2014
Aareal Bank AG	2004	Registered securities	25	EUR	5.38 - 5.95	31 Dec 2016
Aareal Bank AG	2005	Registered securities	6	EUR	5.83	31 Dec 2017

€ 32 million (2005: € 40 million) in interest expenses were incurred with respect to profit-participation certificates issued.

Contributions by silent partners

Contributions by silent partners to Aareal Bank Group totalled € 220 million (2005: € 234 million). These contributions comply with the requirements for liable capital pursuant to section 10 (4) of the KWG. The contributions by silent partners are used as core capital for regulatory purposes (2005: € 220 million) in their full amount.

Total expenditure for silent partnership contributions totalled € 13 million (2005: € 10 million) in the year under review.

(62) Consolidated shareholders' equity

Subscribed capital

Aareal Bank AG's subscribed capital amounted to € 128 million as at the reporting date (2005: € 128 million). It is divided into 42,755,159 notional no-par value shares ("unit shares") with a notional value of € 3 per share. The shares are bearer shares. Each share carries one vote.

Treasury shares

The Company has been authorised by the Annual General Meeting held on 23 May 2006 to purchase and sell treasury shares, pursuant to section 71 (1) no. 7 of the AktG, until 22 November 2007. The volume of shares acquired for this purpose must not exceed 5 % of the bank's share capital at the end of any day. The lowest price at which a share may be acquired is determined by the closing price of the shares in Xetra (or a comparable successor system) on the trading day prior to such purchase less 10 %. The highest price shall not exceed such average closing price plus 10 %.

The Company was authorised at the same Annual General Meeting to purchase own shares not exceeding 10 % of the bank's share capital for other purposes than securities trading until 22 November 2007. Shares may be acquired via the stock exchange or by means of a public offer to buy, directed at all shareholders. Neither the purchase price, excluding ancillary costs, (if the acquisition takes place via the stock market) nor the offering price, excluding ancillary costs, (in case of a public offer to buy) may exceed or fall below the average closing price of the Bank's shares in Xetra (or a comparable successor system) during the three trading days prior to the purchase or the public announcement of the purchase offer by more than ten per cent (10 %).

Said authorities were not utilised. No treasury shares were held at the end of the year under review.

Authorised capital

The Annual General Meeting held on 15 June 2005 resolved to approve a new authorised capital. The Management Board is authorised to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 58,300,000 (Authorised Capital) by issuance of new bearer shares for contribution in cash or in kind (where such contribution may represent the full contribution, or part thereof), subject to the approval of the Supervisory Board; this authority will expire on 14 June 2010. The shareholders shall be granted a subscription right, unless the Management Board exercises its authority to exclude shareholder's pre-emptive subscription rights. The Management Board may exclude shareholders' subscription rights, subject to approval by the Supervisory Board and the conditions set out below:

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

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

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

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

- where the new shares will be issued against contributions in kind.

Exercising said authorisations, and with the approval of the Supervisory Board, the Management Board resolved on 06 November 2005 to increase the Company's issued share capital by € 11,660,496 (equivalent to 10 % of the issued share capital prior to the increase) to € 128,265,477, by issuing 3,886,832 bearer shares against cash contributions, at an issue price of € 25.75. Excluding shareholders' pre-emptive subscription rights, Aareal Holding Verwaltungsgesellschaft mbH, Bayerische Beamtenversicherung and Neue Bayerische Beamten Lebensversicherung AG were admitted to subscribe and acquire the new shares. The capital increase was carried out, and entered in the Commercial Register on 21 November 2005.

Following this increase, the remaining authorised capital amounts to € 46,639,504. This authorisation will expire on 14 June 2010.

Conditional capital

The share capital is subject to a conditional capital increase of up to € 30 million by means of issuing 10 million new no-par value bearer shares. Such conditional capital increase serves to enable the company to service convertible bonds and/or bonds with warrants on the basis of the authorisation resolution of the Annual General Meeting held on 23 May 2006. Said resolution authorised the Management Board, subject to the consent of the Supervisory Board, to issue, on one or more occasions until 22 May 2011, convertible bonds and/ or bonds cum warrants with a limited or an unlimited term in an aggregate nominal amount of € 600 million and to grant option and / or conversion rights to bearers or holders of bonds with regard to no-par value bearer shares of the Company, equivalent to a share in the equity capital of up to € 30 million. The issuance of bonds may be effected against contributions in kind for the purpose of acquiring companies, interests in companies or divisions of companies.

The bonds may be issued in euro as well as in any other currency – with the corresponding equivalent value – which is the legal tender of, for example, an OECD member state. They may also be issued via an indirect or a direct subsidiary of the Company; in this case, the Management Board is authorised, subject to the consent of the Supervisory Board, to issue a guarantee with regard to the bonds on behalf of the Company or to grant to the bondholders conversion or option rights to new no-par value bearer shares of the Company.

The conditional capital increase will be executed only to the extent that holders of conversion or option rights exercise such rights or any conversion obligation from such convertible bonds and / or bonds with warrants are performed, and to the extent that treasury shares are not utilised to service such convertible bonds and / or bonds with warrants. The new shares will be entitled to a share in the profits from the beginning of the financial year in which they come into existence through the exercise of conversion or option rights or the performance of conversion obligations.

No convertible bonds or warrants were in issue as at the balance sheet date.

Capital reserves

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

Retained earnings

Retained earnings are comprised of statutory reserves (pursuant to section 150 of the AktG) of € 5 million (2005: € 5 million) and of other retained earnings of € 309 million (2005: € 339 million).

Changes in retained earnings have been reflected in the consolidated statement of changes in shareholders' equity.

Reserves from transactions under common control

Any differences between cost of assets agreed upon within the scope of the split of the former DePfa Group and the notional IFRS carrying amounts of assets earmarked for transfer are recognised directly in equity, in the reserves from transactions under common control.

Revaluation surplus

The revaluation surplus includes unrealised gains and losses from changes in the market value of available for sale securities, effective portions from cash flow hedges as well as currency translation adjustments.

Minority interest

€ 250 million (2005: € 250 million) in preference shares issued by a subsidiary were outstanding at the end of the financial year. These shares are repaid at their nominal value and carry an exclusive right to termination for the issuer.

Interest expenses on these preference shares amounted to € 18 million (2005: € 18 million).

Dividend

At the Annual General Meeting, it will be proposed to pay a dividend of € 0.50 per share.

(D) REPORTING ON FINANCIAL INSTRUMENTS

A detailed description of the system in place at Aareal Bank AG to measure, limit, and manage risks throughout the Aareal Bank Group is presented in the Risk Report.

(63) Fair value of financial instruments

The fair value is the amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arm's length transaction.

Listed financial instruments (such as futures, equities, bonds, or other debt securities) are generally measured on the basis of valid market prices. In cases where securities are not listed, they are measured on the basis of current market parameters, using generally accepted valuation methods, in particular on the basis of present values.

Options are measured using generally accepted option price models. Contingent liabilities and loan commitments are taken into account at their carrying amount.

The fair values and carrying amounts of financial instruments are presented below.

	31 Dec 2006 Carrying amount € bn	31 Dec 2006 Fair value € bn	31 Dec 2005 Carrying amount € bn	31 Dec 2005 Fair value € bn
Property loans (loans and receivables)	20.3	20.5	21.0	21.1
Other receivables (loans and receivables)	7.0	7.0	6.3	6.4
Positive market value of derivative hedging instruments (held for trading)	0.9	0.9	1.1	1.1
Trading assets (held for trading)	0.7	0.7	0.6	0.6
Debt and other fixed-income securities (loans and receivables)	1.0	1.0	1.3	1.3
Debt and other fixed-income securities (available for sale)	7.0	7.0	7.4	7.4
Equities and other non-fixed income securities (available for sale)	0.5	0.5	0.3	0.3

	31 Dec 2006 Carrying amount € bn	31 Dec 2006 Fair value € bn	31 Dec 2005 Carrying amount € bn	31 Dec 2005 Fair value € bn
Interests in affiliated companies, investments accounted for at equity and other investments (available for sale)	0.0	0.0	0.2	0.2
Other liabilities (other liabilities)	12.7	12.7	15.0	15.0
Negative market values of derivative hedging instruments (held for trading)	1.0	1.0	1.2	1.2
Promissory note loans borrowed (other liabilities)	9.9	10.0	8.4	8.6
Registered mortgage bonds (other liabilities)	4.2	4.2	3.9	4.0
Trading liabilities (held for trading)	0.2	0.2	0.2	0.2
Bearer mortgage bonds (other liabilities)	1.8	1.8	0.5	0.5
Debt securities (other liabilities)	5.2	5.3	7.1	7.1
Subordinated equity (other liabilities)	1.4	1.4	1.6	1.6

(64) Derivative financial instruments

Aareal Bank Group enters into derivative transactions primarily for hedging and refinancing purposes.

In the context of fair value hedges, interest rate swaps and cross-currency interest rate swaps are primarily entered into in order to hedge interest rate and currency risks inherent in securities, mortgage loans, promissory loan notes, money market instruments, registered mortgage bonds, certificated liabilities, and subordinated equity.

Interest rate swaps are also used to hedge future cash flows from securities, mortgage loans, and certificated liabilities, in the context of cash flow hedges.

Spot and forward foreign exchange transactions are almost exclusively used for refinancing purposes. Credit derivatives are used both to hedge Aareal Bank AG's existing credit risk exposure and to assume credit risks for the purpose of portfolio diversification.

Derivatives held for trading are almost exclusively interest-rate based transactions.

Counterparty risks in derivative transactions are monitored by means of counterparty limits, provision of collateral and a uniform lending policy. Limits are set in accordance with the counterparty classification in internally-defined credit classes as well as ratings of Fitch IBCA, Moody's and Standard & Poor's. Collateral is generally provided in the form of cash collateral, which is released to the pledger as soon as the purpose of collateralisation ceases to exist.

Derivative transactions are generally entered into on the basis of the German Master Agreement for Financial Derivatives, or the ISDA Master Agreements only. Such master agreements provide for the netting of claims and liabilities in the event of insolvency or counterparty default, and thus further reduce counterparty risk.

Derivatives have been entered into with the following counterparties:

	Fair value 31 Dec 2006		**Fair value 31 Dec 2005**	
	positive € mn	**negative € mn**	**positive € mn**	**negative € mn**
OECD banks	553	668	926	1,004
Companies and private individuals	9	48	26	19
Total	**562**	**716**	**952**	**1,023**

The nominal amounts of derivatives are broken down by remaining lifetime according to the following table:

	Nominal amount by remaining lifetime				Nominal amount – total	
	up to 3 months € mn	3 months to 1 year € mn	1 year to 5 years € mn	more than 5 years € mn	31 Dec 2006 € mn	31 Dec 2005 € mn
Interest rate instruments						
OTC products						
Interest rate swaps	2,047	3,412	17,097	18,029	40,585	35,241
Swaptions	241	0	144	67	452	220
Caps, floors	43	427	2,565	779	3,814	4,384
Exchange-listed contracts						
Interest rate futures	90	810	0	0	900	385
Options on interest rate futures	10	0	0	0	10	
Total interest rate instruments	**2,431**	**4,649**	**19,806**	**18,875**	**45,761**	**40,230**
Currency-related instruments						
OTC products						
Spot and forward foreign exchange transactions	3,192	85	13		3,290	3,825
Cross-currency interest rate swaps	650	1,227	1,204	301	3,382	3,865
Total currency-related instruments	**3,842**	**1,312**	**1,217**	**301**	**6,672**	**7,690**
Other forward transactions						
OTC products						
Credit default swaps *	0	0	75	4.135	4,210	5,160
Credit-linked notes *				1.014	1,014	1,313
Equity options	0	3	0	53	56	47
Total other forward transactions	**0**	**3**	**75**	**5,202**	**5,280**	**6,520**
Total	**6,273**	**5,964**	**21,098**	**24,378**	**57,713**	**54,440**

** including € 1,715 million (2005: € 2,744 million) in financial guarantees as defined under IAS 39*

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

	Fair value 31 Dec 2006		Fair value 31 Dec 2005	
	positive € mn	negative € mn	positive € mn	negative € mn
Interest rate instruments				
OTC products				
Interest rate swaps	397	647	792	905
Swaptions	0	1	0	1
Caps, floors	9	10	9	9
Exchange-listed contracts				
Interest rate futures	1	0	0	0
Options on interest rate futures	0	0		
Total interest rate instruments	**407**	**658**	**801**	**915**
Currency-related instruments				
OTC products				
Spot and forward foreign exchange transactions	32	13	15	26
Cross-currency interest rate swaps	88	35	90	68
Total currency-related instruments	**120**	**48**	**105**	**94**
Other forward transactions				
OTC products				
Credit default swaps *	30	0	41	0
Credit-linked notes *		6	2	11
Equity options	5	4	3	3
Total other forward transactions	**35**	**10**	**46**	**14**
Total	**562**	**716**	**952**	**1,023**

** excluding financial guarantees as defined in IAS 39*

(E) SEGMENT REPORTING

Aareal Bank Group prepares its segment reporting in accordance with IFRS (IAS 14), based on the methodology of the bank's internal control and information systems. The primary format of segment reporting shows the relevant results and portfolio data by operating business segments. The secondary reporting format is structured by region. The methodology and structural approaches of segment reporting were also applied in full to the 2005 results and portfolio data provided for the purpose of comparison.

The results and portfolio data shown in segment reporting are used for internal control of the individual divisions. Income and expenses within the Aareal Bank Group are predominantly attributable to transactions with third parties, and are directly attributed to the corresponding segment. Internal transactions exist, albeit to a non-significant extent; these are allocated to each relevant segment and consolidated.

Items which cannot be allocated to any segment are reported under "Consolidation / Reconciliation / Other". The results and portfolio data are fully reconciled with the consolidated financial statements.

The performance of business segments is measured using operating profit, as well as the return on equity and cost / income ratio indicators. Return on equity (RoE), which indicates a segment's profitability, is calculated as the ratio of net profit or loss and the portion of equity allocated to that segment. The cost / income ratio – determined as the ratio of input to output of resources – is used as an indicator for segment efficiency.

Segmentation by operating unit

Within the scope of the bank's realignment, the Aareal Bank Group sold its asset management activities at the end of 2006. This sale is classified as the discontinuance of an operation, in accordance with IFRS 5. The results attributable to these asset management activities are now reported under "Results from discontinued operations".

Since segment reporting by operating business segments is determined on the basis of the product and service range, it was adjusted to take the new structure into account. Accordingly, two operating segments were established:

- Structured Property Financing
- Consulting / Services

Structured Property Financing brings together all domestic and international property financing activities. These include structured commercial property finance, portfolio financing and related advisory services.

The **Consulting / Services** segment offers a comprehensive range of services for managing residential property portfolios and processing payment flows for the institutional housing sector.

Segmentation by region

The geographical segmentation of Aareal Bank Group uses a regional breakdown into ”Germany“ and ”International“, based on the registered office of the respective Group company or branch office. Organisational units centralised at head office are classified according to their regional responsibility.

Segment reporting by region is generally based on the same methodology as for the formation of operating segments.

Segment reporting by operating unit

	Structured Property Financing		Consulting / Services		Consolidation / Reconciliation / Other		Aareal Bank Group	
	€ mn		€ mn		€ mn		€ mn	
	2006	2005	2006	2005	2006	2005	2006	2005
Net interest income	340	383	0	-1	49	37	389	419
Provision for loan losses	89	273					89	273
Net interest income after net loan loss provisions	**251**	**110**	**0**	**-1**	**49**	**37**	**300**	**146**
Net commission income	33	27	167	177	-55	-41	145	163
Net result on hedge accounting	9	2					9	2
Net trading income / expenses	13	-25					13	-25
Results from non-trading assets	52	45	14	1			66	46
Results from investments accounted for at equity	1	-13	3	0			4	-13
Results from investment property	-13	-9					-13	-9
Administrative expenses	199	216	164	186	-7	-8	356	394
Net other operating income / expenses	-8	4	1	2	-1	-12	-8	-6
Amortisation of goodwill		0	0	0			0	0
Operating profit from continuing operations	**139**	**-75**	**21**	**-7**	**0**	**-8**	**160**	**-90**
Income taxes	31	-47	5	-2		-3	36	-52
Results from discontinued operations					1	2	1	2
Consolidated net income / loss	**108**	**-28**	**16**	**-5**	**1**	**-3**	**125**	**-36**
Allocation of results								
Consolidated net income / loss attributable to minority interests	16	16	2	3			18	19
Consolidated net income / loss attributable to equity holders of Aareal Bank AG	92	-44	14	-8	1	-3	107	-55
Allocated equity	765	711	86	104	201	147	1,052	962
Cost / income ratio (%)	54.1	59.1	89.1	103.9			63.5	72.3
RoE after taxes (%)	12.0	-6.1	16.3	-8.1			10.1	-5.7
Employees (average)	**1,129**	**1,379**	**1,541**	**1,795**	**42**	**43**	**2,712**	**3,217**

Segment reporting by operating unit (quarterly comparison)

	Structured Property Financing		Consulting / Services		Consolidation / Reconciliation / Other		Aareal Bank Group	
	€ mn		€ mn		€ mn		€ mn	
	Quarter 4 2006	Quarter 4 2005	Quarter 4 2006	Quarter 4 2005	Quarter 4 2006	Quarter 4 2005	Quarter 4 2006	Quarter 4 2005
Net interest income	78	89	0	-2	14	10	92	97
Provision for loan losses	23	24					23	24
Net interest income after net loan loss provisions	**55**	**65**	**0**	**-2**	**14**	**10**	**69**	**73**
Net commission income	3	11	47	46	-16	-10	34	47
Net result on hedge accounting	3	0					3	0
Net trading income / expenses	7	-11					7	-11
Results from non-trading assets	29	19	-2	1			27	20
Results from investments accounted for at equity		-13		2				-11
Results from investment property	-12	2					-12	2
Administrative expenses	53	55	37	47	-2	-1	88	101
Net other operating income / expenses	1	10	-3	0	0	-3	-2	7
Amortisation of goodwill		0	0	0			0	0
Operating profit from continuing operations	**33**	**28**	**5**	**0**	**0**	**-2**	**38**	**26**
Income taxes	1	6	0	0	0	-1	1	5
Results from discontinued operations					1	3	1	3
Consolidated net income / loss	**32**	**22**	**5**	**0**	**1**	**2**	**38**	**24**
Allocation of results								
Consolidated net income / loss attributable to minority interests	4	3	0	1			4	4
Consolidated net income / loss attributable to equity holders of Aareal Bank AG	28	19	5	-1	1	2	34	20
Allocated equity	765	711	86	104	201	147	1,052	962
Cost / income ratio (%)	52.9	51.8	86.8	102.0			61.5	67.9
RoE after taxes (%)	14.6	11.0	23.7	-5.3			12.7	8.4

Balance sheet data by operating unit

	Structured Property Financing		Consulting / Services		Consolidation / Reconciliation / Other		Aareal Bank Group	
	€ mn		€ mn		€ mn		€ mn	
	2006	2005	2006	2005	2006	2005	2006	2005
Cash funds	1,331	1,494	0	0			1,331	1,494
Loans and advances to banks	2,689	1,557	27	29	-25	-5	2,691	1,581
Loans and advances to customers	18,542	19,969	4,467	4,053	-1	-14	23,008	24,008
Trading assets	726	616	0	0			726	616
Non-trading assets	8,705	9,259	50	88	-245	-232	8,510	9,115
Investments accounted for at equity	118	138	2	7		15	120	160
Further assets	1,694	2,012	166	180	-9	9	1,851	2,201
Segment assets	**33,805**	**35,045**	**4,712**	**4,357**	**-280**	**-227**	**38,237**	**39,175**
Liabilities to banks	5,155	7,796	58	64	-1	-5	5,212	7,855
Liabilities to customers	16,954	14,926	4,417	4,005	-25	-32	21,346	18,899
Certificated liabilities	7,078	7,549					7,078	7,549
Trading liabilities	157	207					157	207
Further liabilities	4,491	4,555	235	286	-254	-190	4,472	4,651
Segment liabilities	**33,835**	**35,033**	**4,710**	**4,355**	**-280**	**-227**	**38,265**	**39,161**
Segment investments	12	10	31	19		1	43	30
Segment depreciation / amortisation	10	11	13	15			23	26
Impairments / reversals of impairments	-26	-50					-26	-50

Segment reporting by region

	Germany		International		Consolidation / Reconciliation / Other		Aareal Bank Group	
	€ mn		€ mn		€ mn		€ mn	
	2006	2005	2006	2005	2006	2005	2006	2005
Net interest income	156	196	233	223			389	419
Provision for loan losses	88	256	1	17			89	273
Net interest income after net loan loss provisions	**68**	**-60**	**232**	**206**			**300**	**146**
Net commission income	130	149	15	14			145	163
Net result from hedge accounting	13	5	-4	-3			9	2
Net trading income / expenses	18	-16	-5	-9			13	-25
Results from non-trading assets	56	38	10	8			66	46
Results from investments accounted for at equity	4	-15	0	2			4	-13
Results from investment property	-13	-9	0	0			-13	-9
Administrative expenses	272	308	84	86			356	394
Net other operating income / expenses	-9	-8	1	10		-8	-8	-6
Amortisation of goodwill	0	0					0	0
Operating profit from continuing operations	**-5**	**-224**	**165**	**142**		**-8**	**160**	**-90**
Allocated equity	350	374	501	441	201	147	1,052	962
Cost / income ratio (%)	80.9	92.3	33.8	35.2			63.5	72.3
RoE before taxes (%)	-1.5	-60.1	32.9	32.2			15.2	-9.4
Employees (average)	**2,076**	**2,588**	**594**	**586**	**42**	**43**	**2,712**	**3,217**
Segment assets	**20,418**	**22,996**	**17,819**	**16,117**		**62**	**38,237**	**39,175**

Notes to discontinued operations

	2006 € mn	2005 € mn
Net interest income	0	0
Provision for loan losses		
Net interest income after net loan loss provisions	**0**	**0**
Net commission income	9	6
Net result from hedge accounting		
Net trading income / expenses		
Results from non-trading assets	1	
Results from investments accounted for at equity	2	3
Results from investment property		1
Administrative expenses	11	8
Net other operating income / expenses	0	
Amortisation of goodwill		
Income taxes	0	0
Results from discontinued operations	**1**	**2**

Assets related to discontinued operations		62
Liabilities related to discontinued operations		62

(F) OTHER EXPLANATORY NOTES

(65) Breakdown by remaining lifetime

Breakdown by remaining lifetime as at 31 December 2006

	payable on demand € mn	up to 3 months € mn	3 months to 1 year € mn	1 year to 5 years € mn	more than 5 years € mn	Total € mn
Loans and advances to banks	739	1,645	49	170	88	**2,691**
Loans and advances to customers	1,899	470	1,234	9,420	10,318	**23,341**
Debt and other fixed-income securities	0	67	350	1,875	6,237	**8,529**
Liabilities to banks	643	1,961	420	1,337	851	**5,212**
Liabilities to customers	5,224	4,245	611	1,453	9,813	**21,346**
Certificated liabilities	0	459	821	4,287	1,511	**7,078**
Subordinated equity	0	27	27	430	907	**1,391**

Breakdown by remaining lifetime as at 31 December 2005

	payable on demand € mn	up to 3 months € mn	3 months to 1 year € mn	1 year to 5 years € mn	more than 5 years € mn	Total € mn
Loans and advances to banks	953	232	127	157	112	**1,581**
Loans and advances to customers	2,222	8,341	2,124	7,174	5,287	**25,148**
Debt and other fixed-income securities	0	131	398	2,114	6,451	**9,094**
Liabilities to banks	677	4,399	533	1,560	686	**7,855**
Liabilities to customers	4,829	4,058	463	922	8,627	**18,899**
Certificated liabilities	0	484	1,345	3,886	1,834	**7,549**
Subordinated equity	0	0	91	124	1,345	**1,560**

(66) Assets and liabilities in foreign currency

The euro equivalent of the aggregate amount of assets denominated in foreign currency as at the reporting date amounted to € 8,091 million (2005: € 9,490 million); the euro equivalent of aggregate liabilities denominated in foreign currency amounted to € 8,090 million (2005: € 9,479 million). Amounts in material foreign currencies may be broken down in the following amounts:

	31 Dec 2006 € mn	31 Dec 2005 € mn
Foreign currency assets		
USD	1,661	1,844
GBP	1,795	2,436
Foreign currency liabilities		
USD	1,671	1,851
GBP	1,797	2,436

(67) Subordinated assets

In the event of insolvency or liquidation of the issuer, subordinated assets are those subordinate to the claims of all other creditors.

The following table gives an overview of subordinated assets of the Aareal Bank Group:

	31 Dec 2006 € mn	31 Dec 2005 € mn
Loans and advances to banks	5	2
Loans and advances to customers	83	89
Total	**88**	**91**

(68) Repurchase agreements

Aareal Bank Group enters into securities repurchase agreements. Liabilities to banks and customers include € 104 million (2005: € 1,185 million) liabilities arising from securities repurchase agreements and € 900 million (2005: € 2,008 million) in liabilities from open-market operations.

(69) Leases

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

Maturity of minimum lease payments under operating leases

	31 Dec 2006 € mn	31 Dec 2005 € mn
Aareal Bank Group as the lessee		
up to one year	13	16
longer than one year, and up to five years	20	31
more than five years	3	4
Total minimum lease payments	**36**	**51**
Aareal Bank Group as lessor		
up to one year	7	18
longer than one year, and up to five years	9	48
more than five years		17
Total minimum lease payments	**16**	**83**

€ 8 million (2005: € 14 million) in lease payments was recognised as expense in the financial year.

(70) Trust business

Aareal Bank Group's trust business at the reporting date is analysed below:

	31 Dec 2006 € mn	31 Dec 2005 € mn
Trust assets		
Loans and advances to customers	1,339	915
Non-trading assets	2	2
Total trust assets	**1,341**	**917**
Trust liabilities		
Liabilities to banks	601	649
Liabilities to customers	740	268
Total trust liabilities	**1,341**	**917**

(71) Assets pledged as collateral

Aareal Bank Group provided collateral for its own liabilities. At the reporting date, these comprised the following assets:

	31 Dec 2006 € mn	31 Dec 2005 € mn
Loans and advances to banks	167	362
Loans and advances to customers	516	526
Non-trading assets	2,028	4,368
Total	**2,711**	**5,256**

€ 102 million (2005: € 962 million) of collateral provided by the Aareal Bank Group may be sold or pledged by the collateral taker to third parties; the amount is reported in non-trading assets.

At the reporting date, the total amount of collateralised liabilities was € 2,617 million (2005: € 5,388 million).

Aareal Bank Group has accepted collateral, which it is entitled to sell or pledge without the collateral owner being in default. The fair value of such accepted collateral was € 1,357 million (2005: € 112 million). Of this amount, no collateral was sold or pledged to third parties (2005: € 28 million).

Collateral is predominantly provided on the basis of established national or international agreements.

(72) Contingent liabilities and irrevocable loan commitments

	31 Dec 2006 € mn	31 Dec 2005 € mn
Contingent liabilities on guarantees and indemnity agreements	662	640
Irrevocable loan commitments	2,780	2,338

Contingent liabilities on guarantees include € 165 million (2005: € 193 million) in capital guarantees extended by Aareal Bank to DEPFA Deutsche Pfandbriefbank AG (within the scope of splitting the former DEPFA Group), for the purpose of providing cover against risks of default with respect to the property loan portfolio held by DEPFA Deutsche Pfandbriefbank AG. € 51 million (2005: € 53 million) in provisions related to these capital guarantees was recognised as at 31 December 2006.

Disclosures in accordance with IAS 37.86 and IAS 37.89 are waived for reasons of practicability.

(73) Consolidated Statement of Cash Flows

Aareal Bank Group's consolidated statement of cash flows records cash flows pertaining to the areas of operating activities, investing activities and financing activities for the period under review.

The starting point of the consolidated statement of cash flows is the amount of cash and cash equivalents, consisting of cash on hand, balances with central banks as well as public-sector debt instruments and bills of exchange eligible for refinancing at central banks.

The definition of the term "operating activities" is consistent with the composition of the operating profit in the consolidated income statement. Cash flows from investing activities include proceeds and payments from the disposal and acquisition of property and equipment and non-trading assets.

Cash flows from financing activities include cash flows from transactions with providers of equity capital, as well as from borrowings raised or repaid.

Aareal Bank AG has sold its shareholdings in Aareal Hypotheken-Management GmbH (consideration: € 14 million), Aareal Immobilien Management AG (consideration: € 0 million) as well as Aareal Asset Management GmbH (consideration: € 36 million) during the financial year 2006. The respective consideration was paid in cash. The sale of the shareholdings resulted in the derecognition of the following material assets and liabilities:

Item	€ mn
Intangible assets	11
Property and equipment	4
Other assets	22
Provisions	14
Deferred tax liabilities	3
Other liabilities	23

At the time of disposal, the sold companies did not hold material cash or cash equivalents.

*(74) Breakdown of the property lending portfolio by country**

	31 Dec 2006 € mn	31 Dec 2005 € mn
Germany	6,393	8,992
Italy	2,843	2,423
Sweden	1,932	1,793
France	1,354	1,263
United Kingdom	1,025	1,240
Denmark	956	905
Spain	915	765
Poland	830	509
Netherlands	808	922
Belgium	554	716
Czech Republic	529	306
Finland	514	180
Other	2,029	2,011
Total	**20,682**	**22,025**

** including securitised receivables*

(75) Property financing portfolio by type of property*

	31 Dec 2006 € mn	31 Dec 2005 € mn
Commercial property financing	15,693	15,195
of which: international	13,383	11,747
Property finance for commercial housing	4,989	6,830
of which: international	906	1,286
Total	**20,682**	**22,025**

* including securitised receivables

(76) New property financing business

	01 Jan - 31 Dec 2006 € mn	01 Jan - 31 Dec 2005 € mn
Commercial property financing	8,317	5,159
of which: international	7,621	4,811
Property finance for commercial housing	1,633	1,955
of which: international	727	1,294
Total	**9,950**	**7,114**

(77) Related party disclosures

Related party transactions

Throughout the financial year 2006, the bank has reported purchases and sales subject to reporting requirements under No. 6.6 of the German Corporate Governance Code, as well as under section 15 a of the German Securities Trading Act (WpHG) to BaFin, the German financial services regulatory agency, without delay, and also published such details on its website. Furthermore, Aareal Bank AG has undertaken in its Code to disclose on its website, without delay, each reported purchase or sale by members of the Management Board or the Supervisory Board.

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

	31 Dec 2006 € mn	31 Dec 2005 € mn
Management Board	0.0	0.0
Supervisory Board	3.5	3.1
Other related parties	2.8	3.9
Total	**6.3**	**7.0**

Loans extended generally have a term between 10 and 15 years, and bear interest at (nominal) rates between 4.50 % and 5.55 %. Collateral was provided in line with usual market practice.

Remuneration for members of the Management Board

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

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

In addition to fixed salary components, which are paid in twelve identical monthly instalments, the members of the Management Board receive a variable remuneration. The basis for this variable remuneration component is a target system, largely based on net income (of the Group) as reported under International Financial Reporting Standards (IFRS), as well as qualitative and quantitative targets, which are re-defined annually.

On the basis of the agreements made, the total amount of fixed and variable remuneration paid to members of the Management Board in 2006 was € 6,662,691.31 and can be broken down as follows:

	€
Fixed remuneration	1,820,000.00
Variable remuneration	4,710,000.00
Other remuneration	132,691.31
Total	**6,662,691.31**

The breakdown of fixed and variable remuneration as stated above amongst the members of the Management Board is shown below:

	Fixed remuneration €	Cash bonus €	Long-term component €	Other [1] €	Total €
Dr. Wolf Schumacher	500,000.00	900,000.00	450,000.00	24,144.03	1,874,144.03
Norbert Kickum	300,000.00	435,000.00	435,000.00	22,036.35	1,192,036.35
Hermann Josef Merkens	420,000.00	375,000.00	375,000.00	31,753.05	1,201,753.05
Thomas Ortmanns	300,000.00	435,000.00	435,000.00	22,014.76	1,192,014.76
Christof M. Schörnig	300,000.00	435,000.00	435,000.00	32,743.12	1,202,743.12
					6,662,691.31

[1] Other remuneration includes payments (in particular for company cars) in the amount of € 70,402.47 as well as benefits related to social security contributions totalling € 56,915.46. This item also includes payments for theoretical dividends on phantom shares, in case the Company resolves to pay dividends on its shares.

Additional pension provisions were recognised in an amount of € 242,915.00. The total of pension provisions for active and former members of the Management Board and their surviving dependants amount to 7,910,647.00. Members of the Management Board who joined the Company before 01 January 2005 are entitled to receive contractual pension payments before they reach the age of 65 when they have served for a period of five years, in case the bank rejects an extension of their service contract. Payments from other employment relationships and other pension plans, if any, are taken into account.

Payments to former Management Board members of Aareal Bank AG and their surviving dependants totalled € 490,151.64.

The agreements concluded with members of the Management Board do not include any express obligation to make severance payments in case of an early termination of employment relationships. However, severance payments may be included in individual termination agreements.

In the case of a change of control and a resulting loss of membership in the Management Board, the members affected receive, in settlement of their total remuneration, their fixed remuneration as well as a contractually agreed compensation for the variable remuneration, paid in monthly instalments during the remaining term of the agreements. In addition, the members of the Management Board receive a lump-sum payment of up to 75 % of their annual fixed remuneration.

If, in case of a change of control, members of the Management Board resign from office or are not willing to extend their office in spite of an offer on the part of the Company, the respective member of the Management Board receives, in settlement of the total remuneration, an amount not exceeding 50 % of the relevant fixed remuneration and the contractually agreed compensation for the variable remuneration. In addition, the relevant member of the Management Board receives a lump-sum payment of up to 50 % of the annual fixed remuneration.

Remuneration for members of the Supervisory Board

The remuneration of the Supervisory Board members consists of a fixed and a variable remuneration. This applies both to the former remuneration system in effect until the Annual General Meeting 2006, and to the new remuneration system, which came into effect upon resolution of that Annual General Meeting. The fixed remuneration for the financial year 2006 amounts to a total of € 624,234.56, before deducting withholding tax for Supervisory Board members and solidarity surcharge for any member of the Supervisory Board who is non-German resident for tax purposes. The variable remuneration of the Supervisory Board amounted to € 64,204.10 and includes the above-mentioned tax components. Accordingly, total remuneration for the Supervisory Board amounts to € 688,438.66 (2005: € 0.8 million). This total was recognised under the assumption that the Annual General Meeting approves the Management Board's proposal on the distribution of earnings.

The individual remuneration paid to members of the Supervisory Board is shown in the Corporate Governance Report.

Remuneration for key executives

Total remuneration of executives in key positions [2] is analysed below:

	01 Jan - 31 Dec 2006 € mn	01 Jan - 31 Dec 2005 € mn
Salaries and other short-term benefits	19.5	18.0
Severance pay	1.5	4.1
Post-employment benefits	1.5	0.7
Other long-term benefits	0.7	0.5
Share-based remuneration	3.2	3.2
Total	**26.4**	**26.5**

[2] *Members of the Management Board of Aareal Bank AG are subject to a three-year minimum holding period.*

[3] Members of the Management Board of Aareal Bank AG are subject to a three-year minimum holding period.

Share-based payments

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

The long-term component included in the variable remuneration for members of the Management Board is paid in the form of phantom shares. The calculation of the number of phantom shares is based on the weighted average price on the basis of five (Xetra) trading days after publication of the annual financial statements adopted by the Supervisory Board. The phantom shares must be held for a period of three years after the date of purchase. Subsequently, the shares may be redeemed, in whole or in part, within a period of a further three years after no more than five working days following publication of the quarterly report. Upon redemption of the shares, the relevant proportion of phantom shares is converted at the weighted average price as reported by Bloomberg on the redemption date, and the resulting amount is paid as taxable income (cash payment).

For first-level managers, as well as members of the executive bodies of subsidiaries, the Aareal Bank Group maintains performance- and results-based remuneration plans in the form of "virtual shares": beneficiaries do not receive a cash bonus, but are allocated virtual shares in Aareal Bank AG annually. Payment claims resulting from virtual shares are disbursed in annual instalments, within a three-year period from allocation (cash payment).[3] The amount of such payment claims depends on the Aareal Bank AG share price at the time of payout.

The total amount expensed for share-based payments was € 3,223,674.57 during the financial year 2006. The liability from share-based payments amounts to € 6,233,910.83 as at 31 December 2006.

(78) Events after the balance sheet date

Deutsche Interhotel Holding GmbH & Co. KG (DIH) concluded an agreement dated 11 December 2006 concerning the sale of property and operating companies held in subsidiaries. The realisation of the income from this sale will contribute to a significantly positive result from DIH in 2007. Aareal Bank will recognise the result attributable to the bank within the scope of accounting DIH at equity.

In addition, an agreement was reached with DEPFA Deutsche Pfandbriefbank AG at the start of 2007 with regard to offsetting the effects arising from the completed tax audit of a subsidiary. This applies to a shareholding transferred to Aareal Bank within the scope of the split of the former DEPFA. The related payment is subject to some conditions precedent that have to be met by Aareal Bank.

(79) List of Offices Held – Corporate Governance Report

The List of Offices Held, which has been deposited with the Commercial Register at the Wiesbaden District Court, includes all offices held in German and foreign companies. Like the Corporate Governance Report, the list is available, free of charge, from Aareal Bank AG in Wiesbaden, or in the internet on http://www.aareal-bank.com.

(80) Contingencies

By means of letters of comfort, Aareal Bank AG ensures that Deutsche Structured Finance GmbH, Frankfurt, DSF Beteiligungsgesellschaft mbH, Frankfurt, and Aareal Bank Capital Funding LLC, Wilmington, are able to fulfil their contractual obligations.

Due to its participating interest in Liquiditäts-Konsortialbank GmbH, Frankfurt / Main, in the nominal amount of € 1 million, Aareal Bank AG has call commitments of up to € 6 million. In addition, Aareal Bank AG has a pro-rata principal liability in the event of non-fulfilment of call commitments by other co-shareholders, who hold aggregate interests of € 63 million.

(81) Notice pursuant to section 21 (1) of the WpHG

In June 2006, Aareal Bank AG published that the stake held in the bank by FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, had reached a threshold of 5 %, according to a notification received by the bank on 02 June 2006, and in accordance with section 160 (1) sentence 8 of the AktG in conjunction with section 21 (1) of the WpHG. According to the notification, FMR Corp. held 5.00 % of voting rights in Aareal Bank AG on 01 June 2006.

Also in June 2006, Aareal Bank AG published that the stake held in the bank by FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, had declined below a threshold of 5 %, according to a notification received by the bank on 08 June 2006, and in accordance with section 160 (1) sentence 8 of the AktG in conjunction with section 21 (1) of the WpHG. According to the notification, FMR Corp. held 4.97 % of voting rights in Aareal Bank AG on 07 June 2006.

In July 2006, Aareal Bank AG published that the stake held in the bank by FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, had exceeded a threshold of 5 %, according to a notification received by the bank on 21 July 2006, and in accordance with section 160 (1) sentence 8 of the AktG in conjunction with section 21 (1) of the

WpHG. According to the notification, FMR Corp. held 5.41 % of voting rights in Aareal Bank AG on 20 July 2006.

In October 2006, Aareal Bank AG published that the stake held in the bank by FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, had declined below a threshold of 5 %, according to a notification received by the bank on 24 October 2006, and in accordance with section 160 (1) sentence 8 of the AktG in conjunction with section 21 (1) of the WpHG. According to the notification, FMR Corp. held 4.89 % of voting rights in Aareal Bank AG on 23 October 2006.

(82) Declaration of Compliance within the meaning of section 161 of the German Stock Corporation Act (AktG)

The Management Board and the Supervisory Board issued a Declaration of Compliance as stipulated in section 161 of the AktG, and made this Declaration available to shareholders.

(83) Employees

The number of Aareal Bank Group employees at 31 December 2006 is shown below:

End-of-year numbers	31 Dec 2006	31 Dec 2005
Number of employees in the banking business	1,167	1,236
Number of employees in other businesses	1,465	1,924
Total	**2,632**	**3,160**
of which: Part-time employees	399	336

The average number of Aareal Bank Group employees in 2006 is shown below:

Yearly average	01 Jan - 31 Dec 2006	01 Jan - 31 Dec 2005
Number of employees in the banking business	1,180	1,248
Number of employees in other businesses	1,532	1,969
Total	**2,712**	**3,217**
of which: Part-time employees	398	366

(84) Regulatory indicators

	31 Dec 2006	31 Dec 2005
Ratios calculated in accordance with the German Banking Act (%)		
Core capital ratio	8.3 [2)]	8.4
Total capital ratio	13.5 [2)]	14.5
BIS rules (%) [1)]		
Core capital ratio	7.3 [2)]	7.2
Total capital ratio	12.1 [2)]	12.6

1) The ratios were calculated in accordance with the definitions by the Basel Committee. No agreement regarding the determination of the ratios has been concluded with the German Federal Financial Supervisory Authority (BaFin).

2) After confirmation of Aareal Bank AG's financial statements 2006; the inclusion of retained earnings transferred as part of Aareal Bank AG's liable equity capital as at 31 December 2006 is subject to approval by the Annual General Meeting.

(G) EXECUTIVE BODIES OF AAREAL BANK AG

OFFICES HELD IN ACCORDANCE WITH SECTION 285 No. 10 OF THE GERMAN COMMERCIAL CODE (HGB) IN CONJUNCTION WITH SECTION 125 (1) SENTENCE 3 OF THE GERMAN STOCK CORPORATION ACT (AktG)

Membership in other statutory Supervisory Boards and similar offices held in other governing bodies

SUPERVISORY BOARD

Hans W. Reich, Chairman of the Supervisory Board

Spokesman of the Management Board of Kreditanstalt für Wiederaufbau (until 30 September 2006)

Aareal Bank AG	Chairman of the Supervisory Board	
DEPFA BANK plc	Non-executive member of the Board of Directors	
Deutsche Post AG	Member of the Supervisory Board	until 30 September 2006
Deutsche Telekom AG	Member of the Supervisory Board	until 03 May 2006
HUK-COBURG Haftpflicht Unterstützungskasse kraftfahrender Beamter Deutschlands a. G. in Coburg	Member of the Supervisory Board	
HUK-COBURG-Holding AG	Member of the Supervisory Board	
IKB Deutsche Industriebank AG	Deputy Chairman of the Supervisory Board	until 31 August 2006
ThyssenKrupp Steel AG	Member of the Supervisory Board	

Erwin Flieger, Deputy Chairman of the Supervisory Board

Chairman of the Management Boards of Bayerische Beamten Lebensversicherung a.G., of BBV Holding AG and Bayerische Beamten Versicherung AG

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
Aareal Bank AG	Deputy Chairman of the Supervisory Board	since 23 May 2006
BBV Krankenversicherung AG	Chairman of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH	Chairman of the Supervisory Board	
Neue Bayerische Beamten Lebensversicherung AG	Chairman of the Supervisory Board	

York-Detlef Bülow, Deputy Chairman of the Supervisory Board*

Aareal Bank AG

Aareal Bank AG	Deputy Chairman of the Supervisory Board

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

Christian Graf von Bassewitz, Deputy Chairman of the Supervisory Board (until 23 May 2006)

Spokesman of the General Partners of Bankhaus Lampe KG (until 28 February 2006),
General Partner of Bankhaus Lampe KG (until 31 March 2006), Banker (ret'd.) (since 01 April 2006)

Aareal Bank AG	Deputy Chairman of the Supervisory Board	until 23 May 2006
Aareal Bank AG	Member of the Supervisory Board	since 23 May 2006
Bank für Sozialwirtschaft Aktiengesellschaft	Member of the Supervisory Board	
Condor / Optima Versicherungen AG	Chairman of the Supervisory Boards	until 11 July 2006
DePfa Holding Verwaltungsgesellschaft mbH	Deputy Chairman of the Supervisory Board	until 28 February 2006
Deutscher Ring Krankenversicherungsverein a. G.	Member of the Supervisory Board	
Lampebank International S. A.	Chairman of the Board of Directors	until 31 March 2006
Optima Pensionskasse AG	Chairman of the Supervisory Board	until 11 July 2006
OVB Holding AG	Member of the Supervisory Board	since 01 August 2006
Societaet CHORUS AG	Member of the Supervisory Board	since 01 May 2006
Universal-Investment-Gesellschaft mbH	Member of the Supervisory Board	until 31 March 2006

Manfred Behrens

Managing Director of Schweizerische Lebensversicherungs- und Rentenanstalt (Swiss Life), German branch office

Aareal Bank AG	Member of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	
Swiss Life Insurance Solutions AG	Chairman of the Supervisory Board	since 04 October 2006
Swiss Life Partner AG	Chairman of the Supervisory Board	

Tamara Birke *

Aareal Bank AG

Aareal Bank AG	Member of the Supervisory Board
SIRWIN AG	Member of the Supervisory Board

Dr. Richard Brantner

Retired Bank Management Board member; Chairman of the Accounts and Audit Committee of the Supervisory Board (until 23 May 2006)

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
DEPFA BANK plc	Non-executive member of the Board of Directors	

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

Prof. Dr. Johann Eekhoff

State secretary (ret'd.)

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006

Wolfgang Fauter

Chairman of the Management Boards of Deutsche Ring Versicherungen

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
Atlantic Union Insurance S.A.	Deputy Chairman of the Board of Directors	
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	
Deutscher Ring Bausparkasse AG	Chairman of the Supervisory Board	
MONEYMAXX Lebensversicherungs-AG	Chairman of the Supervisory Board	until 26 September 2006
OVB Holding AG	Chairman of the Supervisory Board	
OVB Vermögensberatung AG	Chairman of the Supervisory Board	
Roland Rechtsschutz-Versicherungs-AG	Member of the Supervisory Board	
ZEUS Service AG	Chairman of the Supervisory Board	
ZEUS Vermittlungsgesellschaft mbH	Chairman of the Supervisory Board	

Lutz Freitag

President of GdW, Bundesverband deutscher Wohnungsunternehmen e.V.

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
Aareon AG	Member of the Supervisory Board	since 31 July 2006
Europäisches Bildungszentrum	Chairman of the Board of Trustees	
Hammonia Verlag GmbH	Member of the Board of Directors	
Norddeutscher Rundfunk	Member of the Board of Directors	

Thomas Hawel*

Aareon Deutschland GmbH

Aareal Bank AG	Member of the Supervisory Board	since 23 May 2006
Aareon Deutschland GmbH	Deputy Chairman of the Supervisory Board	

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

Dr. Friedrich-Adolf Jahn

Parliamentary undersecretary of state (ret'd.)

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006

Ralf Kupka*

Aareal Bank AG

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006

Dr. Peter Lammerskitten

Former Chairman of Deutsche Bau- und Bodenbank Aktiengesellschaft

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
Aareon AG	Deputy Chairman of the Supervisory Board	
burgbad AG	Deputy Chairman of the Supervisory Board	
GWE Gesellschaft für Wohnen im Eigentum AG	Member of the Supervisory Board	

Jacques Lebhar

Président de société Jacques Lebhar Finances S.A.S

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
ESL & Network (France) S.A.S.	Member of the Board of Directors	until 05 April 2006
ESL & Network Holding S.A.	Member of the Supervisory Board	
GFI Informatique	Member of the Board of Directors	
Solving International S.A.	Member of the Supervisory Board	

Dr. Herbert Lohneiß

Chief Executive Officer of Siemens Financial Services GmbH

Aareal Bank AG	Member of the Supervisory Board	since 24 November 2006
INNOVEST Finanzdienstleistungs AG	Member of the Supervisory Board	
Siemens Financial Services Inc. USA	Chairman of the Supervisory Board	
Siemens Kapitalanlagegesellschaft	Chairman of the Supervisory Board	
Siemens Project Venture GmbH	Member of the Shareholder Representatives Group	
UBS Real Estate Kapitalanlagegesellschaft mbH	Deputy Chairman of the Supervisory Board	

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

Joachim Neupel

Tax advisor; Member of the Management Board of IKB Deutsche Industriebank AG (until 31 December 2006); Chairman of the Accounts and Audit Committee (since 23 May 2006)

Aareal Bank AG	Member of the Supervisory Board	since 23.05.2006
IKB Autoleasing GmbH	Member of the Supervisory Board	until 31.12.2006
IKB Facility-Management GmbH	Chairman of the Supervisory Board	until 31.12.2006
IKB Financial Products S. A.	Deputy Chairman of the Supervisory Board	until 31.08.2006
IKB Immobilien Management GmbH	Chairman of the Supervisory Board	
IKB International S. A.	Deputy Chairman of the Supervisory Board	until 07.06.2006
IKB Leasing Berlin GmbH	Member of the Supervisory Board	until 31.12.2006
IKB Leasing GmbH	Member of the Supervisory Board	until 31.12.2006
IKB Private Equity GmbH	Member of the Supervisory Board	until 31.12.2006
Movesta Lease and Finance GmbH	Chairman of the Supervisory Board	until 31.12.2006

Dr. Claus Nolting

Consultant; Chairman of the Management Board of Allgemeine Hypothekenbank Rheinboden AG (since 01 October 2006)

Aareal Bank AG	Member of the Supervisory Board	23 May until 21 August 2006

Kurt Pfeiffelmann*

Aareal Bank AG

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006

Prof. Dr. Stephan Schüller

Spokesman of the General Partners of Bankhaus Lampe KG (since 01 March 2006)

Aareal Bank AG	Member of the Supervisory Board	since 23 May 2006
BVT-Equity-Holding	Chairman of the Board of Directors	
BVT-Holding GmbH	Chairman of the Supervisory Board	
Choren Fuel Freiberg GmbH & Co KG,	Chairman of the Supervisory Board	
Choren Industries GmbH	Chairman of the Supervisory Board	
Condor / Optima Versicherungen AG	Deputy Chairman of the Supervisory Board	since 11 July 2006
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	since 01 April 2006

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

LOYAS Private Finance AG	Chairman of the Supervisory Board	until 05 December 2006
NANORESINS AG	Chairman of the Supervisory Board	
PONAXIS AG	Chairman of the Supervisory Board	
Universal-Investment Gesellschaft mbH	Member of the Supervisory Board	since 01 March 2006

Klaus-Peter Sell*

Investment advisor; Deutsche Vermögensberatung Aktiengesellschaft

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006

Wolf R. Thiel

President and Chairman of the Management Board of Versorgungsanstalt des Bundes und der Länder

Aareal Bank AG	Member of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	

Prof. Dr. Dr. h.c. mult. Hans Tietmeyer

President of Deutsche Bundesbank (ret'd.)

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
Bank for International Settlements (BIS)	Deputy Chairman of the Board of Directors	
BDO Deutsche Warentreuhand AG	Member of the Supervisory Board	
DEPFA BANK plc	Non-executive member of the Board of Directors	
DWS Investment GmbH	Member of the Supervisory Board	
Hauck & Aufhäuser Privatbankiers KGaA	Chairman of the Supervisory Board	

Helmut Wagner*

Aareon Deutschland GmbH

Aareal Bank AG	Member of the Supervisory Board	since 23 May 2006
Aareon Deutschland GmbH	Member of the Supervisory Board	

Reiner Wahl*

Bank employee (ret'd.)

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006

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

Dr. Jürgen Westphal

Barrister and solicitor, Judge at the Hamburg Constitutional Court

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
Treugarant AG Treuhand- und Beratungsgesellschaft Steuerberatungsgesellschaft	Chairman of the Supervisory Board	

Anja Wölbert*

Aareal First Financial Solutions AG

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006

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

MANAGEMENT BOARD

Dr. Wolf Schumacher, Chairman of the Management Board

Aareal Asset Management GmbH	Member of the Supervisory Board	
Aareal Estate AG	Deputy Chairman of the Supervisory Board	
Aareal Hypotheken-Management GmbH	Member of the Supervisory Board	until 01 February 2006
Aareal Valuation GmbH	Member of the Supervisory Board	until 01 May 2006
Aareal Valuation GmbH	Chairman of the Supervisory Board	since 01 May 2006
Aareon AG	Chairman of the Supervisory Board	until 04 September 2006
Aareon AG	Member of the Supervisory Board	since 04 September 2006

Norbert Kickum, Member of the Management Board

Aareal Bank France S.A.	Member of the Board of Directors	since 26 April 2006
Aareal Financial Service Polska Sp.z o.o.	Member of the Supervisory Board	since 16 January 2006
Aareal Financial Services (Singapore) Pte. Ltd.	Member of the Board of Directors	since 10 August 2006
Aareal Financial Services (Singapore) Pte. Ltd.	CEO (Chairman)	since 25 February 2006
Aareal Financial Services USA, Inc.	Chairman des Board of Directors	
Aareal-Financial Service spol. s r.o.	Member of the Supervisory Board	
Deutsche Structured Finance GmbH	Member of the Advisory Board	

Hermann Josef Merkens, Member of the Management Board

Aareal Asset Management GmbH	Chairman of the Supervisory Board	
Aareal Estate AG	Chairman of the Supervisory Board	
Aareal Financial Services (Singapore) Pte. Ltd.	Member of the Board of Directors	since 10 August 2006
Aareal First Financial Solutions AG	Member of the Supervisory Board	
Aareal Hyp AG	Deputy Chairman of the Supervisory Board	until 03 March 2006
Aareal Immobilien Kapitalanlagegesellschaft mbH	Chairman of the Supervisory Board	
Aareal Immobilien Management AG	Chairman of the Supervisory Board	until 30 June 2006
Aareal Property Services B.V.	Chairman of the Supervisory Board	
Aareal Valuation GmbH	Member of the Supervisory Board	
Aareon AG	Member of the Supervisory Board	
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Chairman of the Supervisory Board	
Deutsche Interhotel Holding GmbH & Co. KG	Member of the Council of Shareholders	
Deutsche Structured Finance GmbH	Member of the Advisory Board	

Thomas Ortmanns, Member of the Management Board

Aareal First Financial Solutions AG	Member of the Supervisory Board	until 01 April 2006
Aareal First Financial Solutions AG	Chairman of the Supervisory Board	since 01 April 2006
Aareon AG	Member of the Supervisory Board	until 04 September 2006
Aareon AG	Chairman of the Supervisory Board	since 04 September 2006
Innovative Banking Solutions AG	Member of the Supervisory Board	

Christof M. Schörnig, Member of the Management Board

Aareal Asset Management GmbH	Member of the Supervisory Board	
Aareal Bank France S.A.	Member of the Board of Directors	
Aareal Financial Services (Singapore) Pte. Ltd.	Member of the Board of Directors	since 10 August 2006
Aareal Financial Services USA, Inc.	Member of the Board of Directors	
Aareal First Financial Solutions AG	Chairman of the Supervisory Board	until 01 April 2006
Aareal First Financial Solutions AG	Member of the Supervisory Board	since 01 April 2006
Aareal Hyp AG	Chairman of the Supervisory Board	until 03 March 2006
Aareal Hypotheken-Management GmbH	Chairman of the Supervisory Board	until 01 February 2006
Aareon AG	Member of the Supervisory Board	
FPM Frankfurt Performance Management AG	Member of the Supervisory Board	since 08 December 2006
Mansart Conseil S.A.S.	Member of the Supervisory Board	

(H) OFFICES HELD BY EMPLOYEES

OF AAREAL BANK AG PURSUANT TO SECTION 340 a (4) No. 1 OF THE HGB

Dr. Bernd Bach, Bank Director

ICAS Consulting und Anwendungssysteme AG	Member of the Supervisory Board	

Dr. Michael Beckers, Bank Director

Aareal Financial Service Polska Sp.z o.o.	Member of the Supervisory Board	
Aareal Financial Service spol. s.r.o.	Member of the Supervisory Board	

Sven Eisenblätter, Bank Director

Aareal HM Service GmbH	Member of the Supervisory Board	until 07 February 2006
Aareal Hypotheken-Management GmbH	Member of the Supervisory Board	until 01 February 2006
Aareal HM Processing GmbH	Member of the Supervisory Board	until 07 February 2006
Aareal Valuation GmbH	Member of the Supervisory Board	
Immobilien Scout GmbH	Member of the Supervisory Board	

Hartmut Eisermann, Bank Director

Terrain-Aktiengesellschaft Herzogpark	Member of the Supervisory Board	

Dr. Christian Fahrner, Bank Director

Innovative Banking Solutions AG	Deputy Chairman of the Supervisory Board	

Ralf Gandenberger, Bank Director

Deutsche Interhotel Holding GmbH & Co. KG	Member of the Council of Shareholders	
Terrain-Aktiengesellschaft Herzogpark	Deputy Chairman of the Supervisory Board	

Dagmar Knopek, Bank Director

Aareal Financial Services (Singapore) Pte. Ltd.	Member of the Management Board	since 10 August 2006
Aareal Financial Services USA, Inc.	Member of the Board of Directors	

Dr. Stefan Lange, Bank Director

Aareal Estate AG	Member of the Supervisory Board	
Aareal Hyp AG	Member of the Supervisory Board	until 03 March 2006
Aareal Immobilien Management AG	Deputy Chairman of the Supervisory Board	until 30 June 2006
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Deputy Chairman of the Supervisory Board	
Immobilien Scout GmbH	Member of the Supervisory Board	
Terrain-Aktiengesellschaft Herzogpark	Chairman of the Supervisory Board	
Via Capital Ltd. (in liquidation)	Non-executive Director	

Peter Mehta, Bank Director

Innovative Banking Solutions AG	Member of the Supervisory Board	

Jörg Riepenhausen, Bank Director

Deutsche Bau- und Grundstücks-Aktiengesellschaft	Member of the Supervisory Board	until 07 July 2006

Dr. Peter Schaffner, Bank Director

Aareal Partecipazioni S.p.A.	Member of the Board of Directors	
IMMO Consulting S.p.A.	Member of the Board of Directors	until 20 April 2006

Markus Schmidt

Deutsche Bau- und Grundstücks-Aktiengesellschaft	Member of the Supervisory Board	since 07 July 2006

Peter Schott, Bank Director

Via Capital Ltd. (in liquidation)	Non-executive Director	

Christine Schulze Forsthövel, Bank Director

Aareal Bank France S.A.	Chairman of the Board of Directors	
Aareal Financial Service Polska Sp.z o.o.	Member of the Supervisory Board	
Aareal Partecipazioni S.p.A.	Member of the Board of Directors	
Aareal Financial Service spol. s r.o.	Member of the Supervisory Board	
Mansart Conseil S.A.S.	Chairman of the Supervisory Board	

Martin Vest

Aareal Bank France S.A.	Member of the Board of Directors	

(I) OFFICES HELD BY MEMBERS OF MANAGEMENT BOARDS
OF AAREAL BANK AG'S SUBSIDIARIES (PURSUANT TO IAS 24)

Dr. Manfred Alflen

Aareon AG

Aareon Deutschland GmbH	Chairman of the Supervisory Board
Aareon Schweiz AG	Chairman of the Board of Directors
BauSecura Versicherungsmakler GmbH	Member of the Supervisory Board
OSI AG	Member of the Supervisory Board

Gereon Neuhaus

Aareon AG (since 16 November 2006)

easy AG	Member of the Supervisory Board

Jürgen Pfeiffer

Aareon AG

BauSecura Versicherungsmakler GmbH	Chairman of the Supervisory Board
Wohnungsbaugenossenschaft „Erfurt“ eG	Member of the Supervisory Board

Rolf Buchholz

Aareal Estate AG

Deutsche Interhotel Holding GmbH & CoKG	Member of the Financing Advisory Council
Deutsche Interhotel Holding GmbH & CoKG	Member of the Council of Shareholders

Wiesbaden, 23 February 2007

The Management Board

Dr. Schumacher Kickum Merkens Ortmanns Schörnig

(J) LIST OF SHAREHOLDINGS

SELECTED PARTICIPATING INTERESTS OF AAREAL BANK AG AS AT 31 DECEMBER 2006

The List of Shareholdings of Aareal Bank AG pursuant to Section 313 (2) of the HGB has been deposited with the Commercial Register at the Wiesbaden District Court (Reg. No. HRB 13184), and is available on the Internet (http://www.aareal-bank.com).

No.	Company name	Registered office	Interest held (% of capital)	Shareholders' equity (€ mn)	Results (€ mn)
1	Aareal Bank AG	Wiesbaden			
	I. Consolidated companies				
2	Aareal Bank France S.A.	Paris	100.0	48.7	4.4
3	Aareal Estate AG	Wiesbaden	100.0	2.8	0.0 [1]
4	Aareal Financial Service Polska Sp. z o.o.	Warsaw	100.0	4.0 mn PLN	1.9 mn PLN [3]
5	Aareal Financial Service, spol. s r.o.	Prague	100.0	9.8 mn CZK	1.8 mn CZK [3]
6	Aareal Financial Services (Singapore) Pte. Ltd.	Singapore	100.0	2.4 mn S $	0.2 mn S $
7	Aareal Financial Services USA, Inc.	Wilmington	100.0	1.4 mn USD	0.2 mn USD
8	Aareal First Financial Solutions AG	Wiesbaden	100.0	3.2	0.0 [1]
9	Aareal Valuation GmbH	Wiesbaden	100.0	0.5	0.0 [1]
10	Aareon AG	Mainz	100.0	60.0	1.3 [5]
11	Deutsche Bau- und Grundstücks-Aktiengesellschaft	Berlin	100.0	5.8	1.0
12	Deutsche Structured Finance GmbH	Frankfurt	100.0	17.4	1.2
	II. Associated companies accounted for at equity				
13	Immobilien Scout GmbH	Berlin	30.5	11.0	17.5 [2]
14	Innovative Banking Solutions AG	Wiesbaden	49.0	1.3	0.0 [4]

[1] *Profit transfer agreement/ controlling and profit transfer agreement*
[2] *Preliminary figures as at 31 December 2006*
[3] *Shareholders' equity and profit/loss as at 31 December 2005*
[4] *Financial year ending 31 March 2006*
[5] *Indirect shareholding*

AUDITORS' REPORT

We have audited the consolidated financial statements prepared by the Aareal Bank AG, Weisabden, comprising the balance sheet, the income statement, statement of changes in equity, cash flow statement and the notes to the consolidated financial statements, together with the group management report for the business year from 01 January to 31 December 2006. The preparation of the consolidated financial statements and the group management report in accordance with the IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB ("Handelsgesetzbuch" – German Commercial Code) are the responsibility of the parent Company's Board of Managing Directors. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

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

Our audit has not led to any reservations.

In our opinion based on the findings of our audit the consolidated financial statements comply with the IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group’s position and suitably presents the opportunities and risks of future development.

Frankfurt / Main, 27 February 2007

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftprüfungsgesellschaft

Rabeling	ppa. Hülsen
Wirtschaftsprüfer	Wirtschaftsprüfer
(German Public Auditor)	(German Public Auditor)

REPORT OF THE SUPERVISORY BOARD

REPORT OF THE

REPORT OF THE SUPERVISORY BOARD
OF AAREAL BANK AG, WIESBADEN

Throughout the financial year 2006, the Supervisory Board continually advised, monitored and supervised the management of Aareal Bank AG, in accordance with the law, the Memorandum and Articles of Association, the Internal Rules of Procedure for the Supervisory Board and the bank's Corporate Governance Code. The Management Board informed the Supervisory Board regularly, without delay and comprehensively, both orally and in writing, of all issues important to the Group with regard to its situation, business development, and key financial indicators. The Supervisory Board was also informed about business policy issues (in particular regarding strategic and operative planning), as well as on the current risk exposure and the management and control of risks.

In addition, the Chairman of the Supervisory Board and the Chairman of the Management Board discussed all material issues during numerous contacts between Supervisory Board meetings. The Supervisory Board was involved in all material decisions taken by the company, which were discussed between the Management Board and Supervisory Board in detail, and agreed upon. The approval of the Supervisory Board was granted wherever such approval was required. In particular, the Supervisory Board was involved during 2006 in the disposals of non-performing loan portfolios, and in the sale of participating interests which were no longer part of the company's core area of expertise.

Measures within the scope of the bank's realignment were largely concluded by the end of 2006, significantly ahead of schedule. The Supervisory Board welcomed and supported this positive development.

The Supervisory Board and its Committees

The reduction in the number of Supervisory Board members, which had been prepared for some time, was implemented during the financial year 2006. This involved a restructuring of Supervisory Board Committees. Together with the reduction in the number of committees, the present size of the Supervisory Board allows it to work efficiently.

The Supervisory Board, and the committees formed from amongst its members, met on a total of 15 occasions during the year under review. The number of committees and their functions were amended following the Annual General Meeting 2006, reflecting the reduction in the size of the Supervisory Board. The Executive Committee, Accounts and Audit Committee, Credit and Market Risk Committee, and the Committee for Urgent Decisions continue to exist. Also, the Committee for Urgent Decisions remains to form a part of the Credit and Market Risk Committee.

The duties of the Human Resources Committee and the Capital Adjustment Committee were transferred to the Executive Committee.

The Supervisory Board held four meetings during the year under review. The focus of these meetings was on the realignment of the Aareal Bank Group. The Management Board informed the Supervisory Board of progress made in implementing the six-point programme. Other topics included business policy issues, corporate planning, the company's risk exposure, and the management and control of risks. At its meeting on 23 May 2006, the Supervisory Board elected its Chairman, discussed the restructuring of committees, passing a corresponding resolution, and elected committee members.

The Executive Committee advises the Management Board and prepares the resolutions of the Supervisory Board; it held three meetings during the year under review. The committee's area of responsibility also includes assessing the internal condition of the Group with regard to its operative strength, efficiency and its potential for achieving set objectives. Furthermore, the committee discussed the remuneration of the Management Board members, the approval for the granting of loans to members of the company's executive bodies and other transactions between members of the company's executive bodies and the company or its Group subsidiaries. The Executive Committee assumed these duties from the Human Resources Committee, within the framework of the restructuring of the Supervisory Board; the latter had held one meeting during which the variable remuneration for members of the Management Board for the past financial year was discussed. In keeping with its duties, the Executive Committee also discussed and actively supported the implementation of measures for the realignment of Aareal Bank AG.

The Credit and Market Risk Committee convened three times and dealt with the granting of loans requiring approval.
The Committee also noted any transactions subject to reporting requirements, and any other issues requiring the Supervisory Board's approval pursuant to the company's Memorandum and Articles of Association, or the Managing Board's internal rules of procedure. This also included the decision regarding the update of the bank's credit risk strategy: within the scope permitted under the Minimum Requirements for Risk Management issued by BaFin, the plenary meeting of the Supervisory Board had assigned the relevant authority to the Credit and Market Risk Committee. The committee discussed reports on the bank's risk situation, which were submitted and explained, in great detail.

The Committee for Urgent Decisions as a sub-committee of the Credit and Market Risk Committee, did not convene during the year under review; loans requiring approval were approved in writing.

The Accounts and Audit Committee held four meetings during the year under review. In keeping with its duties under the bank's Memorandum and Articles of Association, the committee appointed the external auditors, following their election by the Annual General Meeting, discussed the focal points of the audit and passed a corresponding resolution. The committee also received and duly noted the report submitted by Internal

Audit, and the Compliance Report. The Management Board presented and explained the Group planning for the years 2007 to 2009 to the committee. The Accounts and Audit Committee concerned itself with the single-entity financial statements and the consolidated financial statements, as well as with the Management Report and the Group Management Report. Following the presentation of the results of the audit conducted by PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt / Main, the committee members discussed the results with the external auditors.

Fulfilling their duties as commissioned by the Supervisory Board, PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft audited the financial statements prepared in accordance with the German Commercial Code (HGB) and the consolidated financial statements prepared in accordance with IFRS (both as at 31 December 2006), including the accounting records, the Management Report, the Group Management Report and the Report of the Supervisory Board, and certified the financial statements without qualification.

All members of the Supervisory Board received the audit reports regarding the financial statements and the consolidated financial statements, including all annexes thereto, in good time before the meeting during which the audit results were discussed. The representatives of the external auditors took part in that meeting, explaining the audit results and answering any further questions.

In its meeting on 21 March 2007, the Supervisory Board approved the results of the audit carried out by PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft. No objections were raised following the detailed examination of the financial statements and Management Report of Aareal Bank AG, prepared in accordance with the HGB; the consolidated financial statements prepared in accordance with IAS / IFRS; the Group Management Report; the proposal of the Management Board regarding the appropriation of profit; and of the audit report. The Supervisory Board approved the financial statements and Management Report of Aareal Bank AG, prepared in accordance with the HGB, which are thus confirmed, together with the consolidated financial statements prepared in accordance with IAS / IFRS and the Group Management Report. The Supervisory Board has endorsed the proposal for the appropriation of profit submitted by the Management Board.

The Chairmen of Supervisory Board committees regularly gave account of the work in the committees to the plenary meeting.

Focus of Supervisory Board activities

As in the previous year, the work performed by the Supervisory Board during the year under review focused on supporting the operative implementation of the six-point programme devised by the Management Board for the bank's realignment. This programme comprised the expansion of new business in line with the bank's strategy, reducing the non-performing loan portfolio, leveraging the bank's mid-sized corporate structure, strengthening its organisational structure, enhancing the transparency of entrepreneurial actions, and establishing a modern corporate culture.

The Supervisory Board discussed the positive development of new business in great detail, together with a review of the bank's opportunities for growth in various domestic and international markets.

The Supervisory Board was closely involved in the successful marketing of non-performing loan portfolios, and was constantly kept informed by the Management Board.

Excellent progress was made in leveraging the bank's mid-sized structure. Specific measures included the disposal of various participating interests, such as the Aareal Asset Management sub-group, the reintegration of Aareal Hyp AG into the parent company, and the sale of Aareal Immobilien Management AG. The Supervisory Board was always kept informed of the measures planned and initiated, and granted its approval where necessary. The disposals carried out during the last quarter of 2006 in particular represented major milestones within the framework of the Aareal Bank's realignment.

Furthermore, the Management Board presented all measures required within the scope of the six-point programme to the Supervisory Board, who duly approved them and passed resolutions as required.

The Management Board regularly informed the Supervisory Board regarding the implementation of the regulatory regime under the Basel II Accord, the Minimum Requirements for Risk Management ("MARisk"), and other changes to the regulatory environment. Discussions focused on a variety of issues and implications of current developments.

Corporate Governance

The implementation of, and compliance with the provisions of the German Corporate Governance Code was particularly evident in the reduction in the number of Supervisory Board members during the year under review. Please refer to the Corporate Governance Report – which forms part of this Annual Report – for details regarding the committees formed after the Annual General Meeting on 23 May 2006, and their elected members. In parallel to these changes, the Annual General Meeting 2006 passed a resolution to implement a new remuneration system for the Supervisory Board, which is also described in detail in the Corporate Governance Report.

The regular examination of efficiency regarding the Supervisory Board, as provided for in the Corporate Governance Code, was carried out after conclusion of the structural changes to the Supervisory Board. This was designed to ensure that proposals and suggestions of new members be implemented in the new framework as swiftly as possible.

The Management Board and Supervisory Board issued a Declaration of Compliance in accordance with the bank's Corporate Governance Code on 01 December 2006, and published it on the bank's website. The wording of said Declaration of Compliance is contained in this Annual Report.

Amendment of section 289 of the German Commercial Code (HGB)

Following an amendment of the provisions of the German Commercial Code governing the contents of a company's management report, the Supervisory Board must obtain information as to whether there are contractual arrangements within the company which would present an obstacle (to a bidder for shares in the company) to the full takeover of the enterprise. In this context, the Supervisory Board is obliged to include an assessment of such contractual arrangements within the scope of this report.

The Supervisory Board complied with this obligation. As outlined in the Management Report for the financial year 2006, change-of-control clauses which might present an obstacle to a takeover exist within Aareal Bank AG, but exclusively in the contracts entered into with members of the Management Board. These arrangements were resolved by the Human Resources Committee of the Supervisory Board.

Personnel matters

The term of office of the following Supervisory Board members ended with the Annual General Meeting on 23 May 2006, at which point they retired from the Supervisory Board: Dr. Richard Brantner, Prof. Dr. Johann Eekhoff, Messrs. Wolfgang Fauter, Lutz Freitag, Dr. Friedrich-Adolf Jahn, Mr. Ralf Kupka, Dr. Peter Lammerskitten, Messrs. Jacques Lebhar, Kurt Pfeiffelmann, Klaus Peter Sell, Prof. Dr. Dr. h.c. mult. Hans Tietmeyer, Mr. Reiner Wahl, Dr. Jürgen Westphal and Ms. Anja Wölbert. The Supervisory Board would like to thank those members who retired from the Supervisory Board for the many years of trusting co-operation, and for their valuable and constructive contribution.

The Annual General Meeting elected Mr. Joachim Neupel, Prof. Dr. Stephan Schüller and Dr. Claus Nolting to the Supervisory Board, as shareholder representatives. Messrs. Thomas Hawel and Helmut Wagner were appointed to the Supervisory Board as employee representatives.

Following his appointment as Chairman of the Management Board of AHBR Allgemeine Hypothekenbank Rheinboden AG, Dr. Claus Nolting resigned from his office with effect from 21 August 2006; he took up his new office as of 01 October 2006. Dr. Nolting considered his new appointment to constitute a conflict of interest as defined in No. 5.5.3 of Aareal Bank AG's Corporate Governance Code, as a result of which he took the said step without delay. We would like to thank Dr. Nolting for the trusting cooperation, and wish him every success in his new office.

Dr. Herbert Lohneiß, a renowned expert in international financial markets, agreed to succeed Dr. Nolting as a member of the Supervisory Board. Dr. Lohneiß, who is currently holding an executive position at Siemens Financial Services GmbH, has many years of experience, including a tenure at J.P. Morgan.

To expedite the completion of the Supervisory Board, Dr. Lohneiß was appointed as a member by the Wiesbaden local court on 24 November 2006. He will be nominated as a candidate at the Annual General Meeting in 2007.

No conflicts of interest of members of the Management Board or the Supervisory Board, as defined in No. 5.5.3 of Aareal Bank AG's Corporate Governance Code, arose during the financial year 2006.

The Supervisory Board would like to thank all staff members of Aareal Bank AG and its affiliated companies for their achievements. It was their strong commitment and contributions which permitted the implementation of the six-point programme and hence, the swift and successful realignment of Aareal Bank.

Wiesbaden, March 2007

The Supervisory Board

Hans W. Reich (Chairman)

SUPERVISORY BOARD

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FINANCIAL CALENDAR

11 May 2007	Presentation of interim report as at 31 March 2007
30 May 2007	Annual General Meeting – Kurhaus, Wiesbaden
August 2007	Presentation of interim report as at 30 June 2007
November 2007	Presentation of interim report as at 30 September 2007

Imprint

Contents:
Aareal Bank AG
Corporate Communications

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Peter Stumpf, Düsseldorf

A view for new perspectives:
The photographs show our Wiesbaden Head Office
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03/2007

Locations Real Estate Structured Finance

Locations Institutional Housing unit

Treasury activities

Countries with lending operations

AMSTERDAM
BERLIN
BRUSSELS
COPENHAGEN
DUBLIN
HAMBURG
ISTANBUL
LONDON
MADRID
MILAN
MUNICH
NEW YORK
PARIS
PRAGUE
ROME
SINGAPORE
STOCKHOLM
WARSAW
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