QUALITY Ⓐ made by AAREAL

Think future.
Create now.

Annual Report 2017

Aareal Bank Group

Aareal Bank Group in 60 seconds

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

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

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

Our digital platforms also integrate property management with related industries.

Key success factors are our local market expertise, our sector know-how, and our long-standing, close client relationships. Because we look beyond the scope of traditional banking and IT services, we are able to reliably assess material developments, opportunities and risks at an early stage and then implement the insights gained particularly quickly.

Think future. Create now.

"Aareal Bank Group is an enterprise with great tradition and continuity. We currently find ourselves in a very dynamic environment that presents us with an opportunity we want to take advantage of. We are well on track with our "Aareal 2020" programme for the future: our two segments successfully continue to develop their existing business further and are systematically expanding their range of digital services. We are best positioned to maintain and extend our leading position in the market in the future too."

Hermann J. Merkens
Chairman of the Management Board

Contents

Aareal Bank Group

Key Indicators

	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Results		
Operating profit (€ mn)	328	366
Consolidated net income (€ mn)	213	234
Consolidated net income allocated to ordinary shareholders (€ mn)[1]	191	199
Cost/income ratio (%)[2]	40.5	41.2
Dividend per share (€)[3]	2.50	2.00
Earnings per ordinary share (€)[1]	3.20	3.33
RoE before taxes (%)[1]	11.9	13.2
RoE after taxes (%)[1]	7.6	8.1

	31 Dec 2017	31 Dec 2016
Statement of financial position		
Property finance (€ mn)[4]	25,088	27,928
of which: international (€ mn)	21,280	23,423
Equity (€ mn)	2,924	3,129
Total assets (€ mn)	41,908	47,708
Regulatory indicators[5]		
Risk-weighted assets (€ mn)	11,785	14,540
Common Equity Tier 1 ratio (CET1 ratio) (%)	19.6	16.2
Tier 1 ratio (T1 ratio) (%)	22.1	19.9
Total capital ratio (TC ratio) (%)	30.0	27.5
Common Equity Tier 1 ratio (CET1 ratio) (%) – Basel III fully phased –[6]	18.9	15.7
Employees	2,800	2,728

	31 Dec 2017	31 Dec 2016
Fitch Ratings		
Deposit rating long-term	A- (outlook: stable)	A- (outlook: stable)
Issuer Default Rating long-term	BBB+ (outlook: stable)	BBB+ (outlook: stable)
short-term	F2	F2
Mortgage Pfandbrief rating	AAA (outlook: stable)	AAA (outlook: stable)
Public Sector Pfandbrief rating	AAA (outlook: stable)	AAA (outlook: stable)
Moody's[7]		
Bank deposit rating long-term	A3 (outlook: stable)	A3 (outlook: stable)
Issuer rating long-term	Baa1	Baa1
short-term	P-2	P-2
Mortgage Pfandbrief rating	Aaa	Aaa
Sustainability[8]		
MSCI	AA	AA
oekom	prime (C)	prime (C)
Sustainalytics[9]	70	70

[1] The allocation of earnings is based on the assumption that net interest payable on the AT1 bond is recognised on an accrual basis.
[2] Structured Property Financing segment only
[3] Proposal to be submitted to the Annual General Meeting
[4] Excluding € 0.8 billion in private client business (31 December 2016: € 1.1 billion) and € 0.5 billion in local authority lending business by former Westdeutsche ImmobilienBank AG (former WestImmo) (31 December 2016: € 0.6 billion)
[5] The calculation of regulatory capital takes into account the Management Board's proposal for the appropriation of net profit for the financial year 2017. The appropriation of profits is subject to approval by the Annual General Meeting.
[6] In accordance with Directive 2013/36/EU and Regulation (EU) 575/2013 of the European Parliament and of the Council – including the effects of the transition to IFRS 9
[7] Published on 12 January 2017.
[8] Please refer to our website (www.aareal-bank.com/en/responsibility/reporting-on-our-progress/) for more details.
[9] Previous year's figure adjusted due to a change in the rating methodology applied by Sustainalytics

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

Making progress – from a position of strength

Interview with Hermann J. Merkens

Mr Merkens, digitalisation is taking hold in every aspect of our lives and every sector. What do you think about this development and what is Aareal Bank Group's approach to the digital transformation?

We see digitalisation as the source of a lot of potential and new opportunities for us. We want to take advantage of them and so have positioned ourselves accordingly. Our range of services has already made us a pioneer in digital solutions in our markets. We want to strengthen this position, and continue to expand it over the years to come. In order to make that goal a reality, we've done things like developing a digital roadmap, equipping our IT landscape to cope with new challenges – making sure that we have the right tools to continue to be a success story in the digital age.

How do you see the past financial year as a whole? What challenges did you encounter? How was the business environment?

The business environment has continued to be very challenging. It's been influenced by many uncertainties and strong competition. Despite that, however, we were able to continue our positive business development. In 2017, we generated a consolidated operating profit of € 328 million, reaching our goals for the past financial year. Taking into account the difficult conditions overall, such as the low interest rate levels, regulatory uncertainty and strong competition, this is a good result. On the whole, we are very pleased with how the financial year went.

What in particular sets Aareal Bank Group apart from its competitors? What are your USPs?

Aareal Bank Group specialises in things related to property and property investment. Our focus, long-standing experience and a broad range of services means we can offer extensive and unique expertise. It also enables us to identify trends and developments in our market early on, and help our clients to benefit from them. In both of our business segments, we are equal partners and a reliable support for our clients. In particular, our USPs in the Structured Property Financing segment are cross-border financings, extensive structuring expertise and a profound understanding of local markets and sectors. In the Consulting/Services segment, we offer a one-of-a-kind combination of banking and IT solutions, extensive digitalisation expertise and a deep-rooted knowledge of processes and systems in the property sector and related industries.

Let's turn to the future: where do you think Aareal Bank Group's **opportunities and potential** lie in the years to come?

In our two business segments, we see a variety of different opportunities to tap into new markets and clients. In the Structured Property Financing segment, we want our expansion in attractive markets to be even more robust and we'd like to develop new digital business opportunities along the value creation chain. In the Consulting/Services segment, we see potential for growth in strong product cross-selling and more fully taking advantage of economies of scale, in enlarging our housing and utilities sector ecosystem, in developing existing platform products for housing companies' B2C business, as well as expanding payment and IT products, and our client base. We are well positioned to take advantage of these market opportunities. Our profitability and financial performance enable us to act from a position of strength.

The **"Aareal 2020"** strategic programme was launched roughly two years ago. Where do things stand currently?

Our "Aareal 2020" strategic programme is designed to realise additional revenue potential by developing the business model, and to ensure our Company is positioned to succeed in future. In this context, and across all Group entities, opportunities arising from investment in digitalisation will be consistently exploited. At the same time, processes and structures are being optimised to make Aareal Bank Group even more efficient and flexible. The programme's implementation is well underway. As planned, we developed the operating business, advanced our transformation and further optimised our processes and structures.

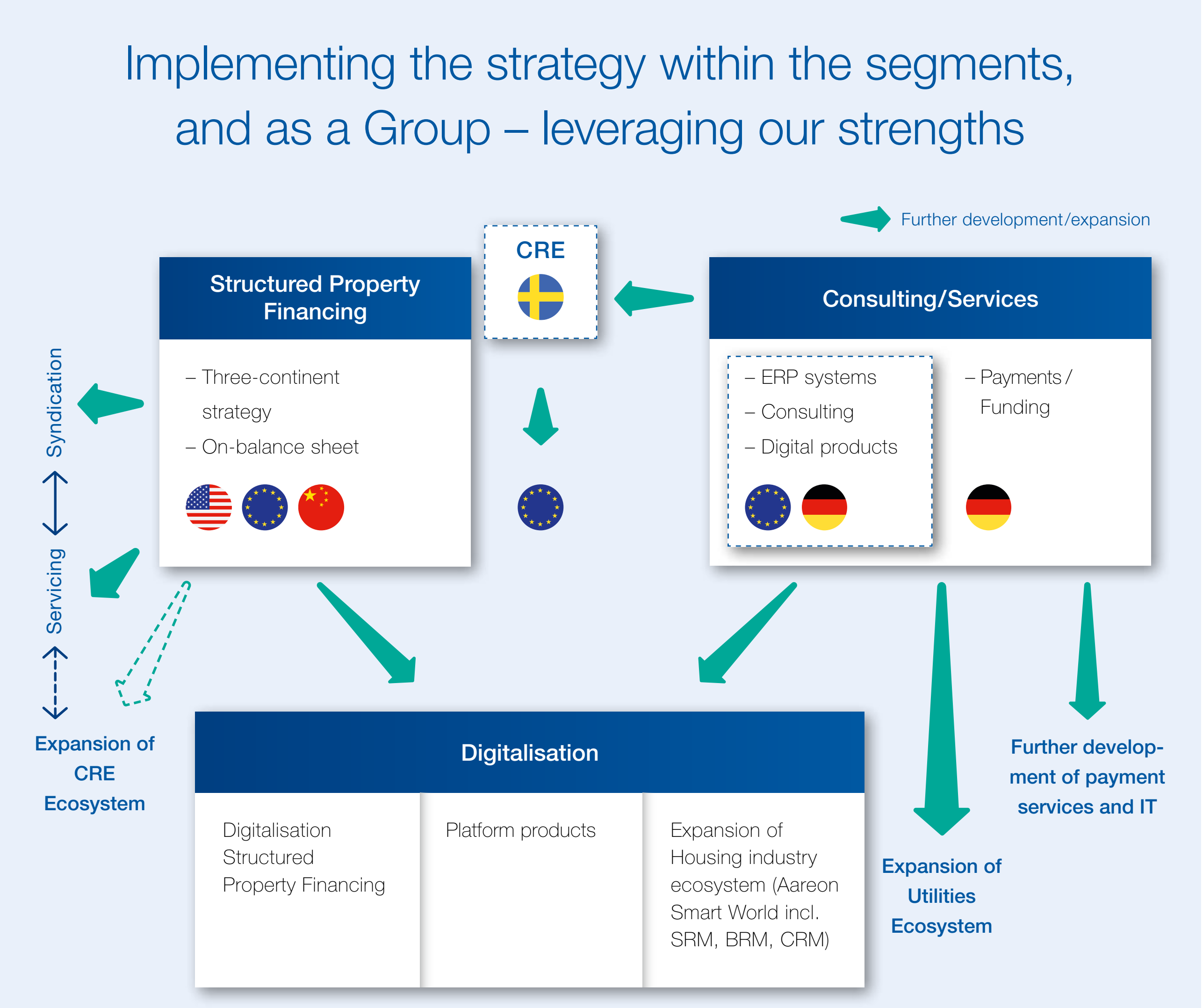
And what are your **expectations** for the 2018 financial year? What areas are you focusing on?

In 2018 we are going to speed up the implementation of "Aareal 2020". We want to grow the foundation of our future success in both business segments, with significant forward-looking investments in our business, our IT and expanding our digital solutions. In addition, we are continuing to work on optimising our processes and structures. We are consistently working towards the challenge we've set for ourselves: to be the leading provider of smart financing, software products and digital solutions for the property sector and related industries. So the 2018 financial year will be very challenging, but also very exciting.

More online:
ar.aareal-bank.com/2017

Our Group, our synergies

Our two business segments afford us the opportunity to utilise the development and momentum of different property-related markets. The Structured Property Financing segment forms the backbone of our business model, while the Consulting/Services segment is our growth driver.



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

Joint booth by Group entiities Aareal Bank AG, Aareon AG and phi-Consulting GmbH at the 2018 "E-world energy & water" trade fair in Essen, Germany

Our two business segments are focused on different client groups, and to this end, they offer different products and services. The segments have a number of common elements, resulting in synergies that benefit our clients. The central objectives of our "Aareal 2020" programme for the future are therefore to get even more out of these synergies and to interlink our activities both within and between our business segments to an even greater extent.

Our two business segments are on the same wavelength – focussing predominantly on topics relevant to the property sector. With our many years of expertise in the commercial property sector, the housing industry and in the energy and utilities industry, we therefore cover the unique expertise required for supporting and advising our clients. This broad market observation and development allows us to anticipate developments and trends ahead of many other market participants, and to transfer solutions and experience to other markets. The increased networking of our portfolio of solutions allows us to increase the number of coordinated services we can consistently offer our clients from a single source.

We will combine and use our different competencies and experiences in an even more targeted manner within our Group in the future. This also applies to the "digitalisation" megatrend: our subsidiary Aareon has specialised for decades in developing digital solutions for the property industry, and is now Europe's leading international consultancy and IT systems house in this and related industries. The entire Group benefits from Aareon's long-standing expertise – both in relation to its own processes as well as with regard to new digital client solutions.

The close networking of our business activities is reflected not least in the deposit-taking business: in the Consulting / Services segment, we offer our clients various IT solutions for managing their property portfolios – while offering them the option to process the incidental payments and cash management through Aareal Bank at the same time. We therefore offer our clients solutions from a single source. For Aareal Bank, deposits from the housing industry are a strategically important additional source of funding for the property financing business, and one that is largely independent of the capital markets. In addition to the German Pfandbrief and unsecured bank bonds, they represent an important pillar in the Bank's long-term funding mix, which in turn benefits our clients.

Our segments

Structured Property Financing

In our Structured Property Financing segment, we support our clients in financing their international property investments. We offer customised and flexible solutions – specialising on financing office buildings, hotels, shopping centres, logistics and residential properties in particular, mostly for existing properties.

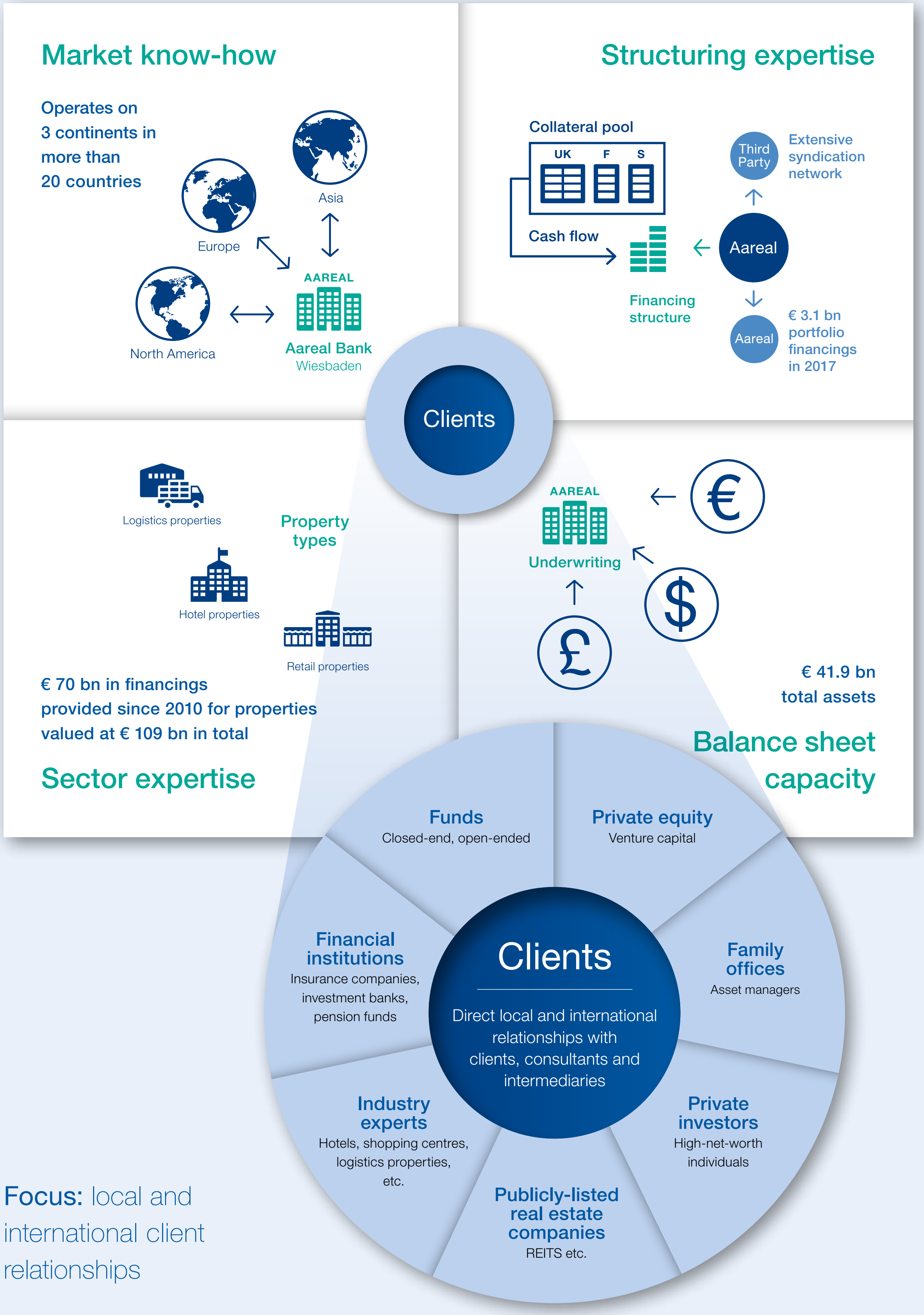
We offer our services in Europe, North America and Asia, and are active in more than 20 countries worldwide. Our clients include especially financial institutions, investment funds, private equity firms, family offices, private individuals, listed property companies and industry experts.

Our particular strengths are our structuring expertise, reliability and the combination of local market knowledge and high-level industry expertise. In addition to local experts, our team also comprises industry specialists for logistics properties, shopping centres and hotels.

"Our distinguishing features in the area of financing property projects are our international orientation and in-depth market and industry expertise, and therefore the associated ability to successfully structure cross-border financings. Partners benefit from our many years of experience, our network and comprehensive competence in the area of structured financing, as they receive all solutions from a single source."

Christof Winkelmann
Member of the Management Board of Aareal Bank

Structured Property Financing segment



Focus: local and international client relationships

”The property industry is going digital – there is no way of avoiding this statement and the fact that this development will accelerate even further. We, Aareal Bank Group, see ourselves as a driver of innovation in the area of digitalisation. We are consistently developing our leading position as a partner for the property industry with innovative products and approaches, also along the interfaces to adjacent ecosystems such as the energy sector.“

Thomas Ortmanns
Member of the Management Board of Aareal Bank

Consulting/Services

In the Consulting/Services segment, we offer solutions to clients from the housing industry, the property, energy and the waste disposal industries. These include specialised banking services and electronic banking solutions, automated mass payments, and optimisation of downstream processes. Through Aareon AG, the leading consultancy and systems house to the property industry, we provide IT consulting, software and IT services in several European countries.

The basic factors driving our success are our expertise in many European countries, and our long-standing close cooperation with local experts and with clients. Because we look beyond the scope of traditional banking and IT services, we are able to reliably assess material developments, opportunities and risks at an early stage, implementing the insights gained particularly quickly. We look back at 60 years of experience, and place a great emphasis on the provision of personal service and on tailor-made solutions to meet our clients’ individual needs.

Aareal Bank Group's Smart World

Aareon Group

Consultancy and systems house
to the European property industry

The provider of digital solutions to the institutional housing industry in Europe – for example, in Germany and France

€ 221.3
million sales revenues

(Residential) units managed by clients
>10 million

Aareal Bank
Bank division Housing Industry

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

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

10
billion in deposits (2017 average)

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

Our "Aareal 2020" programme for the future

Our way forward

Our ”Aareal 2020“ programme for the future is creating the prerequisites for us to continue forging ahead successfully in the digital age as well. Our aspiration: Aareal Bank Group intends to be the leading provider of smart financing, software products and digital solutions for the property sector and related industries.

”Aareal 2020“ aims to establish structures and processes that allow us not only to keep pace with the growing and rapidly changing requirements, but to shape (”Adjust“) the changes, further develop the portfolio of services while consistently focusing on our clients, by developing (”Advance“) new markets and client groups – and hence creating new revenue potential – and creating values for our clients, investors and employees in the future, too (”Achieve“).

We successfully continued to implement our ”Aareal 2020“ programme for the future during the year under review, and have already reached important milestones in this respect:

1. In the Structured Property Financing segment, the North American portfolio was extended significantly, the non-core portfolio was reduced, new syndication partners were acquired, and we made advances in the procedure of digitalising the internal processes and the client interfaces, as planned. In the years ahead, we intend to expand even more into attractive markets, enhance balance sheet flexibility and tap new digital business opportunities along the value creation chain.

2. A series of growth initiatives was launched in the Consulting/Services segment, such as the cross-selling of digital products in Europe through Aareon, the development and migration to modern ERP solutions, establishing digital platforms and marketing new digital products, gaining entry to the utilities sector via IT interfaces and cooperations with start-ups. We will focus in the years ahead on enlarging the housing industry and utilities ecosystem, developing existing platform products for the housing enterprises’ B2C business, as well as expanding the range of payments and IT products, and the client base.

3. We have also made great advances in further developing our organisational structures and processes, including for example, making Group structures more efficient, investing in a new IT landscape and initiating a comprehensive process of cultural change. We have optimised our deposit mix, and already anticipated regulatory aspects at an early stage. Our objective is to further enhance our flexibility and efficiency, reduce complexity, and increasingly digitalise our processes within the scope of an optimised IT landscape. We are also targeting a balanced capital structure and preserving our broadly-diversified funding base.

Shouldering responsibility

Sustainability as standard

We are convinced that solid corporate action with a sense of responsibility is a material requirement for securing the long-term sustainability of a company or enterprise.

We want to make a contribution to global, sustainable growth through the tailored structuring of financings and by developing innovative payments and software solutions, as well as providing digital services for the housing and property industries.

"Aareal Bank Group represents solidity and a sense of responsibility. This is also reflected in our risk management. Our appropriate and sustainable risk management allows us to anticipate risks at an early stage, act with foresight in our lending operations and is a material basis for our exceptionally good financial performance."

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

Our sustainability mission statement

Our principles of corporate responsibility are summarised in our sustainability mission statement:

1	We take an integrated approach and broaden the areas of activity identified in our strategic programme to include social and ecological issues.
2	We analyse trends holistically, evaluate the resulting opportunities and risks, and align our forward-looking sustainability programme with this.
3	We focus on all relevant stakeholder groups, seek to engage in active dialogue with them in a variety of ways and show how we make use of the insights we have gained.
4	We make sure that business decisions take account of ecological, social and governance factors, and communicate our progress and the challenges we face transparently and credibly.
5	We set priorities, implement decisions and hence reinforce corporate sustainability values such as strict client orientation, reliability, innovative ability, corporate integrity and our appeal as an employer.

"With property financings that we support and facilitate, clients benefit from our transaction expertise and our understanding of their business and needs in implementing their projects. Our structuring expertise forms the basis to structure management solutions both nationally and internationally, and to realise portfolio and multi-currency financings."

Dagmar Knopek
Member of the Management Board of Aareal Bank

More online:
ar.aareal-bank.com/2017

Sustainable lending business

Aareal Bank Group finances commercial property, focusing on complex, large-volume financings for completed buildings with an average term of five to eight years. The sustainable intrinsic value of the properties and the very careful selection of business partners are therefore in the fundamental interests of the Company.

Active portfolio management and the variety of the properties we finance, namely office buildings, hotels, shopping centres as well as logistics and residential properties, contribute to a balanced portfolio from a risk perspective. The portfolio therefore contains no potentially controversial industrial plants or other facilities that may be considered as problematic by the public.

To ensure the properties meet our high quality requirements, we base our valuation of them on the market values as well as on the concept of determining mortgage lending values. This routinely takes into account sustainability aspects such as the technical, functional, sociocultural and ecological quality. Deficiencies in quality, such as inadequate energy efficiency, have a negative impact on the valuation.

The sustainability of the property finance portfolio can also be substantiated in quantitative terms. The indicator for credit default risk is thus consistently low: while this indicator was still at 65 basis points in 2009 at the height of the financial crisis, it was only 29 basis points as at 31 December 2017, based on the entire property finance portfolio.

Core action areas to secure corporate success

Twelve main action areas for securing the long-term corporate success form the basis of our sustainability management. Essential elements here are the profitability of the business model, and the risk and client relationship management. Against the background of the change management processes when implementing our Aareal 2020 programme for the future, the appeal as an employer, integrity of entrepreneurial action and know-how management are areas of activity that are particularly relevant.

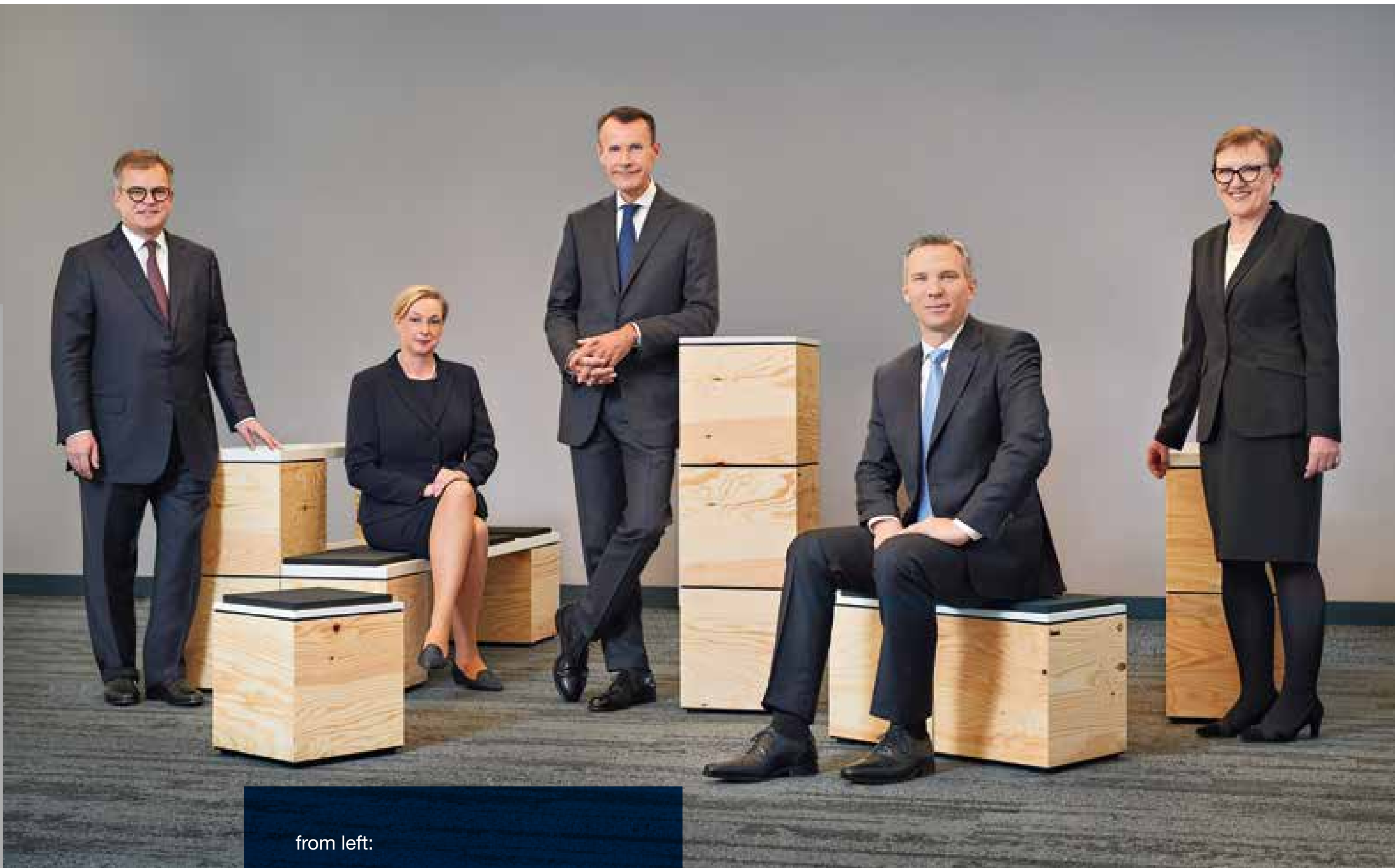
Above-average positive valuations in established sustainability ratings confirm that we address topics that are relevant for our industry and in relation to our business model. You will find information on the initiatives that we promote in the action areas in our sustainability report (cr.aareal-bank.com/2017).

Aareal Bank Group's materiality matrix

* Based on the assessments by management and specialist divisions (including assumed stakeholder expectations)
** e.g. clients/advisory boards, Supervisory Board, rating agencies

To our Shareholders

Think future. Create now.



from left:

Thomas Ortmanns
Member of the Management Board

Christiane Kunisch-Wolff
Member of the Management Board

Hermann J. Merkens
Chairman of the Management Board

Christof Winkelmann
Member of the Management Board

Dagmar Knopek
Member of the Management Board

Letter from the Management Board

Dear shareholders,
business associates and staff members,

With this annual report, we are not only providing the transparency surrounding all relevant processes and figures of the year under review that you rightly expect from us. We also give you a picture of Aareal Bank Group's position today, of the challenges it faces, what opportunities we see for the future, and how we will address them. To come to the point right away: we have every reason to believe we are well positioned to take on the tasks we face in a very challenging market, regulatory and competitive environment in the years ahead.

The hard facts clearly confirm this. Commercially, the 2017 financial year was yet another in the already long series of impressively successful years for our enterprise. Once again, Aareal Bank Group demonstrated in 2017 that it is well able to deal with a difficult environment, and once again delivered on its promises: we reached our financial objectives and met our forecasts. As we can see from all the material indicators, our Company is not only perfectly healthy but also has the necessary substance to shape its own future. As this is by no means taken for granted in our industry these days, we can look upon what Aareal Bank Group's entire team has achieved in the year under review with a certain degree of pride.

Especially so, given that 2017 was not only a good year for us, from a commercial as well as a strategic perspective, but also a very important year. We continue to do everything possible to hold the reins firmly in our own hands, even in a rapidly changing environment. With our "Aareal 2020 – Adjust. Advance. Achieve" programme for the future that was launched in 2016, we are well positioned to face this challenge. In consistently implementing this programme, we invested considerable energy last year as well as significant financial resources. It is therefore all the more encouraging that half-way through the programme, we can say that we are well on track! Our strategy is taking effect and "Aareal 2020" is taking shape.

We made great progress in 2017 in enhancing efficiency and optimising structures and process – one of the cornerstones of our strategy; this is evident from the lower administrative expenses figures. But also the diverse initiatives that we launched to further develop the business models of both segments as part of "Aareal 2020" are increasingly showing a positive effect. This applies both to the business expansion of the Structured Property Financing segment into attractive markets such as the United States, as well as to growth in the Consulting/Services segment, beyond its core housing industry business, and the new digital offers provided by our IT subsidiary Aareon.

Despite all adversities, Aareal Bank Group more than ever before remains consistently – and undeterred – on its operative and strategic path. This is to the benefit of our clients and staff – and of course of our shareholders. Not just in the distant future, but now. In view of another good year, the Management Board and the Supervisory Board will propose to the Annual General Meeting of Aareal Bank AG, to be held on 23 May 2018, another pronounced increase (€ 0.50) in the dividend per share, to € 2.50 per share. We are thus coming close to the upper end of the distribution ratio we communicated, offering our investors an extremely attractive dividend yield.

This step is made possible thanks to Aareal Bank Group's capitalisation, which remains very comfortable; the relevant quotas are significantly above regulatory requirements. This also applies assuming the full implementation of the revised Basel III capital requirements at the end of 2017. With their adoption, we now have the necessary planning security in place to decide on how to utilise the surplus capital during the course of this year on the basis of the adjusted target capital ratios. Fundamentally, we have three options: acquisitions, expanding our own business or returning capital to our shareholders. Our decision will be guided by how we can maximise value. This also applies to selecting the most suitable instruments if we opt for returning capital to our shareholders. We will not allow ourselves to be forced, but will make our decision in a confident and rational manner. This is our concept of a shareholder-friendly policy in the broadest sense, which is committed to creating sustained value rather than being guided by opportunistic considerations.

We will of course focus on creating sustained value in the current financial year too. In an environment of increasingly tough competition, we want to defend our excellent market position in 2018 in our traditional areas of business and continue our positive development. We envisage earnings per share (EpS) of between € 2.60 and € 3.00. We affirm our medium-term target of a return on equity of around 12 per cent before taxes.

The current year will also be characterised entirely by our efforts to consistently implement "Aareal 2020". We will continue to expand the foundation of our future success in both business segments, with significant investments in further expanding digital solutions. We are also concentrating on further optimising the processes and structures – a task that has not yet been completed by the measures passed in the previous year.

We have a clear objective in mind in all this: we will be the leading provider of smart financing, software products and digital solutions for the property sector and related industries. Over the next years, we will prove that it is possible to be sustainably successful as a medium-sized, independent business, in changing markets – provided that you pursue the right business policy, with a forward-looking strategy. We achieved this once again in 2017, and are confident that this will also be the case for 2018 and in the years ahead.

We thank you for the trust you have placed in the path we have pursued to date. The Management Board of Aareal Bank Group, its executives and staff, will devote their energy to continue to uphold this trust. We look forward to your benevolent support along this path in the future, too.

Yours sincerely,

Hermann J. Merkens
Chairman of the Management Board

The Aareal Bank Share

Investor Relations activities

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

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

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

Overall, market communications thus remained at a high level throughout 2017. In the course of the financial year under review, the Investor Relations team took part in eleven international capital markets conferences and conducted more than 200 one-on-one meetings with clearly more than 300 investors and analysts during 15 roadshows in Europe and the US. Investors greatly appreciate the fact that Management Board members also regularly attend conferences and roadshows in order to be available for personal meetings.

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

In the 2018 financial year, we will maintain our proactive communication with capital markets in order to further strengthen shareholders' confidence in the sustainable success of Aareal Bank Group's business model.

Key data and indicators of the Aareal Bank share

	2017	2016
Share price (€)[1]		
Year-end price	37.730	35.765
High	38.400	36.955
Low	33.710	21.660
Book value per share (€)	43.80	43.22
Dividends per share (€)[3]	2.50	2.00
Earnings per ordinary share (€)	3.20	3.33
Price/earnings ratio[2]	11.79	10.94
Dividend yield (%)[2]	6.6	5.6
Market capitalisation (€ mn)[2]	2,258	2,141

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

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

Shareholder structure

since 3 February 2015

Analysts' opinions

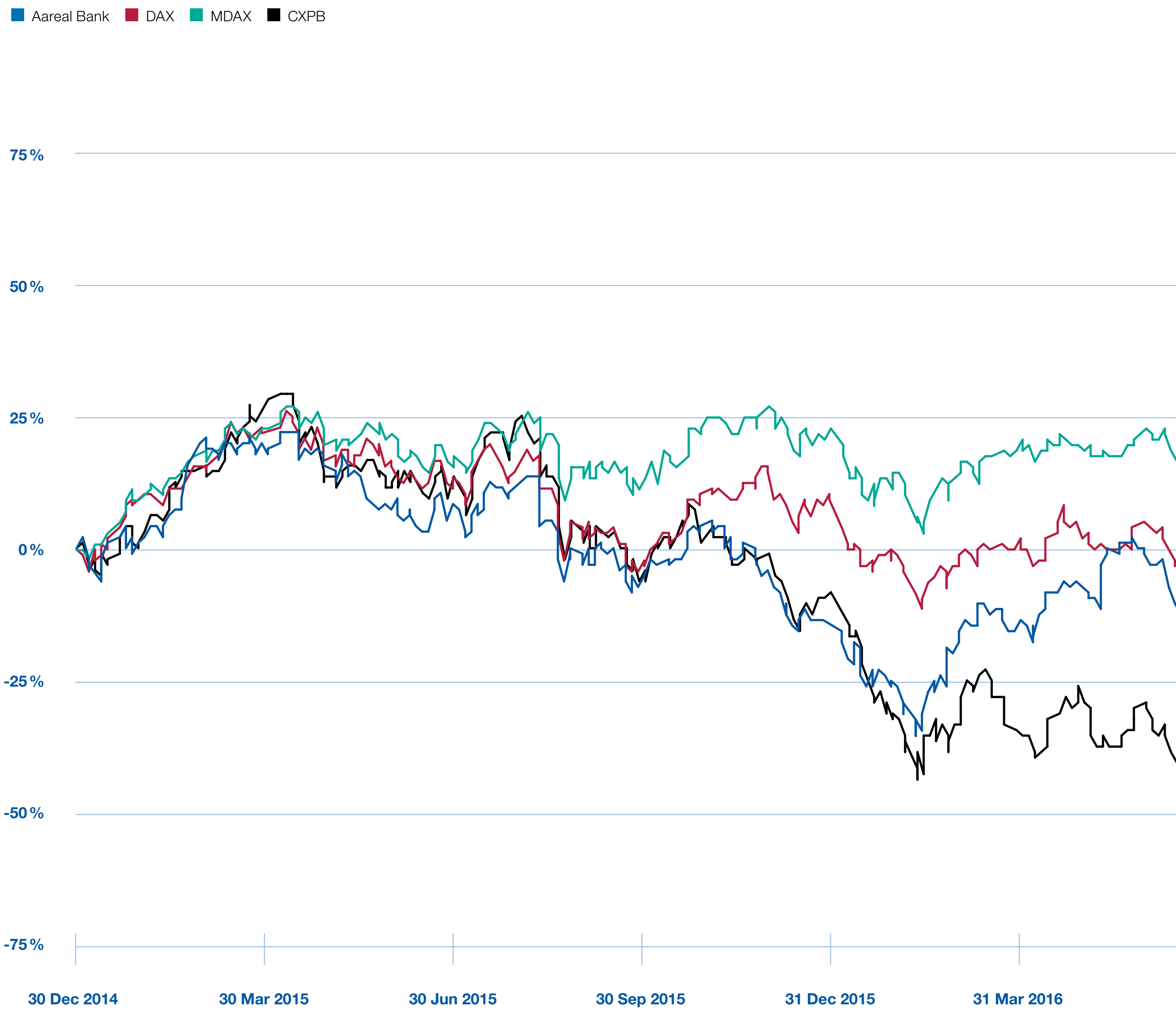
On top of the 13 brokerages and analyst firms that regularly covered Aareal Bank at the start of the financial year, another firm initiated coverage of Aareal Bank, so that at the end of 2017 the number of brokerages and analyst firms publishing independent studies and comments about developments at Aareal Bank Group rose to 14.

Having finished the 2016 financial year on a positive note, Aareal Bank also needed to meet expectations by market participants and analysts in 2017. Aareal Bank fulfilled these high expectations. Currently, there are eight "buy" recommendations, compared with six "neutral" recommendations. There is no "sell" recommendation at present.

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

Relative performance of the Aareal Bank share price

2015-2017



(1) 23 February 2017
Aareal Bank Group posts very good results for the financial year 2016 – proposes dividend increase from € 1.65 to € 2.00 per share

(2) 1 March 2017
Aareal Bank announces repayment of the Aareal Bank Capital Funding Trust, effective 31 Mar 2017

(3) 30 March 2017
Aareal Bank Group publishes its Annual Report 2016

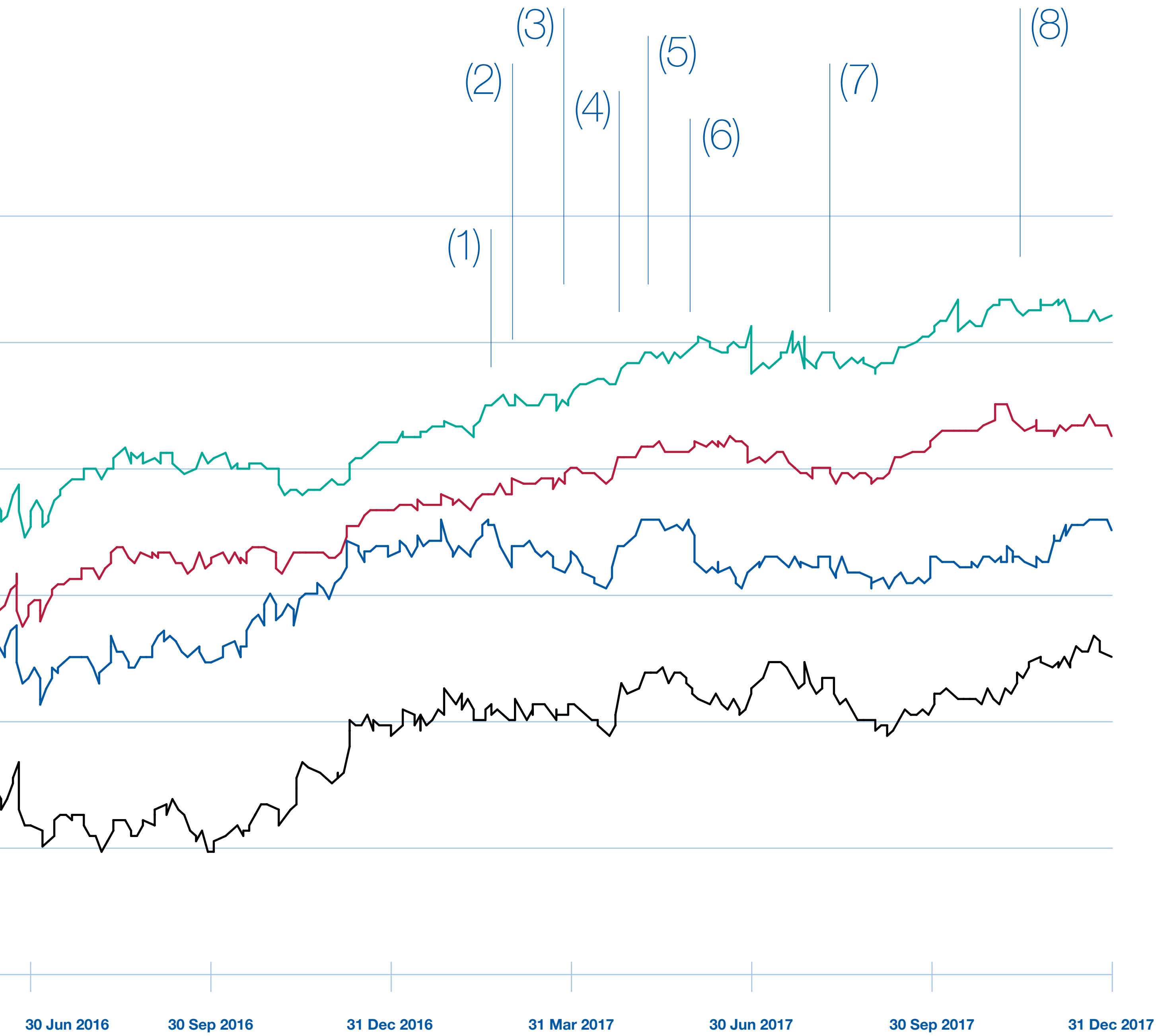
(4) 20 April 2017
Aareal Bank Group reverses provisions recognised within the scope of the acquisition of Corealcredit Bank AG and raises its forecast for annual results

(5) 11 May 2017
Aareal Bank Group remains on course, following solid start into the new year

(6) 31 May 2017
Annual General Meeting of Aareal Bank AG approves a dividend increase to € 2.00 per share for the 2016 financial year

(7) 10 August 2017
Aareal Bank Group affirms full-year guidance, after solid second quarter

(8) 14 November 2017
Aareal Bank Group affirms full-year guidance, after successful third quarter



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

Group Management Report

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

Fundamental Information about the Group

Business model

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

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

Structured Property Financing

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

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

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

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

Funding

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

Consulting / Services

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

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

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

In conjunction with payment transactions processed via Aareal Bank's systems, deposits are generated that contribute significantly to Aareal Bank Group's refinancing base.

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

Management system

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

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

- **Group/consolidated:**
  - » Net interest income (in accordance with IFRSs)
  - » Allowance for credit losses (in accordance with IFRSs)
  - » Net commission income (in accordance with IFRSs)
  - » Administrative expenses (in accordance with IFRSs)
  - » Operating profit (in accordance with IFRSs)
  - » Return on equity (RoE; before taxes)[1]
  - » Earnings per ordinary share (EpS)[2]
  - » Common Equity Tier I ratio (CET I ratio)
  - » Liquidity Coverage Ratio (LCR)

- **Structured Property Financing segment**
  - » New business[3]
  - » Credit portfolio of Aareal Bank Group

- **Consulting/Services segment**
  - » Aareon's contribution to consolidated operating profit (in accordance with IFRSs)

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

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

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

The property financing portfolio is actively managed throughout Aareal Bank Group, with the aim of optimising its risk diversification and profitability. To develop risk- and return-oriented

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

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

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

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

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

Economic Report

Macro-economic environment

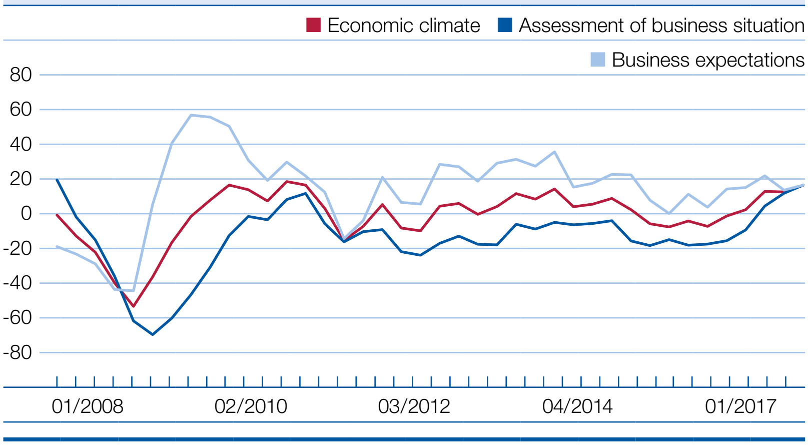
The developed economies reported robust and synchronised growth in 2017. A number of political uncertainties and natural disasters failed to dampen the positive mood. Further focus was on the central banks, some of whom began to, or at least signalled their intention to shift away from extremely expansionary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

Economy

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

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

ifo Business Climate World Economy



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

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

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

Annual rate of change in real gross domestic product

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

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

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

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

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

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

Financial and capital markets, monetary policy and inflation

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

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

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

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

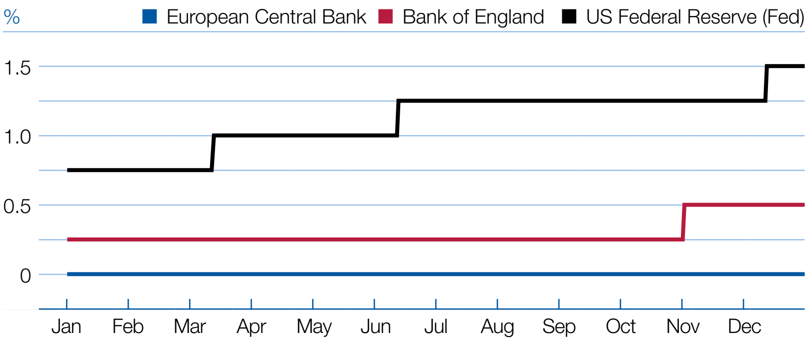
Short-term US dollar rates[2] showed a significant increase over the course of the year compared with the end of 2016. They remained almost unchanged in pound sterling until the third quarter, but rose marginally in line with the interest rate hike at the end of the year. In the euro area, they remained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

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

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

[1] Based on the 10-year swap rate
[2] Calculated on the basis of 3-month EURIBOR or the corresponding LIBOR or other comparable rates for other currencies

Key rate developments in 2017 [1)]



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

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

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

Regulatory environment

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

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

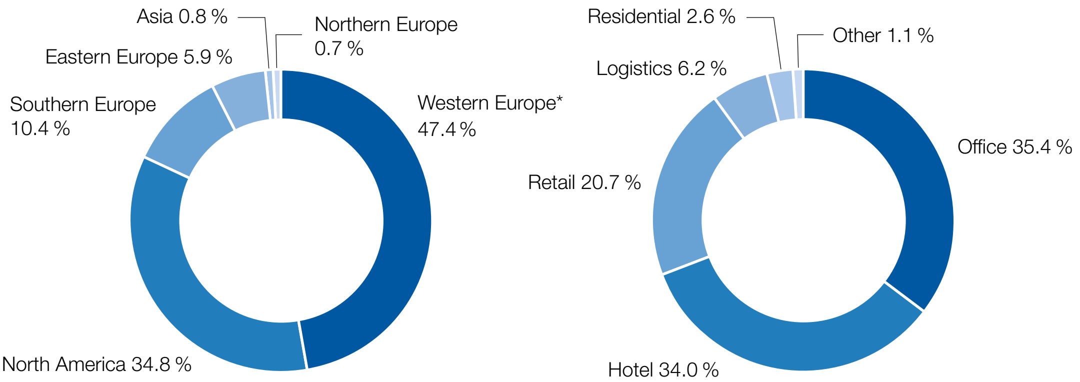
Sector-specific and business developments

Structured Property Financing segment

The transaction volume represents the volume of existing buildings traded on a market and is often

New business 2017

by region | by type of property



* Incl. Germany

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

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

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

In a highly competitive business environment characterised by numerous uncertainty factors, Aareal Bank succeeded in generating € 8.8 billion of new business[2] in 2017. This figure was down slightly on the corresponding figure for the previous year (€ 9.2 billion). The original target was clearly exceeded thanks to high early renewals. With € 6.5 billion, the volume of newly-originated loans was up on the previous year's figure of € 5.8 billion.

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

[1] Office, retail, logistics and hotel property markets were analysed
[2] New business, excluding former WestImmo's private client business and local authority lending business

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

Europe

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

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

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

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

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

North America

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

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

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

politan areas of California, for both office and retail properties.

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

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

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

Asia

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

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

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

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

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

Consulting/Services segment

Bank division Housing Industry

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

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

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

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

Aareon

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

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

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

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

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

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

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

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

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

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

Financial Position and Financial Performance

Financial performance

Group

Consolidated operating profit for the 2017 financial year amounted to € 328 million (including a non-recurring effect of € 50 million, related to net other operating income / expenses), and was thus within the increased guidance of between € 310 million and € 350 million. The previous year's figure of € 366 million was influenced by € 61 million in sales proceeds, reported in the result from non-trading assets.

Net interest income declined to € 634 million (2016: € 701 million) and was thus in line with our expectations (€ 620 million to € 660 million). This was largely due to the scheduled reduction of the former WestImmo and Corealcredit portfolios. In addition, exchange rate fluctuations led to lower net interest income.

Allowance for credit losses fell to € 82 million in the 2017 financial year (2016: € 97 million) and therefore remained within the forecast range of € 75 million to € 100 million for the full year. Net commission income increased to € 206 million (2016: € 193 million), which was mainly due to higher sales revenue at Aareon. The net figure was within the forecast range of € 195 million to € 210 million for the year.

The € 7 million aggregate of net trading income / expenses, the net result from non-trading assets, and the net result on hedge accounting, resulted largely from the measurement of derivatives used to hedge interest rate and currency risk. The previous year's figure of € 86 million included € 61 million from the disposal of wholly-owned subsidiary Aqvatrium, which is the owner of a commercial property located in Stockholm.

Consolidated net income of Aareal Bank Group

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Net interest income	634	701
Allowance for credit losses	82	97
Net interest income after allowance for credit losses	**552**	**604**
Net commission income	206	193
Net result on hedge accounting	-7	0
Net trading income/expenses	14	19
Result from non-trading assets	0	67
Results from investments accounted for using the equity method	–	0
Administrative expenses	511	547
Net other operating income/expenses	74	30
Operating profit	**328**	**366**
Income taxes	115	132
Consolidated net income	**213**	**234**
Consolidated net income attributable to non-controlling interests	6	19
Consolidated net income attributable to shareholders of Aareal Bank AG	207	215

Administrative expenses amounted to € 511 million (2016: € 547 million), and were thus at the top end of the € 470 million to € 510 million range projected for the financial year. The decline reflected lower integration and current costs related to former WestImmo; the total figure includes provisions for personnel measures resulting from the optimisation of processes and structures, within the scope of the "Aareal 2020" programme for the future, as well as costs for strategic projects.

Net other operating income / expenses of € 74 million (2016: € 30 million) includes a positive non-recurring item in the amount of € 50 million, from a subsidiary's reversal of provisions against income. Aareal Bank Group disclosed a corresponding income tax expense of € 26 million.

All in all, consolidated operating profit for the 2017 financial year totalled € 328 million, after € 366 million in 2016. Taking into consideration income tax expenses of € 115 million and non-controlling interest income of € 6 million, consolidated net income attributable to shareholders of Aareal Bank AG amounted to € 207 million (2016: € 215 million). Assuming the pro rata temporis accrual of net interest payments on the AT1 bond, consolidated net income allocated to ordinary shareholders stood at € 191 million (2016: € 199 million). Earnings per ordinary share amounted to € 3.20 (2016: € 3.33) and return on equity (RoE) before taxes stood at 11.9 % (2016: 13.2 %).

Structured Property Financing segment

Operating profit for the Structured Property Financing segment totalled € 351 million; when a non-recurring effect of € 50 million in net other operating income / expenses is taken into account, the figure fell short of the previous year's € 395 million. However, the previous year's figure was influenced by € 61 million in sales proceeds, reported in the result from non-trading assets.

Net interest income declined to € 646 million (2016: € 716 million). This was largely due to the scheduled reduction of the former WestImmo and Corealcredit portfolios. In addition, exchange rate fluctuations led to lower net interest income.

Allowance for credit losses fell to € 82 million in the 2017 financial year (2016: € 97 million). The € 7 million aggregate of net trading income /

Structured Property Financing segment result

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Net interest income	646	716
Allowance for credit losses	82	97
Net interest income after allowance for credit losses	**564**	**619**
Net commission income	7	10
Net result on hedge accounting	-7	0
Net trading income/expenses	14	19
Result from non-trading assets	0	66
Results from investments accounted for using the equity method	–	0
Administrative expenses	296	346
Net other operating income/expenses	69	27
Operating profit	**351**	**395**
Income taxes	123	143
Segment result	**228**	**252**

expenses, the net result from non-trading assets, and the net result on hedge accounting, resulted largely from the measurement of derivatives used to hedge interest rate and currency risk. The previous year's figure of € 85 million included € 61 million from the disposal of wholly-owned subsidiary Aqvatrium, which is the owner of a commercial property located in Stockholm.

Administrative expenses amounted to € 296 million in the 2017 financial year (2016: € 346 million). The decline reflected lower integration and current costs related to former WestImmo; the total figure includes provisions for personnel measures resulting from the optimisation of processes and structures, within the scope of the "Aareal 2020" programme for the future, as well as costs for strategic projects.

Net other operating income / expenses of € 69 million (2016: € 27 million) included a positive non-recurring item in the amount of € 50 million, from a subsidiary's reversal of provisions against income. Aareal Bank Group disclosed a corresponding income tax expense of € 26 million.

Operating profit in the Structured Property Financing segment totalled € 351 million. After inclusion of € 123 million in income taxes, the segment result amounted to € 228 million (2016: € 252 million).

Consulting / Services segment

Operating profit in the Consulting / Services segment remained negative, at € -23 million (2016: € -29 million). At € 34 million, Aareon matched its good result from the previous year. However, low margins from the deposit-taking business with the housing industry, due to the persistent low interest rate levels, clearly influenced the segment result.

Sales revenue increased to € 226 million (2016: € 206 million), mainly due to increased sales revenue at Aareon and at the Bank's Housing Industry division.

Staff expenses of € 151 million rose from the previous year's level, reflecting higher staffing levels and Aareon's acquisitions, amongst other factors. On balance, the Consulting / Services segment generated operating profit of € -23 million (2016: € -29 million). After inclusion of tax effects of € 8 million, the segment result amounted to € -15 million (2016: € -18 million).

Consulting / Services segment result

€ mn	1 Jan - 31 Dec 2017	1 Jan - 31 Dec 2016
Sales revenue	226	206
Own work capitalised	4	6
Changes in inventory	–	0
Other operating income	7	7
Cost of materials purchased	35	35
Staff expenses	151	144
Depreciation, amortisation and impairment losses	12	11
Results from investments accounted for using the equity method	–	0
Other operating expenses	62	58
Interest and similar income / expenses	0	0
Operating profit	**-23**	**-29**
Income taxes	-8	-11
Segment result	**-15**	**-18**

Financial position

Consolidated total assets of Aareal Bank Group as at 31 December 2017 amounted to € 41.9 billion, after € 47.7 billion as at 31 December 2016.

Interbank deposits, repos, and cash funds

Interbank deposits, repos, and cash funds comprise short-term investments of surplus liquidity. As at 31 December 2017, this comprised predominantly cash funds and deposits with central banks and money-market receivables from banks.

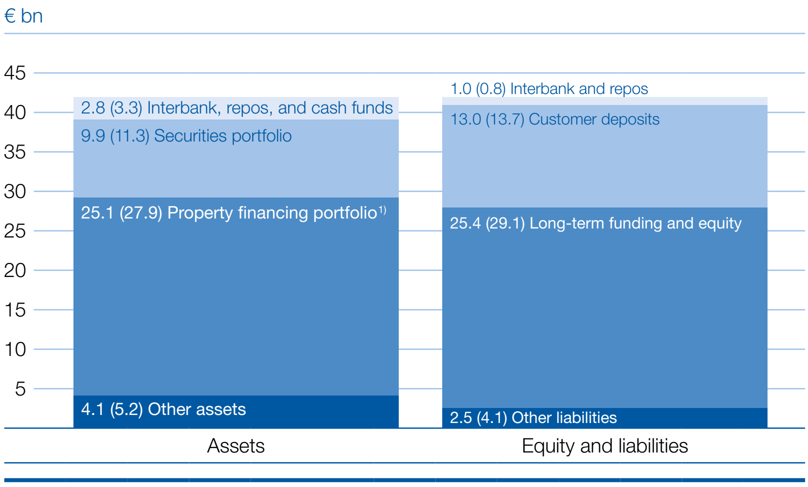
Property financing portfolio

Portfolio structure

The volume of Aareal Bank Group's property financing portfolio stood at € 25.1 billion as at 31 December 2017, down by 10 % from the year-end level 2016 (€ 27.9 billion). This was particularly attributable to the planned portfolio reduction at former WestImmo and Corealcredit, high early loan repayments, and exchange rate fluctuations. The international share of the portfolio increased to 84.8 % (31 December 2016: 83.9 %).

At the reporting date (31 December 2017), Aareal Bank Group's property financing portfolio was composed as shown below, compared with year-end 2016.

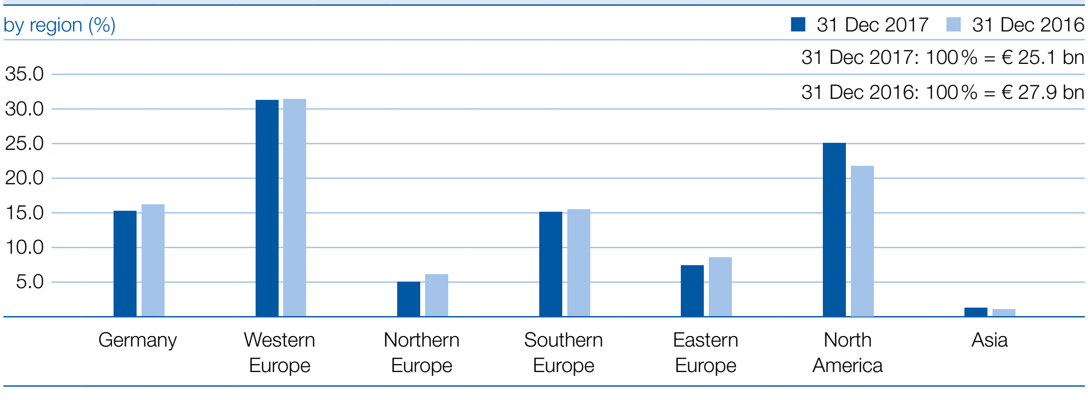
Asset/liability structure as at 31 Dec 2017 (31 Dec 2016)



[1] Excluding € 0.8 billion in private client business (31 December 2016: € 1.1 billion) and € 0.5 billion in local authority lending business by former WestImmo (31 December 2016: € 0.6 billion)

Portfolio allocation by region and continent changed in line with the Bank's strategy, compared with the end of the previous year: whilst the portfolio share of exposures in North America rose by about 3.3 percentage points, it was down by around one percentage point each for Germany, Northern Europe and Eastern Europe – remaining relatively stable for all other regions.

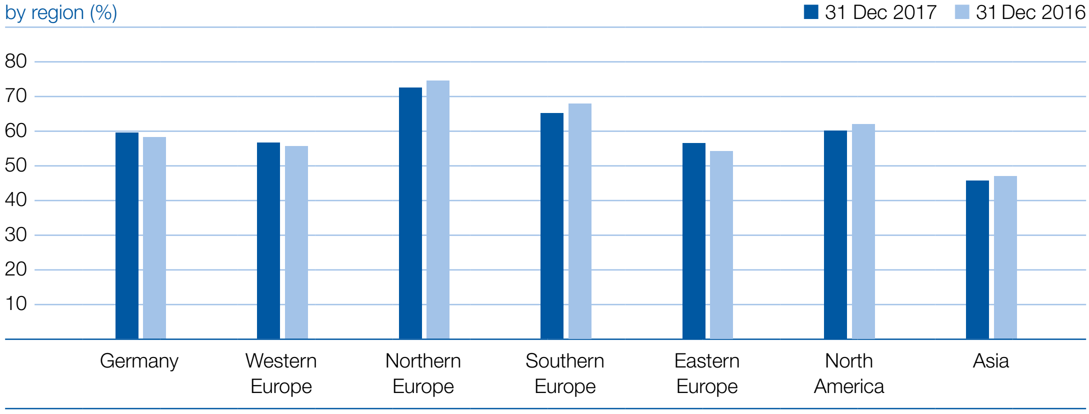
Property financing volume[1] (amounts drawn)



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

Property finance portfolio by ltv range (quarterly comparison)[1)]

by region (%)

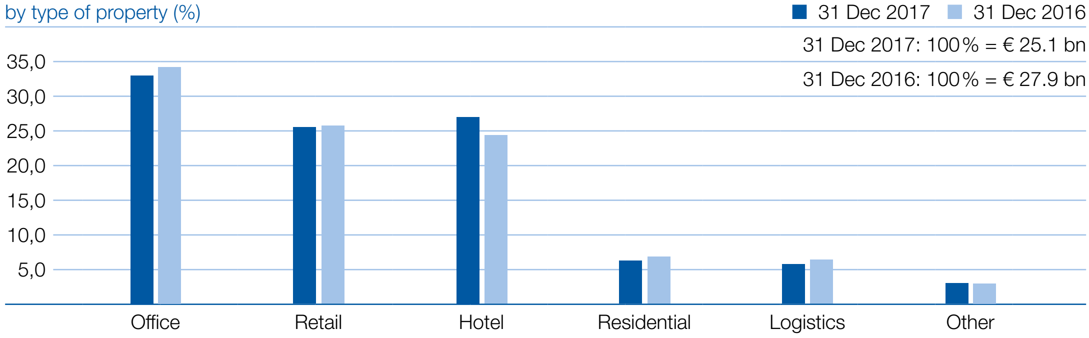


Property financing volume[1)] (amounts drawn)

by type of property (%)

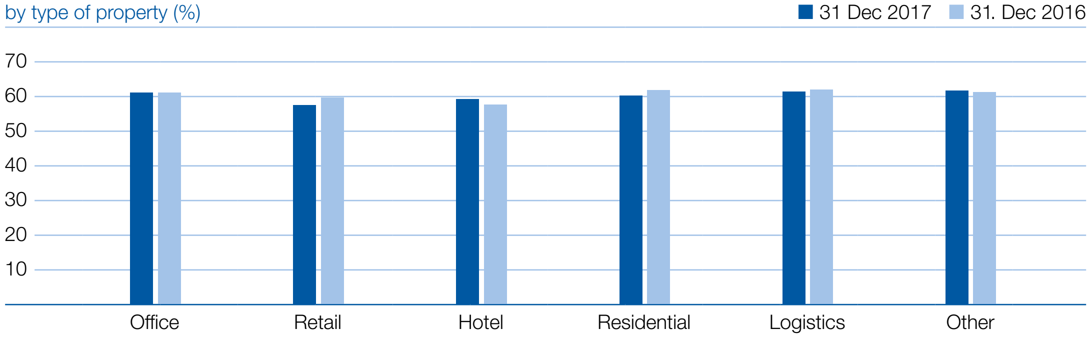
31 Dec 2017: 100% = € 25.1 bn

31 Dec 2016: 100% = € 27.9 bn



Property finance portfolio by ltv range (quarterly comparison)[1)]

by type of property (%)



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

The breakdown of the portfolio by property type changed during the reporting period: the share of hotel property increased by 2.6 percentage points compared to year-end 2016, whilst the share of office property was reduced by 1.2 percentage points. The share of financings for residential, logistics, and retail property as well as other financings in the overall portfolio showed only minor changes compared to the year-end 2016.

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

Securities portfolio

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

As at 31 December 2017, the nominal volume of the consolidated securities portfolio[1)] was € 8.3 billion (31 December 2016: € 9.3 billion).

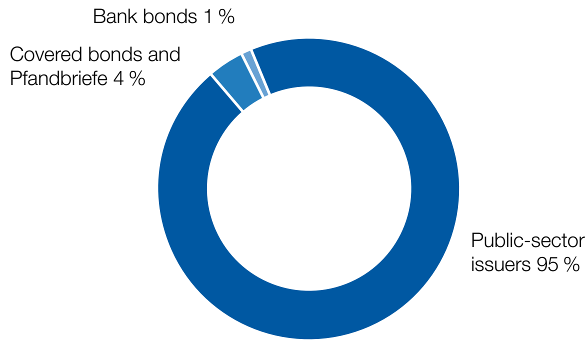
Key aspects taken into account for portfolio management are good credit quality and the related value stability, as well as a high degree of liquidity, particularly with regard to Basel III criteria. The securities portfolio comprises three asset classes: public-sector borrowers, covered bonds and Pfandbriefe, as well as bank bonds.

99 % of the overall portfolio is denominated in euro. 99 % of the portfolio has an investment grade rating.[2)] More than 75 % of the portfolio fulfils the requirements for "High Quality Liquid Assets" (as defined in the Liquidity Coverage Ratio (LCR)).

Public-sector borrowers are the largest asset class held, accounting for a share of approx. 95 %. These include securities and promissory note loans that are eligible cover-pool assets for Public Sector Pfandbriefe. 99 % of these issuers are headquartered in the EU. Some 79 % are rated AAA or AA, and a further 4 % are rated single-A. Overall, 99.5 % have an investment grade rating.

Securities portfolio as at 31 December 2017

% Total volume (nominal): € 8.3 bn



The share of Pfandbriefe and covered bonds at year-end was 4 %. 86 % consist of European covered bonds, with the remainder invested in Canadian covered bonds. All Pfandbriefe and covered bonds were rated AAA.

Due to regulatory changes, bank bonds may be used for liquidity management purposes only to a very limited extent going forward. Against this background, the share of bank bonds in the total portfolio was only 1 % as at year-end.

Financial position

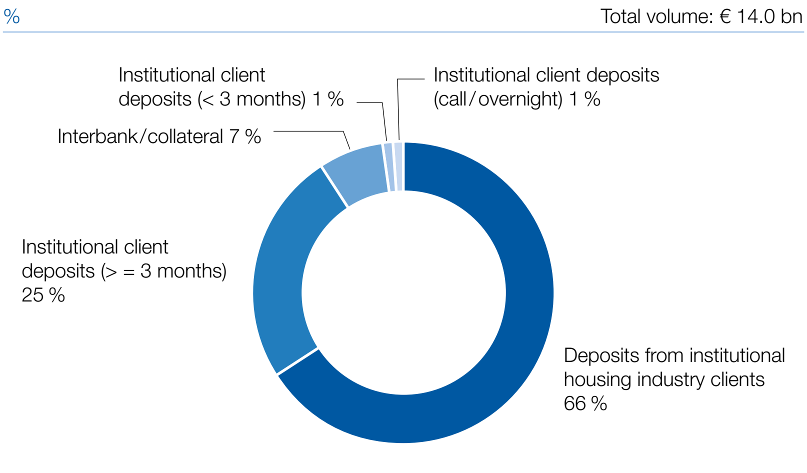
Interbank and repo business

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

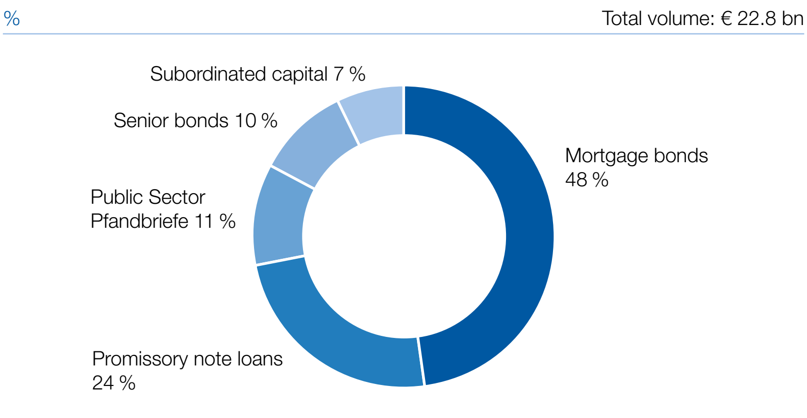
There were no repos and no liabilities vis-à-vis Deutsche Bundesbank or the ECB as at 31 December 2017.

1) As at 31 December 2017, the securities portfolio was carried at € 9.9 billion (31 December 2016: € 11.3 billion).
2) The rating details are based on the composite ratings.

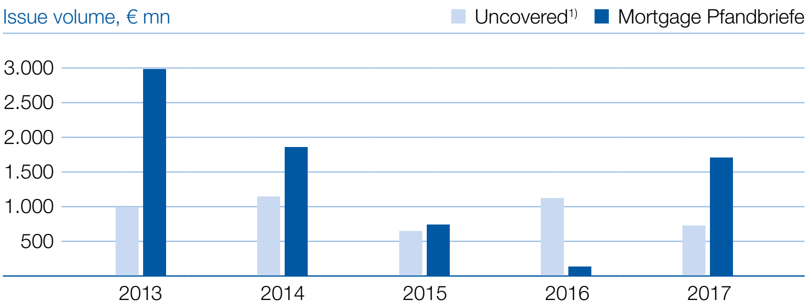
Money market funding mix as at 31 December 2017



Capital market funding mix as at 31 December 2017



Issuing activities – 2013 to 2017



[1] excluding SoFFin-guaranteed issues and subordinated capital

Customer deposits

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

Long-term funding and equity

Funding structure

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

As at 31 December 2017, the long-term refinancing portfolio amounted to € 22.8 billion. Of this amount, Mortgage Pfandbriefe accounted for € 11.1 billion, public-sector Pfandbriefe for € 2.6 billion, uncovered long-term refinancing for € 7.6 billion and subordinated long-term refinancing for € 1.5 billion.

Thus, Mortgage Pfandbriefe accounted for a total share of 48 % of long-term refinancing.

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

Refinancing activities

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

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

Equity

Aareal Bank Group's total equity as disclosed in the statement of financial position amounted to € 2,924 million as at the 31 December 2017 reporting date (31 December 2016: € 3,129 million), comprising € 300 million for the Additional Tier 1 (AT 1) bond. Due to the repayment of the Capital Funding Trust in the first quarter of the year, non-controlling interests were reduced to € 2 million (31 December 2016: € 242 million).

Regulatory capital [1]

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

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

[2] After confirmation of Aareal Bank AG's financial statements for 2017. The calculation of regulatory capital takes into account the Management Board's proposal for the appropriation of profits for the financial year 2017. The appropriation of profits is subject to approval by the Annual General Meeting.

Our Employees

Qualification and training programmes

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

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

Employee data as at 31 December 2017

	31 Dec 2017	31 Dec 2016	Change
Number of employees of Aareal Bank Group	2,800	2,728	2.6%
No. of years' service[3]	12.9 years	13.9 years	-1.0 years
Staff turnover rate	4.0%	3.9%	

[3] The previous year's figure refers to Aareal Bank AG.

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

Promoting the next generation

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

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

Remuneration system

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

Work-life balance

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

Health

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

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

Risk Report

Aareal Bank Group Risk Management

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

Risk management – scope of application and areas of responsibility

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

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

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

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

Type of risk		Risk management	Risk monitoring
Market price risks		Treasury, Transaction Committee	Risk Controlling
Liquidity risks		Treasury	Risk Controlling
Credit risks	Property Finance Single exposures	Business & Syndication Management, Credit Management	Risk Contolling, Credit Management
Credit risks	Property Finance Portfolio risks	Credit Management, Project & Credit Portfolio Management	Risk Controlling
Credit risks	Treasury business	Treasury	Risk Controlling
Credit risks	Country risks	Treasury, Credit Management	Risk Controlling
Operational risks		Process owners	Risk Controlling
Investment risks		Strategy Development	Risk Controlling, Finance & Controlling, Controlling bodies

Process-independent monitoring: Audit

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

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

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

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

Strategies

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

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

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

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

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

Risk-bearing capacity and risk limits

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

In accordance with this approach, potential risk cover is determined using data derived from the income statement and from the statement of financial position; this derivation also forms the basis for determining regulatory capital. This involves setting aside the maximum amount of own funds required as potential risk cover to offset risks without causing a breach of minimum requirements pursuant to the Capital Requirements Regulation (CRR). Freely available funds increased significantly during the period under review. Firstly, this was due to portfolio planning; secondly, Aareal Bank further refined its procedures, defining Tier I (T1) capital (as defined by the CRR) at a level of 7.75 % of forecast risk-weighted assets (RWA) as a deductible, in accordance with regulatory requirements. Only free own funds exceeding this level are applied as potential risk cover, of which a further 10 % is deducted. This deduction is not applied to risk limits, but retained for risk types that cannot be quantified (for example, business or strategic risks). Migration or FX lending risks are no longer deducted as a buffer, but are now included as credit risk exposure.

Likewise, the Bank adopts a conservative stance with respect to setting risk limits. The aggregation of individual limits is based on the assumption that no risk-mitigating correlation effects exist amongst different types of risk. Taking into account the prior deduction of a minimum Tier I ratio of 7.75 % of RWA, the value-at-risk models used to quantify risks are based on a confidence interval of 95 % and a one-year holding period (250 trading days). A monthly report submitted to the Management Board provides information regarding the utilisation of individual limits for the material types of risk, as well as on the overall limit utilisation. The table below summarises the Group's overall risk-bearing capacity as at 31 December 2017.

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

Stress testing

Stress testing, and the analysis of stress test results, form an additional focal aspect of our risk management system. This involves conducting stress tests for all material risks, using both historical parameters as well as hypothetical stress testing scenarios. To also be able to assess cross-relationships between the various types of risk, we have defined multi-factor stress scenarios, so-called "global" stress tests. For instance, the impact of the crisis

Risk-bearing capacity of Aareal Bank Group as at 31 December 2017
– Going concern approach –

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

[1] Other risks such as business or strategic risks

affecting financial markets and the economy, which broke out in 2007, on individual types of risk and aggregate risk is analysed within the scope of a historical scenario. In the hypothetical scenario, current potential developments are derived from factors such as political developments, and are combined with significant macroeconomic deterioration. The stress testing methodology implemented also takes into account the impact of any risk concentrations. We compare the aggregate risk cover available in a stress situation with the results of stress tests, thus assessing Aareal Bank's ability to bear risk in a stressed environment. The Management Board and the Supervisory Board are informed of the results of such stress analyses on a quarterly basis.

Organisational structure and procedures

Lending business

Division of functions and voting

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

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

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

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

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

Process requirements

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

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

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

Early risk detection procedures

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

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

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

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

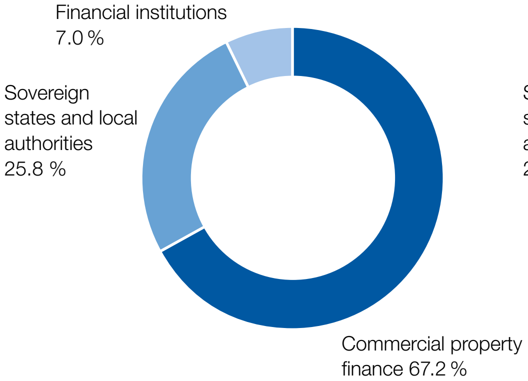
Actively managing client relationships is crucially important in this context: approaching clients in time to jointly develop a solution to any problems which may arise. Where necessary, we muster the support of experts from the independent restructuring and recovery functions.

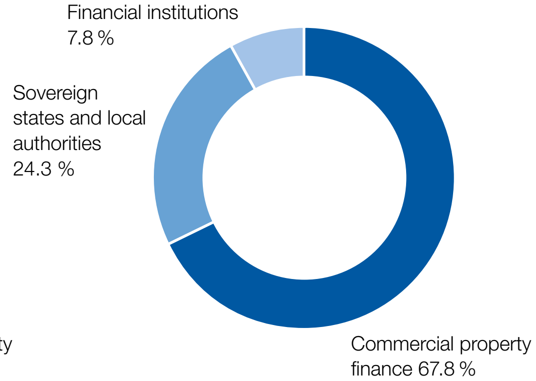
Risk classification procedures

Aareal Bank employs risk classification procedures tailored to the requirements of the respective asset class for the initial, regular, or event-driven assessment of counterparty credit risk. The rating scales and exposure definitions have been customised to match the respective methods. Responsibility for development, quality assurance, and monitoring

Breakdown of exposure by rating procedure

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





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

implementation of risk classification procedures, and for annual validation, lies with two separate divisions outside the Sales units.

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

Property financing business

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

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

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

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

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

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

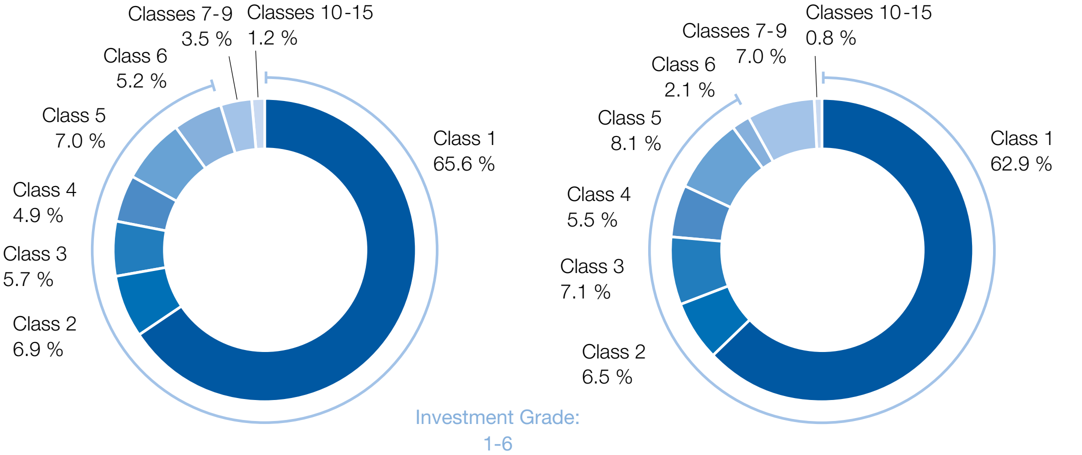
Financial institutions

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

Large-sized commercial property finance

classified by internal expected loss classes

as at 31 Dec 2017 | as at 31 Dec 2016



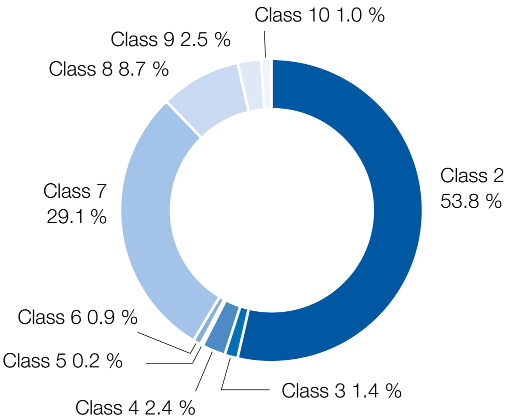
group affiliation, to classify the risk exposure to banks, financial services providers, securities firms, public-sector development banks, and insurance companies. Financial institutions are assigned to a specific rating grade by way of assessing relevant financial indicators and taking into account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

Sovereign states and local authorities

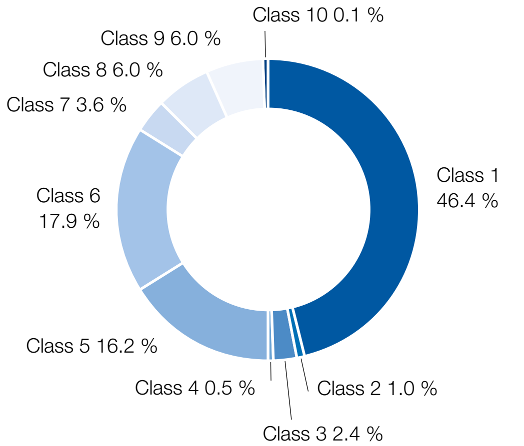
In addition, Aareal Bank Group employs internal rating methods for sovereign borrowers and regional governments, local and other public-sector entities. In this context, rating grades are assigned using clearly-defined risk factors, such as fiscal flexibility or the level of debt. The expert knowledge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

Financial institutions

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



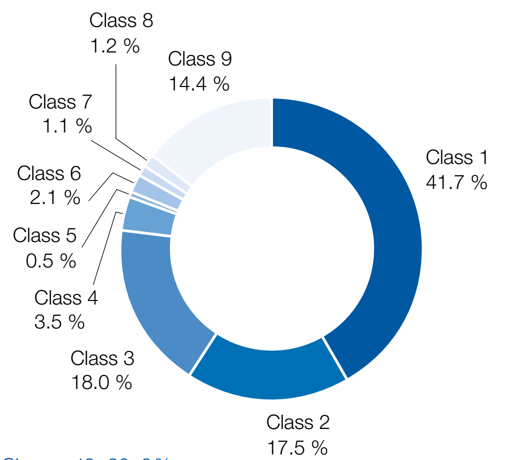
Classes 1, 11-18: 0%



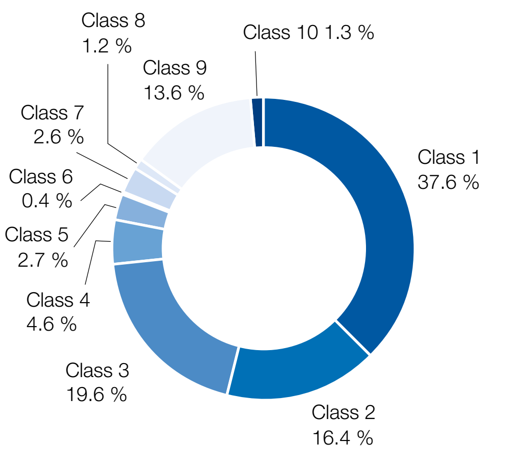
Classes 11-18: 0%

Sovereign states and local authorities

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



Classes 10-20: 0%



Classes 11-20: 0%

rating analysts is also taken into account for the rating.

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

Trading activities

Functional separation

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

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

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

The detailed assignment of responsibilities is outlined below.

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

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

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

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

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

Process requirements

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

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

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

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

Risk exposure by type of risk

Credit risks

Definition

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

Credit risk strategy

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

The credit risk strategy will be reviewed, at least once a year, as to its suitability regarding the Bank's risk-bearing capacity and its business environment; amendments will be made as necessary. The associated process is instigated by management, and implemented by the Sales units and Credit Management, who submit a proposal (on which they both agreed) to management. Designed in principle for a medium-term horizon, the credit risk strategy is adapted when necessary to reflect material changes in the Group's credit risk and business policies, or in the Group's business environment (as in the case of the financial markets crisis).

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

Risk measurement and monitoring

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

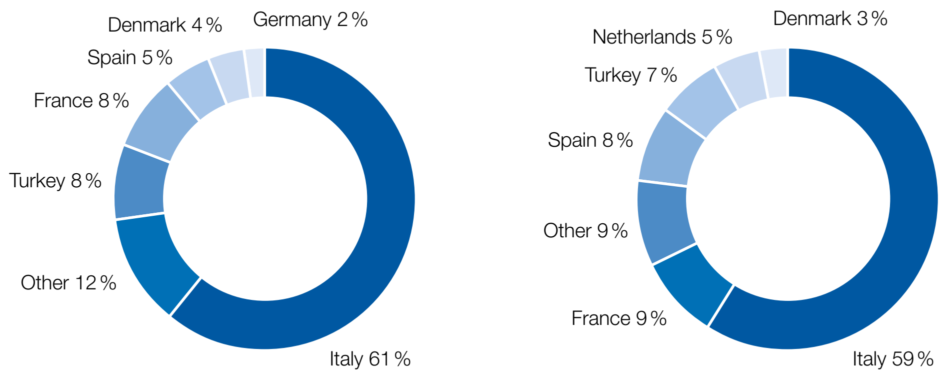
Based on the results of these models, the Bank's decision-makers are regularly informed of the performance and risk content of property finance exposures, and of business with financial institutions. The models permit to identify, measure, monitor and manage risks at a portfolio level.

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

The model-based review and monitoring of risk concentrations is carried out on the basis of the

Individually impaired property financings[1] (carrying amount)

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



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

credit risk models used in the Bank. The models in question allow the Bank to include in particular, rating changes and diversification effects in the model-based assessment of the risk concentrations.

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

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

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

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

Credit risk mitigation

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

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

Market values and mortgage lending values are set in accordance with the responsibilities for decision-making on lending, and form an integral part of the lending decision. The values to be determined by the Bank are generally pegged on the valuation prepared by a valuer; any discrepancies must be substantiated in writing. In any case, the market and mortgage lending values determined by the Bank must not exceed the values assessed by independent internal or external valuers.

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

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

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

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

Credit risk mitigation for trading activities

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

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

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

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

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

financial institutions; in many cases there are additional collateral agreements which further reduce the relevant credit risk.

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

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

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

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

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

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

Country risk

Definition

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

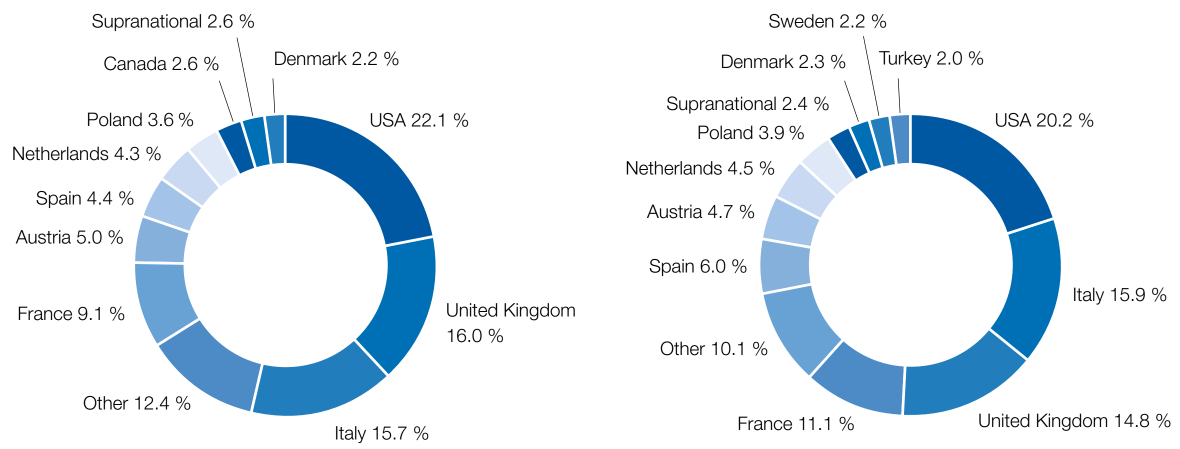
Country risk measurement and monitoring

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

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

Breakdown of country exposure in the international business

% 31 Dec 2017 | 31 Dec 2016



Market price risks

Definition

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

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

Risk measurement and monitoring

Risk Controlling informs the members of the Management Board responsible for Treasury and risk monitoring about the risk position and the market price risk exposure on a daily basis. In addition, the entire Management Board is informed on a monthly basis, within the scope of an extensive risk report. A quarterly report is submitted to the Supervisory Board.

Value-at-risk (VaR) has been broadly accepted as the predominant method for measuring general market price risk. The VaR for market price risk quantifies the exposure as a negative divergence from the current aggregate value of the Bank's financial transactions. This absolute amount indicates the potential loss incurred before countermeasures take effect. Since this is a statistical approach, the forecast for the potential loss that may be incurred within a specific period of time is for a given confidence interval only.

A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. Determined on a daily basis for the Group and all its operating units, the VaR figure takes into account the correlation between individual risk types within market price risk. Statistical parameters used in the VaR model are calculated directly from a 250-day historical data pool maintained within the Bank. The loss potential is determined applying a 95 % confidence interval and a 250-day holding period.

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

The limit set for the VaR figure is derived from the analysis of the Bank's risk-bearing capacity, which is carried out at least once a year. Limits are defined at Group level, as well as for the individual Group entities. Being authorised to maintain a trading book, Aareal Bank AG has defined an additional trading book limit, plus a separate value-at-risk limit for fund assets held.

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

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

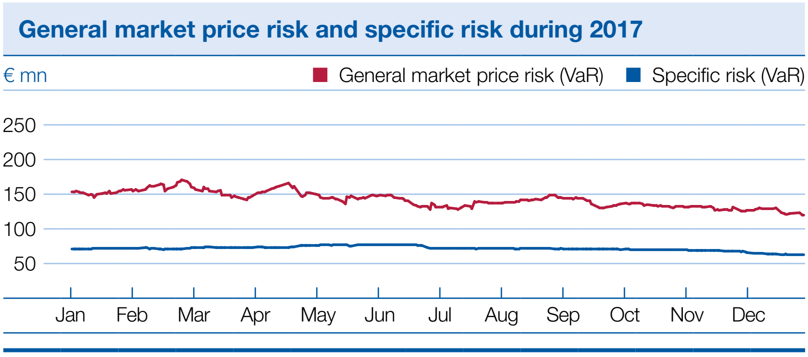
To ensure that Aareal Bank's figures are comparable to those published by other institutions, the risk parameters shown below were determined for a one-day holding period:

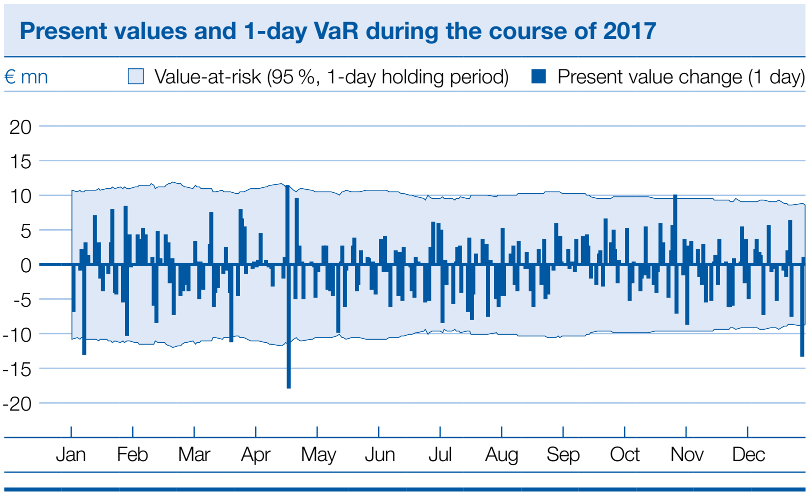
€ mn	MAX	MIN	Mean	Limit
Year-to-date (full previous year), 95 %, 1-day holding period				
Aareal Bank Group – general market price risk	11.0 (19.3)	7.6 (10.2)	9.1 (14.2)	– (–)
Group VaR (interest rates)	8.1 (13.4)	4.5 (6.5)	6.1 (9.5)	– (–)
Group VaR (FX)	6.3 (11.8)	4.4 (6.5)	5.3 (8.6)	– (–)
VaR (investment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

Aggregate VaR – Aareal Bank Group

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

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





Backtesting

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

Stress testing

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

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

The hypothetical scenario implied a present value loss of approximately 15 % of the stressed aggregate risk cover limit as at year-end 2017. No breach of set limits occurred during the year under review.

Interest rate sensitivity

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

Interest rate gap analysis

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

Trading book

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

Liquidity risks

Definition

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

Risk measurement and monitoring

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

a) Cash flow forecast

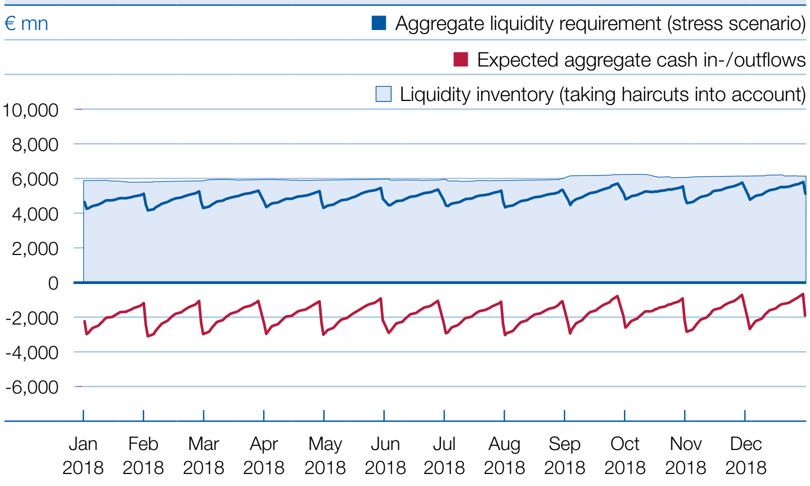
We have developed a cash flow forecast, tracking cash flows from all balance sheet items and derivatives, on a daily basis, over a ten-year period. This liquidity risk information helps to assess the Bank's short-term liquidity position, broken down by currency or product. Strategic liquidity is taken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

b) Liquidity run-off profile

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

The chart beside shows the planned development of the liquidity stock, expected aggregate cash inflows and outflows, and the total liquidity requirements (based on stressed assumptions) until the end of 2018. This presentation demonstrates that the liquidity stock will always exceed liquidity requirements, even under unfavourable conditions.

Liquidity



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

c) Funding profile

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

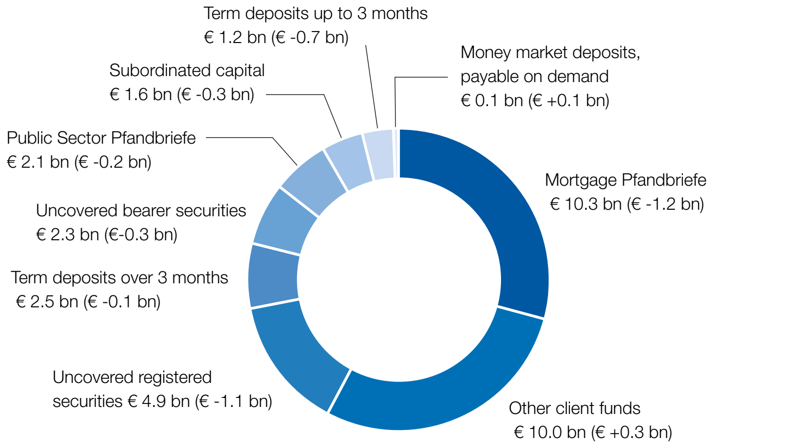
Stress testing

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

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

Refinancing portfolio diversification by product

as at 31 Dec 2017 versus 31 Dec 2016 Total volume (nominal): € 35.0 bn



Operational risks

Definition

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

Risk measurement and monitoring

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

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

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

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

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

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

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

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

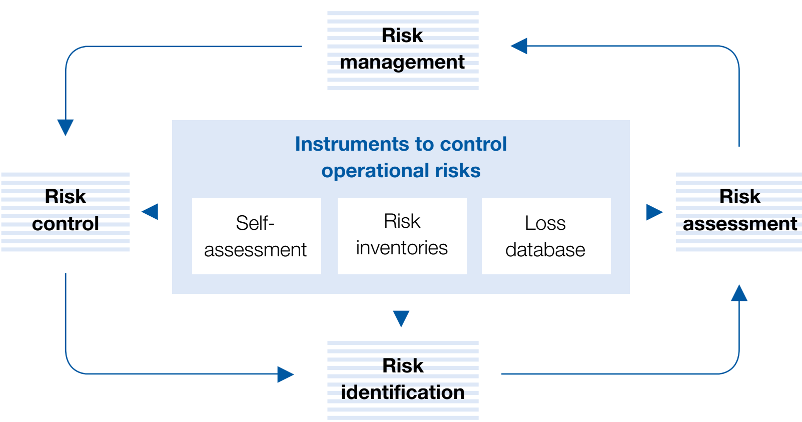
The legal department reports to the Management Board, (at least) on a quarterly basis, as well as on an event-driven basis. Moreover, information about legal risks is included in operational risk reporting.

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

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

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

Management of operational risks



Investment risks

Aareal Bank Group's risk exposure is largely concentrated on risks generally associated with banking, such as credit risk, market price risk, liquidity risk, and operational risk. Some Group subsidiaries, however, are exposed to a variety of other types of risk outside typical banking risk, which we include in our centralised risk management system through an Investment Risk Control concept.

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

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

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

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

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

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

Other risks

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

Reputational risk is defined as the risk of events that negatively affect the Bank's reputation with investors, analysts, or clients. To protect and enhance the reputation of Aareal Bank Group, and to ensure the Group's uniform strategic position, the Group Communication Policy sets out procedures for (and the approach to be taken in) external media relations, internal communications, governmental affairs, financial reporting, as well as marketing, under the central responsibility of Corporate Communications.

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

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

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

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

Accounting-related Internal Control and Risk Management System

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

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

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

Organisation of the accounting-related ICS and RMS

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

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

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

The Supervisory Board is responsible for monitoring the Management Board. It approves both the single-entity financial statements and the management report of Aareal Bank AG as well as the consolidated financial statements and group management report. Measures taken by the Supervisory Board to ensure an efficient performance of its control functions include the establishment of an Audit Committee, which is primarily responsible for financial reporting issues and monitors the effectiveness of Aareal Bank's Internal Control System. The committee analyses and assesses the financial statements submitted to it, the internal risk reports, and the annual Internal Audit report.

In addition, the Audit Committee is responsible for determining the focal points of the audit, as well as for evaluating the auditors' findings. The Audit Committee includes an expert in the fields of accounting or auditing, pursuant to section 100 (5) of the German Public Limited Companies Act (Aktiengesetz – "AktG").

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

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

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

Components of the accounting-related ICS and RMS

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

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

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

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

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

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

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

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

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

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

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

Report on Expected Developments and Opportunities

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

Macro-economic environment

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

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

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

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

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

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

Economy

Despite the numerous uncertainty factors and burdens, economic momentum – which already prevailed in 2017, driven by strong consumer spending and robust investment – is set to continue this year. The growth rate of real global economic output is expected to slightly exceed the levels seen during 2017. In this context, global trade is expected to grow further – which will especially benefit emerging market economies. Moderate inflation in the industrial countries is likely to provide additional support for purchasing power.

Still, developments will differ across the regions. Moreover, risks and uncertainty factors, were they to materialise to a substantial extent, could mute the economic development, or even cause recessive tendencies in certain regions.

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

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

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

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

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

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

Financial and capital markets, monetary policy and inflation

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

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

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

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

Regulatory environment

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

EBA has also finalised its Guidelines on the collection of information related to the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP). In addition, the Single Supervisory Mechanism (SSM) has developed expectations regarding the structure of ICAAP and ILAAP based on a multi-year plan. These expectations are set to be specified in more detail in 2018.

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

Regulators have yet to come up with final details for some of these additional regulatory requirements; hence, various technical standards, guidelines and regulations still have to be finalised. Moreover, EBA has published guidelines for PD and LGD estimates, and on the treatment of defaulted exposures, which must be implemented by the end of 2020.

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

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

Sector-specific and business developments

Structured Property Financing segment

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

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

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

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

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

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

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

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

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

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

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

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

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

dication is set to be one of the instruments for managing the portfolio, and managing risk. Syndication is a suitable tool here, which also offers scope for providing larger-scale financing solutions.

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

Consulting / Services segment

Bank division Housing Industry

The German housing and commercial property industries are expected to continue showing solid development in 2018, on the back of stable rents and a high degree of stability in property values. Companies in this sector will continue to pursue sustainable portfolio optimisation. Energy-efficient renovation, deployment of technical assistance systems, expanding the digital infrastructure and serial construction are the trends currently shaping investment trends.

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

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

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

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

Aareon

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

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

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

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

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

Business strategy

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

Group targets

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

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

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

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

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

Corporate Governance Statement

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

The full Corporate Governance Statement pursuant to sections 289f and 315d of the HGB is publicly available on the Company's website (www.aareal-bank.com/en/about-us/corporate-governance/), and in the "Transparency" section.

Consolidated Non-Financial Report

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

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

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

The Supervisory Board determines the remuneration system, and the amount of remuneration for members of Aareal Bank AG's Management Board.

The Remuneration Control Committee (Vergütungskontrollausschuss) fulfils the requirements according to section 25d (12) of the German Banking Act (Kreditwesengesetz – "KWG") and section 15 of the InstitutsVergV. It held eight meetings throughout the 2017 financial year. The Supervisory Board of Aareal Bank AG discussed remuneration issues at five meetings during the 2017 financial year.

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

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

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

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

All targets for Management Board members are integrated into the Bank's overall strategy and are geared towards achieving the objectives set out in the Bank's business and risk strategies. The targets comprise quantitative components and qualitative components, which are also related to non-financial parameters. Aareal Bank Group's overall performance is determined using the categories of consolidated operating profit/loss before taxes and risk-weighted assets.

The initial value of the performance-related remuneration may increase – depending on the Management Board member's degree of target achievement – up to a maximum of 150 % of the target value. If the overall target achievement level exceeds 150 %, the initial value of the performance-related remuneration will not increase any further (cap). Any negative deviations from targets will reduce performance-related remuneration. If the overall target achievement level is 0 %, no performance-related remuneration will be awarded for the financial year concerned. Unconscionable behaviour or behaviour in breach of duties cannot be balanced out by positive performance contributions in other areas and will automatically lead to an appropriate reduction in the variable remuneration. The Supervisory Board is entitled to increase or decrease the overall target achievement level by up to 20 %, applying reasonable discretion, in the event of any material, specified external or internal non-recurring effects, provided that the upper limit of 150 % for overall target achievement must not be exceeded. The variable remuneration generally depends on the Supervisory Board's decision to provide for the applicable financial year an amount (mathematically) sufficient for all variable remuneration components to be paid out in accordance with section 45 (2) sentence 1 no. 5a of the KWG and section 7 of the InstitutsVergV.

To ensure that the remuneration system provides long-term incentives, the initial value for variable remuneration – as determined according to the principles set out above – is awarded at the end of the financial year, according to the following principles:

20 % of the variable remuneration is paid out in cash (cash bonus) after the Supervisory Board has determined the overall target achievement level. A further 20 % of the variable remuneration is awarded as a share bonus subject to a holding period (and forms part of the share-based bonus plan), in the form of virtual shares, also after the Supervisory Board has determined the overall target achievement level. 30 % of the variable remuneration is retained (cash deferral), and disbursed in cash – pro rata temporis – over a defined retention period.The remaining 30 % of variable remuneration is credited, as a cash amount, to a virtual account maintained on behalf of each Management Board member, and forms part of the share deferral plan. With regard to the portion of performance-related remuneration that is deferred initially as a cash deferral or a share deferral, the Supervisory Board makes a decision regarding the granting of one third of the amount, as well as the associated interest, in the three years following the determination of the performance-related remuneration (retention period). Starting with performance-related remuneration for the 2018 financial year, the retention period will be extended to five years. Until the end of the retention period, there is no right to the relevant remuneration components. Once the deferred remuneration components for Management Board members are vested, the cash deferral is paid out in cash and the share deferral is converted into virtual shares, subject to a two-year

(starting with variable remuneration for the 2018 financial year: one-year) holding period.

In making its determination about the amount to be awarded, the Supervisory Board particularly takes into account any negative aspects of the Management Board member's performance, that of the division he/she is responsible for, as well as any weakness in the performance of Aareal Bank Group (ex-post risk adjustment). A negative individual performance contribution is deemed to be present, for example, in the event of breaches of the Code of Conduct and/or of Compliance guidelines, conduct that damages the Bank's reputation, or in the event of other misconduct which would justify a termination for good cause. Ex-post risk adjustment also involves a retrospective review as to whether the performance contributions assumed at the time of determining the initial value of performance-related remuneration are proven to be sustainable (backtesting). The Supervisory Board decides upon any adjustments to variable remuneration, according to its own best judgment, based on a recommendation by the Remuneration Control Committee. If any retained performance-related remuneration components are not awarded, or only in part, the remaining sum is forfeited, i.e. it is not carried forward into subsequent years. Moreover, an award of the deferred variable remuneration components will not be made insofar and for so long as the German Federal Financial Supervisory Authority ("BaFin") forbids this according to section 45 (2) sentence 1 nos. 5a and 6 of the KWG. The entitlement no longer exists if BaFin so orders by way of a final and conclusive decision pursuant to section 45 (5) sentences 5 to 8 of the KWG.

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

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

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

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

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

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

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

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

Explanatory Report of the Management Board on Takeover Disclosures in Accordance with Section 315a (1) of the German Commercial Code (Handelsgesetzbuch – HGB)

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

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

Restrictions affecting voting rights or the transfer of shares

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

Shareholdings exceeding 10 % of voting rights

Details regarding any shareholdings exceeding 10 % of voting rights are provided in Note 93 to the consolidated financial statements.

Shares with special rights granting the holder supervisory powers

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

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

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

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

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

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

Authorisation of the Management Board to issue or repurchase shares

Authorised capital

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

Conditional capital

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

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

Authorisation to purchase treasury shares

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

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

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

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

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

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

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

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

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

Consolidated Financial Statements

Contents II

Consolidated Financial Statements
Statement of Comprehensive Income

Income Statement

€ mn	Note	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Interest income		737	847
Positive interest from financial liabilities		7	3
Interest expenses		98	137
Negative interest from financial assets		12	12
Net interest income	27	**634**	**701**
Allowance for credit losses	28	82	97
Net interest income after allowance for credit losses		**552**	**604**
Commission income		243	234
Commission expenses		37	41
Net commission income	29	**206**	**193**
Net result on hedge accounting	30	-7	0
Net trading income/expenses	31	14	19
Results from non-trading assets	32	0	67
Results from investments accounted for using the equity method	33	–	0
Administrative expenses	34	511	547
Net other operating income/expenses	35	74	30
Operating profit		**328**	**366**
Income taxes	36	115	132
Consolidated net income		**213**	**234**
Consolidated net income attributable to non-controlling interests		6	19
Consolidated net income attributable to shareholders of Aareal Bank AG		207	215
Earnings per share (EpS)			
Consolidated net income attributable to shareholders of Aareal Bank AG [1]		207	215
of which: allocated to ordinary shareholders		191	199
of which: allocated to AT1 investors		16	16
Earnings per ordinary share (in €) [2]		3.20	3.33
Earnings per AT1 unit (in €) [3]		0.16	0.16

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

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

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

Statement of Comprehensive Income

Reconciliation from Consolidated Net Income to Total Comprehensive Income

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Consolidated net income	**213**	**234**
Items that will not be reclassified subsequently to profit or loss		
Changes in the reserve from remeasurements of defined benefit plans	**9**	**-20**
Remeasurements	13	-29
Taxes	-4	9
Items that are reclassified subsequently to profit or loss		
Changes in revaluation surplus	**-5**	**1**
Gains and losses on remeasuring AfS financial instruments	-7	3
Reclassifications to the income statement	0	0
Taxes	2	-2
Changes in hedging reserves	**-18**	**4**
Profit/loss from derivatives used to hedge future cash flows	-27	2
Reclassifications to the income statement	0	4
Taxes	9	-2
Changes in currency translation reserves	**-15**	**-1**
Profit/loss from translating foreign operations' financial statements	-15	-2
Reclassifications to the income statement	–	1
Taxes	–	–
Other comprehensive income	**-29**	**-16**
Total comprehensive income	**184**	**218**
Total comprehensive income attributable to non-controlling interests	6	19
Total comprehensive income attributable to shareholders of Aareal Bank AG	178	199

Statement of Financial Position

€ mn	Note	31 Dec 2017	31 Dec 2016
Assets			
Cash funds	7, 37	2,081	1,786
Loans and advances to banks	8, 38	779	1,583
Loans and advances to customers	9, 39	27,845	31,203
Allowance for credit losses	10, 40	-540	-554
Positive market value of derivative hedging instruments	11, 41	1,926	2,481
Trading assets	12, 42	327	502
Non-trading assets	13, 43	8,537	9,730
Investments accounted for using the equity method	14, 44	7	0
Intangible assets	15, 45	153	126
Property and equipment	16, 46	253	252
Income tax assets	47	52	68
Deferred tax assets	17, 48	99	134
Other assets	18, 49	389	397
Total		**41,908**	**47,708**
Equity and liabilities			
Liabilities to banks	19, 50	1,914	1,703
Liabilities to customers	20, 51	25,765	29,077
Certificated liabilities	21, 52	7,594	8,346
Negative market value of derivative hedging instruments	11, 53	1,479	2,529
Trading liabilities	12, 54	224	652
Provisions	22, 55	570	680
Income tax liabilities	56	29	71
Deferred tax liabilities	17, 57	19	28
Other liabilities	23, 58	125	127
Subordinated capital	24, 59	1,265	1,366
Equity	25, 60		
Subscribed capital		180	180
Capital reserves		721	721
Retained earnings		1,798	1,734
AT1 bond		300	300
Other reserves		-77	-48
Non-controlling interests		2	242
Total equity		2,924	3,129
Total		**41,908**	**47,708**

Statement of Changes in Equity

€ mn	Subscribed capital	Capital reserves	Retained earnings	AT1 bond	Other reserves: Reserve from remeasurements of defined benefit plans	Other reserves: Revaluation surplus	Other reserves: Hedging reserves	Other reserves: Currency translation reserves	Total	Non-controlling interests[1]	Equity
Equity as at 1 January 2017	**180**	**721**	**1,734**	**300**	**-100**	**29**	**17**	**6**	**2,887**	**242**	**3,129**
Total comprehensive income for the period			207		9	-5	-18	-15	**178**	6	**184**
Payments to non-controlling interests										-6	**-6**
Dividends			-120						**-120**		**-120**
AT1 coupon			-16						**-16**		**-16**
Other changes			-7						**-7**	-240	**-247**
Equity as at 31 December 2017	**180**	**721**	**1,798**	**300**	**-91**	**24**	**-1**	**-9**	**2,922**	**2**	**2,924**

[1] Reduction due to repayment of the Capital Funding Trust

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

Statement of Cash Flows

€ mn	Cash flow 1 Jan-31 Dec 2017	Cash flow 1 Jan-31 Dec 2016
Consolidated net income	**213**	**234**
Write-downs, valuation allowances and write-ups on loans and advances	119	136
Additions to and reversals of loan loss provisions, net	-1	-8
Amortisation, depreciation, impairment and write-ups of non-current assets	27	38
Other non-cash changes	-1,070	-584
Gains/losses on the disposal of non-current assets	-7	-69
Other adjustments	130	-163
Subtotal	**-589**	**-416**
Changes in loans and advances to banks	761	319
Changes in loans and advances to customers	2,862	3,513
Changes in trading assets	68	94
Changes in other assets from operating activities	103	-154
Changes in liabilities to banks	565	-116
Changes in liabilities to customers	-2,788	-1,061
Changes in certificated liabilities	-657	-2,436
Changes in trading liabilities	-25	-55
Changes in provisions	-101	-179
Changes in other liabilities from operating activities	-336	-110
Income taxes paid	-107	-115
Interest received	346	840
Interest paid	-182	-334
Dividends received	–	–
Cash flow from operating activities	**-80**	**-210**
Proceeds from the disposal of non-trading assets and investments accounted for using the equity method	970	971
Payments for the acquisition of non-trading assets and investments accounted for using the equity method	-61	-168
Proceeds from the disposal of property and equipment, intangible assets and investment properties	13	8
Payments for the acquisition of property and equipment, intangible assets and investment properties	-43	-34
Effect of changes in reporting entity structure	-28	116
Changes due to other investing activities	–	–
Cash flow from investing activities	**851**	**893**
Dividends paid and AT1 coupon payments	-135	-114
Changes in subordinated capital	-87	-46
Changes due to other funding activities	-254	-19
Cash flow from financing activities	**-476**	**-179**
Cash and cash equivalents as at 1 January	**1,786**	**1,282**
Cash flow from operating activities	-80	-210
Cash flow from investing activities	851	893
Cash flow from financing activities	-476	-179
Cash and cash equivalents as at 31 December	**2,081**	**1,786**

Notes
Basis of Accounting

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

As a listed public limited company, Aareal Bank AG has prepared its consolidated financial statements for the financial year ended on 31 December 2017 in accordance with International Financial Reporting Standards (IFRSs) applicable within the European Union (EU) as at the reporting date, in connection with the provisions pursuant to section 315e of the German Commercial Code (Handelsgesetzbuch – "HGB"). The reporting currency is the euro (€).

The consolidated financial statements were released for publication by the Management Board on 6 March 2018, and have been deposited with the Register of Companies at the Wiesbaden District Court (Amtsgericht Wiesbaden, HRB 13 184) and are also available from Aareal Bank AG in Wiesbaden, Germany.

Accounting Policies

(1) Accounting standards

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(2) Changes in accounting policies

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

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

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

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

Until 31 December 2017, the following financial reporting standards (IASs/IFRSs) and interpretations (SICs and IFRICs) had been published by the International Accounting Standards Board (IASB) and adopted by the EU Commission:

New International Financial Reporting Standards/Interpretations		Issued	Endorsed	Effective Date
IFRIC 22	Foreign Currency Transactions and Advance Consideration	December 2016		Financial years beginning on or after 1 January 2018
IFRS 15	Revenue from Contracts with Customers Effective Date of IFRS 15	May 2014 September 2015	September 2016	Financial years beginning on or after 1 January 2018
IFRS 9	Financial Instruments	July 2014	November 2016	Financial years beginning on or after 1 January 2018
IFRS 16	Leases	January 2016	October 2017	Financial years beginning on or after 1 January 2019
IFRS 17	Insurance Contracts	May 2017		Financial years beginning on or after 1 January 2021
IFRIC 23	Uncertainty over Income Tax Treatments	June 2017		Financial years beginning on or after 1 January 2019

Revised International Financial Reporting Standards		Issued	Endorsed	Effective Date
	Annual Improvements Cycle 2014-2016	December 2016		Financial years beginning on or after 1 January 2017 and 1 January 2018, respectively
IAS 40	Transfers of Investment Property	December 2016		Financial years beginning on or after 1 January 2018
IFRS 15	Revenue from Contracts with Customers	April 2016	October 2017	Financial years beginning on or after 1 January 2018
IFRS 2	Classification and Measurement of Share-based Payment Transactions	June 2016		Financial years beginning on or after 1 January 2018
IFRS 4	Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts	September 2016	November 2017	Date of first-time application, depending upon the first-time application of IFRS 9
IAS 28	Long-term Interests in Associates and Joint Ventures	October 2017		Financial years beginning on or after 1 January 2019
IFRS 9	Prepayment Features with Negative Compensation	October 2017		Financial years beginning on or after 1 January 2019
	Annual Improvements Cycle 2015-2017	December 2017		Financial years beginning on or after 1 January 2019

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

- **IFRS 15 Revenue from Contracts with Customers**
  IFRS 15 governs the recognition of revenue from contracts with customers based on a uniform model. The standard supersedes the current revenue recognition provisions set out in IAS 11 and IAS 18 as well as the related interpretations. IFRS 15 has to be applied by all companies that enter into contracts with customers for the delivery of goods or the provision of services unless these contracts are within the scope of other standards. Accordingly, amongst other things, financial instruments and other contractual rights or obligations within the scope of IAS 39 or IFRS 9 are excluded from the scope of IFRS 15. The core principle of IFRS 15 for revenue recognition is that an entity has to recognise revenue

when the performance obligations assumed are satisfied, i.e. when control over the goods and services has been transferred. Revenue has to be recognised in an amount that reflects the consideration that the entity expects to receive in exchange for those goods or services. IFRS 15 introduces a 5-step model based on which the amount and the timing of revenue recognition are determined. In addition, the standard requires additional disclosures, including, amongst other things, a disaggregation of total revenue, performance obligations, a reconciliation of opening and closing balances of contractual net assets and liabilities as well as significant judgements and estimates. Aareal Bank Group has reviewed the effects of the new standard on the consolidated financial statements by analysing the relevant standard contracts on the basis of the 5-step model. Within the Group, these changes mainly affect Aareon. Aareon has adjusted its processes. Overall, there was no material impact for the Group.

- **IFRS 9 Financial Instruments**
  IFRS 9 Financial Instruments introduces new rules for the accounting of financial instruments, and will replace IAS 39 Financial Instruments: Recognition and Measurement from the next financial year beginning on 1 January 2018. We expect the first-time application to have an effect of approximately € -27 million (after taxes) on equity carried on the statement of financial position, and of approximately € -17 million on regulatory equity (full Basel III implementation pursuant to Directive 2013/36/EU and Regulation (EU) No 575/2013 of the European Parliament and the Council); the effect of first-time application comprises various individual effects.

  Under the new model for classification and measurement of financial assets, the subsequent measurement of financial assets is based on three categories with different measurement methods and different recognition methods related to changes in value:

  » ”Financial assets measured at amortised cost using the effective interest method”,
  » ”Financial assets at fair value through profit or loss”, and
  » ”Financial assets at fair value through other comprehensive income”.

The classification to the measurement categories is based on the criteria of business model and contractual characteristics of the financial assets (the so-called ”SPPI criterion”). The allocation of financial instruments to the business models was made as at 1 January 2018. The major portion of the financial instruments was allocated to the “amortised cost” measurement category. We anticipate a positive overall effect of approximately € 28 million (after taxes) from the transition on the revaluation surplus, due to the reversal of the revaluation surplus from securities reclassified in accordance with IAS 39, and from changes in the measurement category of individual securities (to FVTPL, because the SPPI criterion is not met, or due to an assignment to the residual business model). In addition, adjustments during the contract term that lead to a change in the contractual cash flows, but that are not of an extent that the previous financial asset is derecognised and a new financial asset is recognised, will result in non-substantial modifications. In this case, the carrying amount of a financial asset is adjusted and a modification gain or loss is determined. We anticipate a transition effect from market-induced modifications of approximately € -6 million (after taxes). Credit-driven modification effects are included in the effects resulting from the allocation of items into the Stage 3 category of expected credit losses.

There are special rules for equity instruments as there is an option to measure these either through other comprehensive income or through profit or loss. This did not have any transition effect.

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

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

Portfolio-based allowances for credit losses were already recognised within the Group under IAS 39. Calculation under Stage 1 in accordance with IFRS 9 continues to be on the basis of a 12-month loss. In Stage 2, additions to allowances were recognised due to the recognition of an allowance for expected losses over the entire remaining term. The transition effect for Stage 1 and Stage 2 is expected to amount to approximately € -27 million (after taxes).

Specific allowances for credit losses pursuant to IAS 39 were recognised where estimated future cash flows fall below the carrying amount of a loan receivable. This methodology was developed further into a multi-scenario analysis including a range of dispersion. A transition effect of approximately € -22 million (after taxes) is thus expected for Stage 3.

Hedge accounting rules were changed by establishing a closer relationship between the entity's risk management strategy, the reasons for entering into hedging instrument and the recognition of hedging relationships in the entity's financial statements. Non-derivative items may also be included in hedge accounting; net positions are now also eligible for designation as hedges. A voluntary discontinuation of hedge accounting – so-called de-designation – is no longer permitted under the new regulations. Hedging relationships may only be discontinued when the objective of risk management has been changed. In contrast, the new IFRS 9 allows for an adjustment of hedging relationships if this is necessary (rebalancing). The requirements regarding effectiveness have also been simplified: only qualitative assessments of effectiveness and prospective effectiveness tests have to be performed. In addition, foreign currency basis spreads may be recognised as part of the costs of the hedge. Changes in the fair value due to this component are recognised directly in equity in the reserve from foreign currency basis spreads. Due to the separation of the macro hedge accounting project from IFRS 9 and its postponement, the application of the new hedge accounting rules in IFRS 9, for the time being, allows for the continued application of special rules for fair value hedge accounting for portfolio hedges of interest rate risks in IAS 39. The Group does not currently use this option. The Group will use the simplifications under micro hedge accounting and for foreign currency basis spreads. This did not have any transition effect on equity.

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

- **IFRS 16: Leases**
  The new financial reporting standard IFRS 16, regarding lease accounting, will replace IAS 17 as well as the related interpretations IFRIC 4, SIC 15 and SIC 7. IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise (in the statement of financial position) any leases and the related contractual rights and obligations with a term of more than twelve months, unless the underlying asset is of low value. The lessee recognises a right-of-use asset (representing its right to use the underlying leased asset) and also a lease liability (representing its obligation to make lease payments). Similar to the previous rules set out in IAS 17, the lessor continues to classify its leases as finance or operating leases. The criteria for classification under IFRS 16 equal those of IAS 17. In addition, IFRS 16 sets outs a number of further rules for presentation, disclosures in the Notes and sale-and-lease-back transactions. Measures were initiated to ensure a timely implementation of IFRS 16. Overall, we do not expect any material impact on the consolidated financial statements.

- **IFRIC 23: Uncertainty over Income Tax Treatments**
  The objective of this interpretation is to clarify the accounting for uncertainty in relation to income taxes.

- **Annual Improvements Cycle 2014-2016**
  Within the scope of the Annual Improvements Cycles, the IASB publishes clarifications and minor changes to the existing standards IFRS 1, IFRS 12 and IAS 28.

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

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

- **Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions**
  In June 2016, the IASB issued amendments to IFRS 2 that clarify classification and measurement of share-based payment transactions. The amendments relate to the following areas: (i) accounting for cash-settled share-based payment transactions that include a performance condition, (ii) the classification of share-based payment transactions with a settlement feature for withholding tax obligations and (iii) accounting for modifications of share-based payment transactions that change the classification from ”cash-settled” to ”equity-settled”.

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

- **Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures**
  The amendments clarify that a company is obliged to apply IFRS 9 Financial Instruments, including its impairment rules, to long-term interest in associates or joint ventures that, in substance, form part of the company's net investment in the associate or joint venture, rather than using the equity method. Accordingly, the application of IFRS 9 has priority over the application of IAS 28.

- **Amendments to IFRS 9: Prepayment Features with Negative Compensation**
  Minor changes to IFRS 9 Financial Instruments for financial assets with so-called symmetrical termination rights to facilitate their measurement at amortised cost or at fair value through other comprehensive income. In addition, the accounting for a modification of a financial liability that does not result in derecognition was clarified.

- **Annual Improvements Cycle 2015-2017**
  Within the scope of the Annual Improvements Cycles, the IASB publishes clarifications and minor changes to the existing standards IFRS 3, IFRS 11, IAS 12 and IAS 23.

Aareal Bank Group did not opt for early application of these standards in 2017, which are required to be applied in future financial years.

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

(3) Consolidation

Consolidation principles

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

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

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

Initial consolidation of entities is based on the purchase method, in accordance with IFRS 3, whereby remeasured amounts must be used when recognising assets and liabilities (including any hidden reserves and hidden encumbrances) of an entity to be consolidated. This may lead to the recognition of new assets and liabilities that were previously not reported in the statement of financial position of the company to be consolidated. Any excess of acquisition cost over the Group's interest in the fair value of net assets is recognised as (positive) goodwill. Any negative goodwill determined during this comparison is charged against income.

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

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

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

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

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

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

Reporting entity structure

As at 31 December 2017, the reporting entity structure comprised 73 companies (2016: 67), including Aareal Bank AG as well as 65 (2016: 62) subsidiaries, two joint arrangements (2016: one) as well as five associates (2016: three).

Material changes to the basis of consolidation included the acquisition of Kalshoven Groep B.V. and of FIRE B.V. as well as the acquisition of the mse companies. The purchase price amounted to € 22 million, including € 10 million of goodwill. The acquisitions are allocated to the Consulting / Services segment. Moreover, Aareal Bank AG purchased interests in Mount Street Group Limited and in Mount Street US Group LLP.

Note 98 "List of Shareholdings" includes an overview of the Group companies.

(4) Currency translation

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

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

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

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

(5) Determination of fair value

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

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

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

(6) Recognition and measurement of financial instruments

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

Recognition

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

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

Measurement

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

Measurement categories in accordance with IAS 39

Loans and receivables (LaR)

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

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

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

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

Held to maturity (HtM)

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

Financial assets or liabilities at fair value through profit or loss (FVtPL)

A further differentiation is made within the category "Financial assets at fair value through profit or loss" into held for trading (HfT) and designated as at fair value through profit or loss (dFVtPL).

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

Entities have the option, subject to certain conditions, to irrevocably designate financial instruments as at fair value, irrespective of any intention to trade (fair value option). In the past, Aareal Bank Group has used the fair value option for certain structured financial instruments that comprise one or more embedded derivatives. The fair value option has only been exercised with respect to the measurement of financial assets, but not to the measurement of financial liabilities.

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

Available for sale (AfS)

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

Aareal Bank Group reviews at any balance sheet date whether there is objective evidence of impairment for financial assets of the AfS category. Criteria were defined for this purpose which – if such criteria are met – trigger a review to determine whether there is objective evidence of impairment. If there is objective evidence and a negative impact on the future cash flows generated from the financial asset can be expected as a result of the loss event, impairment losses are recognised.

For debt securities held, such a criterion is, for example, a downgrade of an external credit rating to "BB+ or worse", arrears with respect to interest and principal payments, the discontinuance of an active market for bonds of a particular issuer due to significant financial difficulties of such issuer or an increased likelihood of the issuer's insolvency. The relevant criteria for equity instruments are either a price decrease by more than 20 % below the average acquisition costs or when the price of the equity instrument concerned at the valuation date has been below the average acquisition costs for more than one year. If an impairment of a financial asset of the "Available for sale" category has been identified, the amount of the impairment is calculated as the difference between the asset's (amortised) cost and its current fair value. In the event of such impairment, the accumulated losses previously recognised directly in equity in the revaluation surplus are reclassified to the income statement. If the reasons for impairment cease to exist, a reversal of the impairment loss (up to amortised cost) is recognised in income for debt securities. Amounts exceeding amortised cost as well as reversals of impairment losses of equity instruments are always recognised directly in equity in the revaluation surplus.

Financial liabilities measured at amortised cost (LaC)
At Aareal Bank Group, all financial liabilities not designated as at fair value through profit or loss are allocated to the category "Financial liabilities measured at amortised cost". Financial liabilities so allocated are measured subsequently at amortised cost. Premiums and discounts are amortised over their term using relevant effective interest rates.

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

The existence of observable quoted prices in an active market is the best evidence of fair value, and when they exist they are used to measure the financial asset or financial liability involved. In order to determine the quoted market price of a financial instrument in an active market, a transaction involving the financial instrument concerned on the reporting date or the last trade date must be used as the basis. If no transaction has occurred in the financial instrument on the reporting date, the Bank shall rely on transaction prices applicable shortly before the reporting date.

Exchange-traded financial instruments (such as equities, bonds, or other debt securities) as well as exchange-traded derivatives are generally measured on the basis of applicable market prices if there is an active market.

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

If past or comparable market prices are not available for certain products, the Bank uses proven valuation models for pricing financial instruments. Pricing using validated valuation models is based on parameters observable in the market (such as interest rates, volatilities, credit spreads). Cash flows are determined on the basis of the contractual arrangements until the expected end of the term and discounted using the interest rate curve of the relevant market, taking into account mark-ups based on credit quality and liquidity, if applicable.

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

Structured products

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

Hedging relationships

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

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

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

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

(7) Cash funds

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

(8) Loans and advances to banks

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

(9) Loans and advances to customers

Loans and advances to customers comprise property loans, money market receivables, promissory note loans and other loans and advances to customers, including deferred interest. Loans and advances to customers are generally allocated to the measurement category "Loans and receivables" (LaR). Property loans acquired or incurred principally for the purpose of selling or repurchasing them in the near term with a syndication covenant are allocated to the measurement category "Held for trading" (HfT).

(10) Allowance for credit losses

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

Specific allowances for credit losses are recognised for significant exposures where estimated future cash flows fall below the carrying amount of a loan receivable. This is reviewed if there is objective evidence that not all interest and principal payments will be made as contractually agreed. The estimated recoverable amount is determined on the basis of the present values of expected future cash flows from the asset (taking into account the marketability of collateral provided). Cash flows determined in this way are discounted over the estimated marketing period, using the original effective interest rate. Collateral is largely provided in the form of land charges or mortgages and measured at fair value based on rents agreed, or on prevailing market rents and management costs specific to the property. Fair value is determined using the income capitalisation approach or the discounted cash flow method. The interest rates used can be derived from the type and location of the property as well as from the current market situation. Time for reletting as well as structural vacancies are taken into account as appropriate. Valuation is based on estimates prepared by in-house or external valuers. It is subject to several uncertainties and often requires significant estimates made by the management in relation to various factors such as local economic conditions, financial position and development of the counterparty, and the value of collateral held for which there is no easily accessible market.

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

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

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

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

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

The bulk of Aareal Bank Group's portfolio of derivative financial instruments (derivatives) have been entered into in order to hedge interest rate and currency risk exposures.

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

Hedge accounting is based on clean fair values.

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

(12) Trading assets and trading liabilities

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

(13) Non-trading assets

Non-trading assets include securities in the form of bonds and other fixed-income securities as well as equities and other non-fixed income securities. In addition, this item includes investments in companies over which Aareal Bank AG neither has economic control nor may exercise any significant influence.

All assets included in non-trading assets are recognised at cost, plus attributable transaction costs.

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

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

(14) Investments accounted for using the equity method

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

Investments in associates included in this item are recognised at cost when the significant influence arises, and subsequently carried at amortised cost whereby, in particular, the share of results of operations of any financial year is recognised in income.

(15) Intangible assets

The item ”Intangible assets” consists of proprietary software, goodwill and other intangible assets such as purchased software and licenses.

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

Research costs incurred in connection with software development are expensed as they are incurred. Development costs are capitalised from the time when the software development can be regarded as completed from a technical perspective, and several other conditions are fulfilled. Borrowing costs directly attributable to software development are also part of the cost. They are amortised on a straight-line basis, using an estimated economic life of ten years. Purchased software is also deemed to have a limited useful life. The procedure followed for the determination of amortisation of purchased software is the same as the procedure used for proprietary software. Amortisation is recognised in administrative expenses.

Goodwill is defined as the excess of the cost of acquisition over the fair value of the Group's interest in the net assets of an acquired entity, at the time of acquisition (positive difference). Goodwill is carried at historical cost less accumulated impairments. Any negative goodwill (badwill) arising upon acquisition is immediately charged against income.

In case the annual impairment test shows that there are indications of impairment of intangible assets (as set out in IAS 36) and that the recoverable amount is lower than the carrying amount of the asset concerned, the asset is written down through profit or loss, to the estimated recoverable amount.

If it is impossible to estimate the recoverable amount for a specific asset, the recoverable amount of the cash-generating unit that the asset belongs to must be determined. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Aareal Bank Group defines cash-generating units either on the basis of a single subsidiary or on product level. The recoverable amount of an asset or a cash-generating unit is the higher of fair value less costs to sell and value in use. (Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset or cash-generating unit.) Future cash flows are determined based on medium-term projections. The present value of the future cash flows is determined using discount factors which are in line with the risks involved. Accordingly, the recognition of intangible assets and the impairment test is also subject to estimation uncertainties.

(16) Property and equipment

Property and equipment includes owner-occupied land and buildings, office furniture and equipment as well as a hotel which is operated by Aareal Bank. Property and equipment is measured at cost, less accumulated depreciation and impairment losses. Depreciation and impairment losses are reported under administrative expenses, while those of the owner-operated hotel are shown in net other operating income / expenses.

Owner-occupied buildings reported under property and equipment are depreciated on a straight-line basis, over a period of 25 to 50 years. Owner-occupied land is not depreciated. Please refer to the explanations in the Notes on other assets for the accounting method to be applied for land and buildings which are not owner-occupied. Office furniture and equipment items are depreciated using the straight-line method, applying the following periods:

	Depreciation period
Other property and equipment	
IT equipment	3-7 years
Other office furniture and equipment	5-13 years

Tenant improvements are depreciated based on the principles applicable for the relevant building.

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

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

The costs to purchase property and equipment in the amount of up to € 150.00 (low-value assets) are expensed as they are incurred.

Any items of property and equipment with a cost of more than € 150.00, but not exceeding € 1,000.00, are combined in a collective account for the year, which is then depreciated on a straight-line basis over a period of five years.

(17) Deferred tax assets / Deferred tax liabilities

Deferred taxes are reported in the items "Deferred tax assets" and "Deferred tax liabilities".

Deferred tax assets are recognised when they are deemed recoverable. The recoverability is assessed using tax planning (internal assessment) on the basis of medium-term Group planning. Accordingly, deferred tax assets are only recognised to the extent that we deem it probable that future taxable profits will be available against which the temporary differences and tax loss carryforwards can be utilised. Deferred taxes are calculated on the basis of country- and company-specific tax rates expected to apply at the time of the realisation of temporary differences and set-off against loss carryforwards.

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

(18) Other assets

The item "Other assets" includes properties, trade receivables and miscellaneous assets. Properties reported under other assets are intended for short-term disposal, though the IFRS 5 criteria are not met. They are measured at the lower of cost or net realisable value, in accordance with IAS 2, and therefore are subject to estimation uncertainties. Trade receivables are allocated to the measurement category "Loans and receivables" (LaR).

(19) Liabilities to banks

The item "Liabilities to banks" comprises money market liabilities, registered mortgage Pfandbriefe, registered public sector Pfandbriefe, promissory note loans and other liabilities to banks, including deferred interest. Liabilities to banks are allocated to the measurement category "Liabilities measured at amortised cost" (LaC).

(20) Liabilities to customers

The item "Liabilities to customers" comprises money market liabilities, registered mortgage Pfandbriefe, registered public sector Pfandbriefe, promissory note loans and other liabilities to customers, including deferred interest. Liabilities to customers are allocated to the measurement category "Liabilities measured at amortised cost" (LaC).

(21) Certificated liabilities

The item "Certificated liabilities" includes bearer mortgage Pfandbriefe, bearer public sector Pfandbriefe and other bonds, including deferred interest. Certificated liabilities are allocated to the measurement category "Liabilities measured at amortised cost" (LaC).

(22) Provisions

The item "Provisions" comprises provisions for pensions and similar obligations, provisions for staff expenses and non-staff operating costs, provisions for risks related to unrecognised items in the lending business, provisions for legal or tax risks, as well as other provisions. Provisions are recognised when there is a present legal or constructive obligation towards third parties arising from a past event, the outflow of resources to meet this obligation is probable and the amount of the obligation can be reliably estimated. Provisions, including uncertain tax positions, are measured on the basis of the best estimate of expenditure required to settle the obligation (most likely value) required as at the reporting date. In the context of acquisitions in accordance with IFRS 3, contingent liabilities, including uncertain tax obligations, were also recognised at their expected value. These are released when the reasons for their recognition cease to exist.

Measurement is subject to several uncertainties and often requires significant estimates made by the management in relation to various factors that may not apply subsequently. The final amount of the liabilities may deviate significantly from the measurement previously made in accounting. For example, the outcome of individual legal proceedings may not be predicted with certainty.

If utilisation in the short term, i.e. within twelve months, from the obligation is not expected, the provision will be recognised at present value.

Provisions for pensions and similar obligations

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

Under defined contribution plans, an enterprise pays fixed contributions into a separate entity or a fund and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. Contributions paid to the statutory pension insurance scheme are also classified as defined contribution plans. The contributions paid to a defined contribution plan are recorded as staff expenses.

Defined benefit obligations are all pension obligations that do not meet the criteria of a defined contribution obligation. The amount of obligations usually depends on one or several factors, including age, length of service, and salary.

The Group's obligations under defined benefit plans are recognised as a provision in the consolidated statement of financial position. These are based on company agreements on an employee pension scheme, individual agreements with executive staff as well as individual agreements concluded with the members of the Company's senior management. Projected economic and demographic developments as well as salary trends must be applied to the calculation of the provisions. Calculating the amount of provisions in the Group is based on actuarial opinions which are prepared by external actuaries on the basis of Aareal Bank-specific and Group-wide standardised parameters.

Provisions for pensions and similar obligations under defined benefit plans are determined in accordance with IAS 19 on the basis of the projected unit credit method; the various defined benefit plans are measured separately. The fair value of the plan assets is deducted from the present value of the pension obligation, taking into account, if applicable, the rules for the asset ceiling in relation to a surplus of plan assets over the benefit obligation. The resulting amount represents the net defined benefit liability (provision) or the net defined benefit asset. The net interest expense in the financial year is determined by applying the discount factor calculated at the beginning of the financial year to the net liability calculated as at that date. The discount rate used to determine the present value of the obligation is based on the capital market rate of high quality corporate bonds at the reporting date. Determination is based on the GlobalRate:Link method by Willis Towers Watson. The data basis consists of corporate bonds recorded by Bloomberg which have a rating of at least "AA" and are denominated in the same currency as the underlying pension obligation. Actuarial gains and losses (remeasurements), which – in connection of the amount of obligations – arise on changes in expectations regarding life expectancy, pension increases, salary development, discount rate compared to the estimation made at the beginning of the period or compared to the actual trend during the period, are recorded in other comprehensive income in the item "Changes in the reserve from remeasurements of defined benefit plans". Actuarial gains and losses (remeasurements) recorded in other comprehensive income may not be reclassified subsequently to profit or loss (recycling). Differences between the expected return on plan assets, determined at the beginning of the period using the then applicable discount rate, and the actual return on plan assets (remeasurement) at the end of the period are also recognised in other comprehensive income. Actuarial gains and losses as well as the difference between expected and actual return on plan assets are included in other reserves. They are reported separately in the statement of changes in equity. Accordingly, the recognition of pension obligations is also subject to estimation uncertainties.

Share-based payment

Aareal Bank Group maintains share-based payment plans subject to cash settlement in accordance with IFRS 2. We refer to the remuneration report as part of the Notes to the consolidated financial statements, which includes a detailed description of the plans and their scope as well as information on the valuation model applied and the effects of share-based payments on the Group's financial position and performance.

Provisions for obligations arising from share-based remuneration plans have been recognised under administrative expenses, in the amount of the fair value of the relevant obligation at the reporting date.

(23) Other liabilities

Other liabilities include, among other items, liabilities from outstanding invoices, trade payables, as well as liabilities from other taxes.

(24) Subordinated capital

The item "Subordinated capital" consists of subordinated liabilities, profit-participation certificates and silent participations. Subordinated funds raised do not provide for any early repayment obligation. In the event of liquidation or insolvency, claims on interest and principal from these liabilities are subordinated to the claims of all other creditors, which are not subordinated themselves. Pursuant to the terms and conditions of issue, holders of profit-participation certificates have a claim on interest payments which takes precedence over the profit entitlements of shareholders. To the extent that a distribution would cause a net loss, said interest claim would be reduced, possibly down to zero, creating a claim for back-payment during the term of the certificates at the same time. Repayment takes place at the nominal amount (subject to any loss sharing), on the day after the Annual General Meeting passing resolutions regarding the relevant financial year. The profit-participation certificates evidence creditors' rights; they do not grant any share in the liquidation proceeds.

Items of subordinated capital are allocated to the measurement category "Liabilities measured at amortised cost" (LaC).

(25) Equity

Equity comprises subscribed capital, capital reserves, retained earnings and other reserves. Other reserves include the reserve from remeasurements of defined benefit plans, the revaluation surplus, hedging reserves and currency translation reserves. In addition, the item "Equity" includes non-controlling interests as well as the so-called Additional Tier 1 bond (AT1 bond). The AT1 bond is classified as equity since there is neither an obligation to repay the bond nor is there an obligation for ongoing debt service (payment of a dividend). The transaction costs directly attributable to the issue of the AT1 bond as well as dividends paid are deducted directly from equity, net of taxes.

(26) Financial guarantee contracts

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when due. A guarantor recognises a financial guarantee contract as a liability at the date of addition, using the fair value of the guarantee obligation. The obligation is subsequently measured at the greater of a provision recorded in accordance with IAS 37 and the original amount, less any accumulated amortisation. Within Aareal Bank Group, financial guarantee contracts are presented based on the present value of the claim resulting from the future premium payments of the holder, and offset with the obligation for the guarantee (net basis).

Notes to the Statement of Comprehensive Income

(27) Net interest income

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Interest income from		
Property loans	667	752
Public sector loans	7	7
Other lending and money market operations	50	61
Debt and other fixed-income securities	13	27
Current dividend income	0	0
Total interest income	**737**	**847**
Positive interest from financial liabilities	**7**	**3**
Interest expenses for		
Bonds issued	29	32
Registered Pfandbriefe	4	12
Promissory note loans	30	41
Subordinated capital	28	30
Money market transactions	6	20
Other interest expenses	1	2
Total interest expenses	**98**	**137**
Negative interest from financial assets	**12**	**12**
Total	**634**	**701**

Net interest income decreased to € 634 million. This is largely due to the scheduled reduction of the former WestImmo and Corealcredit portfolios. In addition, exchange rate fluctuations led to lower net interest income.

Interest income from property loans includes income from impaired loans (so-called unwinding) in the amount of € 30 million (2016: € 32 million).

(28) Allowance for credit losses

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Additions	131	152
Reversals	53	44
Direct write-offs	43	19
Recoveries on loans and advances previously written off	39	30
Total	**82**	**97**

The additions to the allowance for credit losses comprise specific valuation allowances in the amount of € 131 million (2016: € 149 million), but no portfolio-based valuation allowances (2016: € 3 million). Reversals of allowances for credit losses include € 16 million (2016: € 40 million) for specific valuation allowances and individually recognised provisions for off-balance sheet risks within the lending business as well as € 37 million (2016: € 4 million) for portfolio-based valuation allowances.

(29) Net commission income

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Commission income from		
Consulting and other services	220	211
Trustee loans and administered loans	0	2
Securities transactions	–	–
Other lending and money market operations	10	8
Other commission income	13	13
Total commission income	**243**	**234**
Commission expenses for		
Consulting and other services	32	32
Trustee loans and administered loans	–	–
Securities transactions	1	1
Other lending and money market operations	1	2
Other commission expenses	3	6
Total commission expenses	**37**	**41**
Total	**206**	**193**

Net commission income increased to € 206 million (2016: € 193 million), which was mainly due to higher sales revenue at Aareon.

The net amount of commission income and commission expenses from financial assets and financial liabilities not measured at fair value amounts to € 8 million (2016: € 5 million).

(30) Net result on hedge accounting

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Ineffective portion of fair value hedges	-2	0
Ineffective portion of cash flow hedges	-5	0
Ineffective portion of net investment hedges	0	0
Total	**-7**	**0**

This item contains the measurement gains or losses from hedging instruments and the associated hedged items in the context of hedging relationships.

(31) Net trading income/expenses

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Net income/expenses from positions held for trading	7	19
Currency translation	7	0
Total	**14**	**19**

Net trading income/expenses are primarily attributable to the measurement of derivatives used to hedge interest rate and currency risks.

(32) Results from non-trading assets

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Result from debt securities and other fixed-income securities	0	5
of which: Loans and receivables (LaR)	–	5
Held to maturity (HtM)	–	–
Available for sale (AfS)	0	0
Result from equities and other non-fixed income securities	0	1
of which: Available for sale (AfS)	0	1
Results from equity investments (AfS)	0	61
Total	**0**	**67**

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

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

In the past financial year, there were no results from investments accounted for using the equity method (2016: € 0 million).

(34) Administrative expenses

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Staff expenses	313	339
Wages and salaries	257	285
Social security costs	33	33
Pensions	23	21

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€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Other administrative expenses	176	187
Depreciation, amortisation and impairment of property and equipment and intangible assets	22	21
Total	**511**	**547**

Administrative expenses declined to € 511 million, reflecting lower integration costs and lower running costs for former WestImmo; the total figure includes € 27 million in expenses for personnel measures resulting from the optimisation of processes and structures, within the scope of the "Aareal 2020" programme for the future.

Staff expenses include contributions to defined contribution plans in the amount of € 14 million (2016: € 14 million).

Other administrative expenses include administrative costs for research and development not eligible for capitalisation in the amount of € 5 million (2016: € 4 million).

This item also includes the total fees charged by the auditor of the consolidated financial statements in the financial year 2017, which consists of the following sub-items:

€ 000's	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Auditing fees	5,271	5,141
Other assurance services	411	93
Tax advisory services	7	54
Other services	587	1,081
Total	**6,276**	**6,369**

Other assurance services are related, inter alia, to the review pursuant to the German Securities Trading Act, deposit guarantee schemes, the bank levy, software affirmations, letters of comfort, the separate non-financial statement, and the review of the split-off and capital coverage for former WestImmo. Tax advisory services relate to general tax advice rendered. Other services include, in particular, due diligence services and regulatory advice.

(35) Net other operating income/expenses

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Income from properties	62	40
Income from the reversal of provisions	83	66
Income from goods and services	0	1
Miscellaneous	23	24
Total other operating income	**168**	**131**

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€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Expenses for properties	54	48
Write-downs of trade receivables	0	0
Expenses for other taxes	5	4
Miscellaneous	35	49
Total other operating expenses	**94**	**101**
Total	**74**	**30**

Net other operating income/expenses in the amount of € 74 million includes a positive one-off effect of € 50 million arising from the reversal of provisions through profit or loss at a subsidiary. Aareal Bank Group disclosed a corresponding income tax expense of € 26 million.

(36) Income taxes

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Current income taxes	82	36
Deferred taxes	33	96
Total	**115**	**132**

The differences between calculated and reported income taxes are presented in the following reconciliation:

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Operating profit (before income taxes)	328	366
Expected tax rate	31.7 %	31.7 %
Calculated income taxes	**104**	**116**
Reconciliation to reported income taxes		
Different foreign tax burden	9	-2
Tax attributable to tax-exempt income	-24	-18
Tax attributable to non-deductible expenses	10	46
Remeasurement of deferred taxes	–	25
Taxes for previous years	17	-28
Effect of changes in tax rates	–	-2
Non-controlling interests	–	-6
Other tax effects	-1	1
Reported income taxes	**115**	**132**
Effective tax rate	35 %	36 %

The expected tax rate of 31.7 % (2016: 31.7 %), including a trade tax rate of assessment of 453 %, comprises trade taxes (15.9 %), corporation taxes (15 %) and the solidarity surcharge (0.825 %; 5.5 % of corporation tax).

Notes to the Statement of Financial Position

(37) Cash funds

€ mn	31 Dec 2017	31 Dec 2016
Cash on hand	0	0
Balances with central bank	2,081	1,786
Total	**2,081**	**1,786**

(38) Loans and advances to banks

€ mn	31 Dec 2017	31 Dec 2016
Money market receivables	713	1.458
Promissory note loans	61	119
Securities repurchase agreements	–	–
Other loans and advances	5	6
Total	**779**	**1.583**

(39) Loans and advances to customers

€ mn	31 Dec 2017	31 Dec 2016
Property loans [1]	25,021	26,833
Promissory note loans	1,338	1,442
Other loans and advances	1,486	2,928
Total	**27,845**	**31,203**

[1] Excluding € 0.8 billion in private client business (31 December 2016: € 1.1 billion) and € 0.5 billion in local authority lending business by former WestImmo (31 December 2016: € 0.6 billion), which are reported under "Other loans and advances".

(40) Allowance for credit losses

31 December 2017

€ mn	Specific valuation allowances	Portfolio impairment allowance	Total allowance for credit losses for recognised items	Provisions in the lending business for unrecognised items	Total allowance for credit losses and provisions in the lending business
Allowance for credit losses as at 1 January	**435**	**119**	**554**	**5**	**559**
Additions	131	–	**131**	–	**131**
Write-downs	57	–	**57**	0	**57**
Reversals	15	37	**52**	1	**53**
Unwinding	30	–	**30**	–	**30**
Reclassifications	–	–	**–**	–	**–**
Changes in basis of consolidation	–	–	**–**	–	**–**
Currency adjustments	-5	-1	**-6**	0	**-6**
Balance as at 31 December	**459**	**81**	**540**	**4**	**544**

31 December 2016

€ mn	Specific valuation allowances	Portfolio impairment allowance	Total allowance for credit losses for recognised items	Provisions in the lending business for unrecognised items	Total allowance for credit losses and provisions in the lending business
Allowance for credit losses as at 1 January	**412**	**116**	**528**	**14**	**542**
Additions	149	3	**152**	0	**152**
Write-downs	58	–	**58**	1	**59**
Reversals	36	–	**36**	8	**44**
Unwinding	32	–	**32**	–	**32**
Reclassifications	–	–	**–**	–	**–**
Changes in basis of consolidation	–	–	**–**	–	**–**
Currency adjustments	0	0	**0**	0	**0**
Balance as at 31 December	**435**	**119**	**554**	**5**	**559**

The allowance for risks associated with unrecognised items relates to loans and advances to customers and loans and advances to banks classified as "Loans and receivables" (LaR). These allowances are reported under allowance for credit losses on the asset side of the statement of financial position. The provisions for risks associated with unrecognised items relate to contingent liabilities and loan commitments. These provisions are reported under provisions on the liability side of the statement of financial position.

(41) Positive market value of derivative hedging instruments

€ mn	31 Dec 2017	31 Dec 2016
Positive market value of fair value hedges	1,714	2,169
Positive market value of cash flow hedges	8	29
Positive market value of net investment hedges	3	–
Pro rata interest receivable	201	283
Total	**1,926**	**2,481**

(42) Trading assets

€ mn	31 Dec 2017	31 Dec 2016
Positive market value of trading assets	327	502
Total	**327**	**502**

(43) Non-trading assets

€ mn	31 Dec 2017	31 Dec 2016
Debt and other fixed-income securities	8,535	9,728
of which: Loans and receivables (LaR)	2,823	3,259
Held to maturity (HtM)	290	522
Available for sale (AfS)	5,422	5,947
Equities and other non-fixed income securities	0	1
of which: Available for sale (AfS)	0	1
Other investments (AfS)	2	1
Total	**8,537**	**9,730**

The item "Debt and other fixed-income securities" mainly consists of public-sector bonds as well as asset-covered bonds (Pfandbriefanleihen) and bank bonds.

(44) Investments accounted for using the equity method

Aareal Bank holds interests in five associates (2016: three) and one joint arrangement (2016: nil) that are accounted for using the equity method. The sum total of the carrying amounts of the equity investments amounted to € 7 million (31 December 2016: € 0 million).

(45) Intangible assets

€ mn	31 Dec 2017	31 Dec 2016
Goodwill	85	76
Proprietary software	24	22
Other intangible assets	44	28
Total	**153**	**126**

Goodwill completely refers to the Aareon sub-group (Consulting/Services segment) and can be allocated to the following business divisions defined as cash-generating units:

€ mn	31 Dec 2017 Goodwill	31 Dec 2016 Goodwill
Business divisions		
Germany	35	28
International Business	50	48
Total	**85**	**76**

Goodwill is generally tested for impairment in the fourth quarter of each year. The basis for the valuation is the present value of future cash flows (value in use), which are determined using medium-term projections. In this context, the projected pre-tax cash flows – determined on the basis of the three-year plan adopted by Aareon AG's Management Board and approved by the Supervisory Board – are used. Accordingly, there is an individual planning of revenue and expense items within the first three years. The parameters underlying the major assumptions are based on internal and external factors as well as on past experience. The major basis is the previous year's planning. Revenue projections are largely subject to assumptions in relation to migration plans, new business, as well as renewals of contracts and follow-up business with existing customers. At the same time, these represent the key sources for estimation uncertainty. Regular sales revenues, such as maintenance and fees from transactions with existing customers, are normally not subject to estimation uncertainty. The projections for cost of materials are derived from revenue projections. These projections for staff expenses predominantly take into account the number of employees, as well as wage and salary trends. Other costs are projected based on the previous year's figures, taking into account known one-off effects. Estimation uncertainties in relation to costs arise as a result of unplanned price increases or unforeseeable one-off effects. In principle, estimation uncertainty increases if assumptions are made further into the future. Cash flows beyond the three-year horizon are determined by way of a perpetual annuity.

The present values of future cash flows were determined consistently throughout the Aareon sub-group on the basis of a risk-adequate discount factor of 6.1 % before taxes. The discount factor is calculated based on a risk-free basic interest rate of 1.29 % plus a company-specific risk premium of 6 %, multiplied with a beta factor of 0.8. Due to the uncertainties surrounding the planning beyond the three-year horizon, we assume constant values, i. e. no further growth, to reflect our cautious view of the market environment. The recoverable amounts show a significant excess compared to the carrying amounts, which means that a deficit is not considered possible, even if the above-mentioned assumptions change dramatically. To that extent, even a likely increase of the risk-adequate discount factor by 1.0 % as well as a reduction in EBIT included in the cash flows by 5.0 % does not result in an impairment loss in the reporting period. There was no need to recognise impairment losses in the year under review.

Intangible assets developed as follows:

	2017				2016			
€ mn	Goodwill	Proprietary software	Other intangible assets	Total	Goodwill	Proprietary software	Other intangible assets	Total
Cost								
Balance as at 1 January	**133**	**87**	**78**	**298**	**132**	**82**	**84**	**298**
Additions	10	5	11	**26**	2	6	5	**13**
Transfers	-4	0	26	**22**	–	–	0	**0**
Disposals	0	–	7	**7**	0	0	9	**9**
Changes in basis of consolidation	–	1	16	**17**	–	–	–	**–**
Currency translation differences	-1	0	0	**-1**	-1	-1	-2	**-4**
Balance as at 31 December	**138**	**93**	**124**	**355**	**133**	**87**	**78**	**298**
Amortisation and impairment losses								
Balance as at 1 January	**57**	**65**	**50**	**172**	**57**	**63**	**52**	**172**
Amortisation and impairment losses	–	4	7	**11**	–	2	7	**9**
of which: impairment losses	–	–	–	**–**	–	–	–	**–**
Write-ups	–	–	–	**–**	–	–	–	**–**
Transfers	-4	–	26	**22**	–	–	–	**–**
Disposals	–	–	3	**3**	0	–	9	**9**
Changes in basis of consolidation	–	–	–	**–**	–	–	–	**–**
Currency translation differences	–	0	0	**0**	0	0	0	**0**
Balance as at 31 December	**53**	**69**	**80**	**202**	**57**	**65**	**50**	**172**
Carrying amount as at 1 January	**76**	**22**	**28**	**126**	**75**	**19**	**32**	**126**
Carrying amount as at 31 December	**85**	**24**	**44**	**153**	**76**	**22**	**28**	**126**

(46) Property and equipment

€ mn	31 Dec 2017	31 Dec 2016
Land and buildings and construction in progress	221	220
Office furniture and equipment	32	32
Total	**253**	**252**

Intangible assets developed as follows:

	2017			2016		
€ mn	Land and buildings and construction in progress	Office furniture and equipment	Total	Land and buildings and construction in progress	Office furniture and equipment	Total
Cost						
Balance as at 1 January	**288**	**81**	**369**	**292**	**68**	**360**
Additions	19	8	**27**	14	8	**22**
Transfers	1	9	**10**	-10	10	**0**
Disposals	9	12	**21**	8	5	**13**
Changes in basis of consolidation	–	0	**0**	0	0	**0**
Currency translation differences	0	0	**0**	0	0	**0**
Balance as at 31 December	**299**	**86**	**385**	**288**	**81**	**369**
Amortisation and impairment losses						
Balance as at 1 January	**68**	**49**	**117**	**47**	**46**	**93**
Amortisation and impairment losses	9	7	**16**	21	8	**29**
of which: impairment losses	–	0	**0**	12	–	**12**
Write-ups	–	0	**0**	–	–	**–**
Transfers	1	9	**10**	–	–	**–**
Disposals	0	11	**11**	0	5	**5**
Changes in basis of consolidation	–	–	**–**	–	–	**–**
Currency translation differences	0	0	**0**	0	0	**0**
Balance as at 31 December	**78**	**54**	**132**	**68**	**49**	**117**
Carrying amount as at 1 January	**220**	**32**	**252**	**245**	**22**	**267**
Carrying amount as at 31 December	**221**	**32**	**253**	**220**	**32**	**252**

(47) Income tax assets

Income tax assets in a total amount of € 52 million as at 31 December 2017 (2016: € 68 million) include € 2 million (2016: € 7 million) expected to be realised after a period of more than twelve months.

(48) Deferred tax assets

When recognising deferred taxes, claims and liabilities arising vis-à-vis the same tax authority, which may be netted and paid in one amount, were offset in the amount of € 546 million (2016: € 736 million).

Deferred tax assets were recognised in relation to the following items of the statement of financial position:

€ mn	31 Dec 2017	31 Dec 2016
Loans and advances to banks/to customers	–	–
Positive and negative fair values of derivative hedging instruments	–	4
Trading assets and trading liabilities	47	64
Non-trading assets	–	–
Intangible assets	0	0
Property and equipment	0	0
Other assets/liabilities	26	20
Liabilities to banks/to customers, and certificated liabilities	463	669
Provisions	85	84
Subordinated capital	19	27
Tax loss carryforwards	5	2
Deferred tax assets	**645**	**870**

Of the deferred taxes on loss carryforwards, an amount of € 1 million (2016: € 1 million) is attributable to foreign permanent establishments. The existing loss carryforwards may be carried forward for an unlimited period. Deferred taxes on losses carried forward were recognised to the extent that they are expected to be realised within the next five years.

The deferred tax assets not recognised or not subject to valuation adjustments amount to € 43 million (2016: € 68 million).

Deferred tax assets in the amount of € 25 million (2016: € 16 million) were reported under other reserves.

(49) Other assets

€ mn	31 Dec 2017	31 Dec 2016
Properties	203	234
Trade receivables (LaR)	56	50
Miscellaneous	130	113
Total	**389**	**397**

(50) Liabilties to banks

€ mn	31 Dec 2017	31 Dec 2016
Money market liabilities	998	813
Promissory note loans	258	352
Registered mortgage Pfandbriefe	575	496
Registered public-sector Pfandbriefe	60	21
Other liabilities	23	21
Total	**1,914**	**1,703**

(51) Liabilities to customers

€ mn	31 Dec 2017	31 Dec 2016
Money market liabilities	12,987	13,696
Promissory note loans	5,163	6,369
Registered mortgage Pfandbriefe	5,142	6,066
Registered public-sector Pfandbriefe	2,473	2,945
Other liabilities	0	1
Total	**25,765**	**29,077**

(52) Certificated liabilities

€ mn	31 Dec 2017	31 Dec 2016
Bearer mortgage Pfandbriefe	5,319	5,956
Bearer public-sector Pfandbriefe	45	45
Other debt securities	2,230	2,345
Total	**7,594**	**8,346**

(53) Negative market value of derivative hedging instruments

€ mn	31 Dec 2017	31 Dec 2016
Negative market value of fair value hedges	1,350	2,357
Negative market value of cash flow hedges	15	5
Negative market value of net investment hedges	–	12
Pro rata interest payable	114	155
Total	**1,479**	**2,529**

(54) Trading liabilities

€ mn	31 Dec 2017	31 Dec 2016
Negative market value of trading assets	224	652
Total	**224**	**652**

(55) Provisions

€ mn	31 Dec 2017	31 Dec 2016
Provisions for pensions and similar obligations	351	359
Other provisions and contingent liabilities	219	321
Total	**570**	**680**

Provisions for pensions and similar obligations

The pension obligations result mainly from retirement benefit plans maintained at Aareal Bank, Aareon, BauGrund and Westdeutsche Immobilien Servicing (former WestImmo), which are classified as defined contribution plans or defined benefit plans in accordance with IAS 19.

Aareal Bank contributed assets held to cover the Bank's existing pension obligations into a Contractual Trust Arrangement (CTA). This is to ensure improved insolvency protection of the pension claims as a result of the limited protection provided by the German Pension Guarantee Association (Pensionssicherungsverein; PSVaG). For this purpose, a bilateral trust was agreed between Aareal Bank AG (trustor) and Aareal Pensionsverein e.V. as legally independent third party (trustee). The trustee is registered at the Wiesbaden District Court.

The trustee holds in trust the special fund for the trustor (administrative trust). Simultaneously, but senior to the administrative trust, the trustee holds the special fund for all beneficiaries on trust to secure the recorded entitlements (security trust).

The security trust is established in the interest of the beneficiaries by way of a genuine agreement for the benefit of third parties (section 328 (1) of the German Civil Code (Bürgerliches Gesetzbuch – "BGB")). On the basis of this security trust, the beneficiaries may request from the trustee that the trustee holds and manages this special fund pursuant to the regulations of this trust agreement for the purpose of securing the recorded entitlements. Upon the occurrence of an insured event, the beneficiaries may, based on the security trust, request from the trustee that the trustee satisfies their recorded entitlements pursuant to the regulations of this trust agreement out of the special fund.

The Bank is the economic beneficiary of the assets. The assets are managed by HSBC INKA in a special fund under German investment law ("Spezialfonds"). Based on an investment guideline, HSBC INKA takes investment decisions for staff pensions. A joint investment committee was established, comprising staff from HSBC and Aareal Bank. The Bank transfers new assets to be invested to Aareal Pensionsverein on an annual basis, which in turn acquires additional units in the special fund. The fund manager invests interest income during the course of the year.

The Bank has taken out reinsurance policies for a portion of the benefit entitlements of active members of the Management Board and former Management Board members. These policies were also transferred to Aareal Pensionsverein e. V. on a trust basis. The Bank provides corresponding funds for contribution paid to these policies.

Transferring assets to Aareal Pensionsverein e. V. on the one hand secures benefit entitlements and claims under occupational pension schemes, and on the other hand creates plan assets within the meaning of IAS 19 which may be offset with benefit obligations of the trustor.

Brief description of the material pension plans

DePfa Bank Betriebsvereinbarung dated 14 December 1999 (BV 97)

BV 97 applies for new joiners since 1 January 1997. The following benefits are granted after a waiting period of five pensionable service years: old-age pension after completing the 65th year of age (also after any previous disability), early old-age pension, disability pension until completing the 65th year of age, as well as widow(er)'s pension.

The Bank shall grant its employees a basic pension from own contributions and additional benefits in the form of corresponding individual agreements on deferred compensation. The basic pension for the pensionable service period is calculated based on an annual benefit expense of 3.5 % for portions of the pensionable income below the contribution ceiling and 10 % for portions of pensionable income above the contribution ceiling. The employer contributions thus calculated as well as the contributions from deferred compensation are contributed into a CTA at the end of each financial year. The benefit assets, including any allocated surpluses, bear interest at a rate of at least 4 %. The annual benefit payments are calculated based on an annuitisation of the benefit assets upon occurrence of the insured event, using a fixed annuitisation table.

The pensionable service period is deemed to be the period from completing the 20th year of age to completing the 65th year of age. Pensionable income is the gross remuneration within the year.

Any actuarial deductions upon claiming old-age pensions before completing the 65th year of age are taken into account through an annuitisation of the benefit assets. The widow(er)'s pension amounts to 60 % of the employee pension. The Bank increases the current benefit payments annually by 1 %; there is no obligation to provide for an inflation adjustment.

Management Board

The five Management Board members receive their benefits based on individual commitments (a total of seven individual benefit commitments).

Five individual benefit commitments are fixed amount commitments related to monthly benefit payments upon retirement and disability, including a widow(er)'s pension of 60 % of the beneficiary's pension entitlement. The current benefit payments are adjusted based on the development of standard wages within the private banking sector.

Two individual benefit commitments are aligned to the fixed annual employer contributions and the amounts from deferred compensation, which are paid to the relevant benefit account and bear interest at a rate of 4 %. The benefit assets and the assets from deferred compensation are translated into a lifelong old-age or disability pension upon the occurrence of an insured event, using actuarial principles. Annuitisation is based on biometric principles and a notional interest rate of 4 % p. a. and takes into account a guaranteed pension increase of 1% p.a. The widow pension amounts to 60 % of the beneficiary's pension entitlement. The current benefit payments are increased annually by 1 %; there is no obligation to provide for an inflation adjustment. The old-age pension benefits based on this commitment were secured through reinsurance policies. These reinsurance policies include benefits in the case of disability or death.

DePfa Bank Dienstvereinbarung dated 30 December 1955 (DePfa 55)

DePfa 55 is a pay-related benefit commitment for new entrants before 31 December 1988. It provides for benefit payments after completing the 65th year of age after a waiting period of five service years and benefits paid in case of occupational incapacity (disability) as well as benefits for surviving dependants, each in form of a monthly annuity.

The amount of the entitlement is based on the following increases: 5 % of the last annual salary for the first five service years each, 2 % of the last annual salary for the next 20 service years each, and 1 % of the last annual salary for any following service year, up to a maximum percentage of 75 % of the last annual salary after 35 service years. The widow(er)'s pension amounts to 60 % of the old-age or disability pension. Benefits paid by social security insurance and VBL / Gerling are charged to the benefit entitlements. DePfa 55 does not include any provision allowing for an early payout of old-age pensions or for an adjustment of current benefit payments.

These commitments are based on final salary. The obligation resulting from the respective benefit commitment is therefore very sensitive to unexpected salary changes.

Current benefits are not subject to a fixed adjustment rate; therefore, the adjustment is made pursuant to section 16 of the German Occupational Pensions Act (BetrAVG). Accordingly, an inflation adjustment has to be made every three years given an appropriate economic situation of the Bank. Changes in inflation and, hence, pension increases have an impact on the benefit volume as regards these commitments.

BauBoden agreement dated 1 July 1968 (BauBoden 68)

This agreement applies to employees after completing their 18th year of age who were employed by the Bank on 1 January 1967 or joined the Bank not later than on 31 December 1983. The following benefits are granted after a waiting period of ten service years: old-age pension after completing the 65th year of age, early old-age pension, (total) occupational incapacity pension as well as widow(er)'s pension.

Benefits consist of an overall pension, comprising the statutory pension insurance scheme, the additional pension insurance scheme at VBL or BVV (which is taken into account), or the group insurance contracts and the bank subsidy. The overall pension amounts to 55 % of the pensionable salary after ten years of service. The overall pension is increased by 1 % of the pensionable salary for any further service year, up to the maximum rate of 75 %. The pensionable salary is the last monthly gross salary received during service.

No actuarial deductions are made upon claiming old-age pensions before completing the 65th year of age. The widow(er)'s pension amounts to 60 % of the bank subsidy. The current pension payments are adjusted pursuant to section 16 of the German Company Pensions Act (Betriebsrentengesetz).

These commitments are based on final salary. The obligation resulting from the respective benefit commitment is therefore very sensitive to unexpected salary changes.

Current benefits are not subject to a fixed adjustment rate; therefore, the adjustment is made pursuant to section 16 of the German Occupational Pensions Act (BetrAVG). Accordingly, an inflation adjustment has to be made every three years given an appropriate economic situation of the Bank. Changes in inflation and, hence, pension increases have an impact on the benefit volume as regards these commitments.

BauBoden agreement dated 12 December 1984 (BauBoden 84) and DePfa Bank Versorgungsordnung dated 28 November 1990 (DePfa 90)

BauBoden 84 applies to employees who joined the Company after 31 December 1983 and have completed their 20th year of age. DePfa 90 applies to employees who joined the Company after 31 December 1988. The following benefits are granted after a waiting period of ten service years: old-age pension and early old-age pension, (total) occupational incapacity pension as well as widow(er)'s pension.

The benefit entitlements of the employees vest after completing their 65th year of age. The amount of the monthly pension entitlement is calculated for each pensionable service year (up to a maximum of 40 service years) as follows: 0.6 % of pensionable salary up to the contribution ceiling, 2 % of the portion of pensionable salary exceeding the contribution ceiling, with pensionable salary and contribution ceiling being calculated using the average for the last twelve months. Benefits paid by BVV are charged to the benefit entitlements under BauBoden 84.

The Bank does not make any actuarial deductions upon claiming early old-age pensions. The widow(er)'s pension amounts to 60 % of the entitlements to benefit payments. The current pension payments are adjusted pursuant to section 16 of the German Company Pensions Act (Betriebsrentengesetz).

These commitments are based on final salary. The obligation resulting from the respective benefit commitment is therefore very sensitive to unexpected salary changes.

Current benefits are not subject to a fixed adjustment rate; therefore, the adjustment is made pursuant to section 16 of the German Occupational Pensions Act (BetrAVG). Accordingly, an inflation adjustment has to be made every three years given an appropriate economic situation of the Bank. Changes in inflation and, hence, pension increases have an impact on the benefit volume as regards these commitments.

AHB-General works agreement on additional pension benefits (company pension scheme) of former Corealcredit

The pension benefits to former employees of Allgemeine Hypothekenbank AG, whose employment relationship began prior to 1 January 1994, are governed by the additional benefit arrangement dated 29 August 1995 on the basis of the complementing general works agreement dated 7 March 1995.

This benefit commitment is based on aggregate benefits derived from pension benefits for civil servants. After a waiting period of five years of service, the aggregate benefit rate is 50 % of pensionable income. For each year after completing the 37th year of age, the aggregate benefit rate increases by 1 % of pensionable income, up to a maximum 75 % of pensionable income. The entitlement amounts to at least 65 % of pensionable income in the case of (total) occupational incapacity and 75 % of pensionable income in the case of workplace accidents. Pensionable income is the annual income (calculated on the basis of 14 monthly salaries), divided by 12.

The pension benefits of the statutory pension insurance and the BVV Versicherungsverein des Bankgewerbes a.G., which are based on mandatory contributions, are taken into account in the pension determined as described. To that extent, the benefit obligation directly depends on the development of the level of pensions from the statutory pension insurance on the one hand and from the BVV on the other. As a result of the German Pension Reform Act of 1992 and the associated cuts in statutory pension insurance, the pension scheme was restructured in 1995. The main pillar of the new structure is the limitation of the Bank's deficiency guarantee for the declining level of statutory pensions due to deduction factors applied at early retirement (Rentenzugangsfaktor) and the lower adjustment of the pension value. Accordingly, the Bank continues to assume the deficiency guarantee on a pro-rata basis for the periods of service until the restructuring on 31 December 1995 in relation to the deduction factors applied at early retirement and for the reduced level of the current pension value (net adjustment factor). The reduction in the level of statutory pensions that occurred during the service periods from the restructuring date until retirement is taken into account at the expense of the beneficiary.

From the start of retirement, the AHB pension is decoupled from the development of the statutory pension and the BVV pension already prior to the restructuring since only the AHB pension is adjusted for inflation on an annual basis.

Accordingly, the obligation for the pension commitment during the qualification period is, on the one hand, directly dependent upon the development of the statutory pension and the BVV pension. On the other hand, it is fully dependent upon salary development for all years of service, even including past service. The volume of the obligation also depends upon the fluctuation of inflation and hence pension increases.

Rheinboden Hypothekenbank AG – pension scheme in the version dated 1 December 1991 of former Corealcredit

The former employees of Rheinboden Hypothekenbank AG are entitled to old-age and disability pensions as well as surviving dependant's benefits in accordance with the pension schemes in the version dated 1 December 1991.

The monthly benefits for employees who commenced service prior to 1 October 1978 amount to 5 % of pensionable remuneration (most recent monthly salary based on collective or individual agreements) after ten service years and increase by 0.5 % of pensionable remuneration for each service year, up to 14 % of pensionable remuneration after 15 service years. The monthly benefit entitlement increases by 0.3 % of pensionable remuneration for any additional service years, up to a maximum of 20 %. The BVV benefits are taken into account in such entitlement to the extent that these are based on employer contributions.

The benefits for employees who commenced service after 30 September 1978 amount to 0.15 % of pensionable remuneration up to the contribution ceiling as well as 1.5 % of pensionable remuneration above the contribution ceiling for each year of service between the 25th and 65th year of age. The maximum number of recognisable service years is 35.

The old-age pension under the Rheinboden pension schemes is paid after completing the 65th year of age or upon commencement of old-age pension under the statutory pension insurance scheme (full pension). In case of early retirement, the benefits are subject to deductions of 0.3 % per month of early retirement prior to the age of 65 as a partial compensation for the additional costs associated with early retirement. The surviving dependant's benefits amount to 60 % of the employee's pension entitlement for widow(er)s as well as 15 % for half-orphans and 20 % for orphans, however, in aggregate not exceeding the amount of the employee's pension entitlement.

Supplementary individual contractual arrangements were agreed with individual pensioners and leavers with vested benefits for the purpose of the transition from the old to the new Rheinboden pension scheme and the application of the BVV benefits.

In addition, individual contractual commitments apply to former management board members and general managers – currently pensioners and one leaver with vested benefits.

The adjustment of current pensions on the basis of the Rheinboden commitments is performed on the basis of the inflation allowance set out in section 16 of the German Occupational Pensions Act (BetrAVG), with the exception of a small group of approximately ten pensioners where adjustment is made pursuant to the collective agreement for banks.

WestImmo – Pension fund rules dated 1 October 1995

The pension fund rules dated 1 October 1995 represent a defined contribution scheme. The following benefits are paid after a waiting period of five year of service: old-age pension, early old-age pension, (total) occupational incapacity pension as well as widow(er)'s and orphan's pension.

The amount of the old-age pension, the early old-age pension and the (total) occupational incapacity pension is calculated based on the sum of the pension components earned during the pensionable service period. If the pensionable service period exceeds 40 years, the monthly pension is calculated based on the sum of the highest 40 pension components earned during the pensionable service period. The amount of one pension component is derived from multiplying the reference contribution (since 2014: € 260), the personal earnings relation (relation between pensionable income and contribution ceiling of the German statutory pension insurance; earnings components above the contribution ceiling are weighted with a factor of 3.75) and the annuitisation factor in the relevant age pursuant to the annuitisation table. The amount of the early old-age pension is reduced by 0.5 % for each month in which annuity is paid prior to completing the 65th year of age. The widow(er)'s pension entitlement amounts to 60 %.

If necessary, the determination of the amount of pension obligations is based on the following actuarial assumptions applied consistently throughout the Group:

	31 Dec 2017	31 Dec 2016
Calculation method	Projected unit credit	Projected unit credit
Calculation basis	Actuarial tables issued by K. Heubeck in 2005	Actuarial tables issued by K. Heubeck in 2005
Actuarial assumptions (in %)		
Interest rate used for valuation	1.84	1.81
Development of salaries	2.00	2.00
Pension increase	1.59	1.86
Rate of inflation	1.75	2.00
Staff turnover rate	3.00	3.00

Development of net pension liabilities:

€ mn	Present value of pensions obligations	Fair value of plan assets	Net pension liability
Balance as at 1 January 2017	**432**	**-73**	**359**
Pension expense	**19**	**-1**	**18**
Current service cost	11	–	11
Net interest cost	8	-1	7
Payments	**-9**	**-5**	**-14**
Pension benefits paid	-12	0	-12
Employer's contributions	–	-2	-2
Contributions made by beneficiaries of defined benefit plans	3	-3	–
Remeasurements	**-12**	**-1**	**-13**
due to experience adjustments	-7	–	-7
due to changes in financial assumptions	-5	–	-5
due to changes in demographic assumptions	–	–	–
Difference between actual return and return calculated using an internal rate of interest (plan assets)	–	-1	-1
Changes in basis of consolidation	**1**	**-**	**1**
Balance as at 31 December 2017	**431**	**-80**	**351**

€ mn	Present value of pensions obligations	Fair value of plan assets	Net pension liability
Balance as at 1 January 2016	**396**	**-63**	**333**
Pension expense	**17**	**-1**	**16**
Current service cost	8	-	8
Net interest cost	9	-1	8
Payments	**-10**	**-9**	**-19**
Pension benefits paid	-12	0	-12
Employer's contributions	–	-7	-7
Contributions made by beneficiaries of defined benefit plans	2	-2	–
Remeasurements	**29**	**0**	**29**
due to experience adjustments	-5	–	-5
due to changes in financial assumptions	34	–	34
due to changes in demographic assumptions	–	–	–
Difference between actual return and return calculated using an internal rate of interest (plan assets)	–	0	0
Changes in basis of consolidation	**–**	**–**	**–**
Balance as at 31 December 2016	**432**	**-73**	**359**

The weighted duration of pension liabilities is 18.7 years as at 31 December 2017 (2016: 18.9 years).

Expected maturities of the defined benefit obligation (DBO):

€ mn	31 Dec 2017	31 Dec 2016
Up to 1 year	13	12
More than 1 year and up to 5 years	55	54
More than 5 years and up to 10 years	78	77
Total	**146**	**143**

Contributions in the amount of € 10 million (2017: € 8 million) are expected to be paid in the financial year 2018.

Sensitivity of the defined benefit obligation (DBO) compared to the central actuarial assumptions

Based on the qualitative plan description, the valuation parameters significant for calculating the amount of the obligation were derived and corresponding calculations were made as regards sensitivity:

		Defined benefit obligation 2017	Change	Defined benefit obligation 2016	Change
		€ mn	%	€ mn	%
Present value of obligations		**431**		**432**	
Interest rate used for valuation	Increase by 1.0 percentage points	362	-16	362	-16
	Decrease by 1.0 percentage points	523	21	524	21
Development of salaries	Increase by 0.5 percentage points	440	2	439	2
	Decrease by 0.5 percentage points	422	-2	424	-2
Pension increase	Increase by 0.25 percentage points	439	2	442	2
	Decrease by 0.25 percentage points	423	-2	419	-3
Life expectancy	Increase by 1 year	452	5	453	5
	Decrease by 1 year	410	-5	410	-5

The sensitivity analysis takes into account, in each case, the change of an assumption, while the other assumptions remain unchanged compared to the original calculation, i.e. any potential correlation effects between the individual assumptions are not taken into consideration.

Plan assets can be broken down as follows:

€ mn	31 Dec 2017	31 Dec 2016
Cash	0	0
Equities	–	–
Investment funds	53	47
Bonds	–	–
Reinsurance	27	26
Total	**80**	**73**

Apart from the usual actuarial risks, the risks associated with defined benefit obligations primarily relate to financial risks in connection with plan assets. Amongst others, these may include counterparty credit risks and market price risks. These risks are taken into account in the risk management of Aareal Bank Group. The measurement of investment funds has to be allocated to Level 2 of the fair value hierarchy.

Other provisions

Other provisions developed as follows:

€ mn	Provisions for staff expenses and non-staff operating costs	Provisions in the lending business for unrecognised items	Provisions for legal and tax risks	Miscellaneous other provisions	Total
Carrying amount as at 1 Jan 2017	**187**	**5**	**103**	**26**	**321**
Additions	89	–	1	7	**97**
Utilisation	71	0	2	8	**81**
Reversals	16	1	89	10	**116**
Interest	0	–	–	0	**0**
Reclassifications	0	–	–	0	**0**
Changes in basis of consolidation	–	–	–	0	**0**
Currency translation differences	-2	0	–	0	**-2**
Carrying amount as at 31 Dec 2017	**187**	**4**	**13**	**15**	**219**

€ mn	Provisions for staff expenses and non-staff operating costs	Provisions in the lending business for unrecognised items	Provisions for legal and tax risks	Miscellaneous other provisions	Total
Carrying amount as at 1 Jan 2016	**166**	**14**	**236**	**34**	**450**
Additions	108	0	8	9	**125**
Utilisation	70	1	68	15	**154**
Reversals	10	8	74	2	**94**
Interest	1	–	1	0	**2**
Reclassifications	-8	–	–	0	**-8**
Changes in basis of consolidation	–	–	–	0	**0**
Currency translation differences	0	0	–	0	**0**
Carrying amount as at 31 Dec 2016	**187**	**5**	**103**	**26**	**321**

Other provisions of € 219 million include € 62 million expected to be realised after a period exceeding twelve months.

Provisions for staff expenses and non-staff operating costs refer to personnel provisions in the amount of € 140 million (2016: € 89 million) and provisions for non-staff operating costs in the amount of € 47 million (2016: € 98 million). Personnel provisions consist of, among other things, provisions for bonuses, partial retirement, severance pay and existing working hours accounts. Provisions for non-staff operating expenses mainly include provisions for professional and legal advice.

The provisions for staff and non-staff operating expenses include € 88 million of provisions for severance pay and restructuring provisions for non-staff operating expenses of € 1 million.

Provisions for tax risks that were recognised largely to cover risks in connection with ongoing tax audits at the former Corealcredit could be reversed to a large extent in the year under review.

Concerning the part of the credit portfolio of the former Corealcredit that was acquired subject to credit-related purchase price discounts, as at 31 December 2017, there were no further compensation payments to the seller to be recognised directly in equity. The level of such compensation payments largely corresponded to the surplus amount of borrower payments relative to the carrying amount of the corresponding accounts receivable. Compensation payments made to the seller to date (and recognised directly in equity) totalled € 65 million.

The item "Provisions in the lending business for unrecognised items" includes portfolio-based valuation allowances in the amount of € 2 million (2016: € 2 million).

(56) Income tax liabilities

Income tax liabilities in a total amount of € 29 million as at 31 December 2017 (2016: € 71 million) include € 7 million (2016: € 6 million) expected to be realised after a period of more than twelve months.

(57) Deferred tax liabilities

When recognising deferred taxes, claims and liabilities arising vis-à-vis the same tax authority, which may be netted and paid in one amount, were offset in the amount of € 546 million (2016: € 736 million).

Deferred tax liabilities were recognised in relation to the following items of the statement of financial position:

€ mn	31 Dec 2017	31 Dec 2016
Loans and advances to banks/to customers	135	155
Positive and negative fair values of derivative hedging instruments	37	124
Trading assets and trading liabilities	61	81
Non-trading assets	302	370
Investments accounted for using the equity method	–	–
Intangible assets	12	7
Property and equipment	6	3
Other assets/liabilities	12	20
Liabilities to banks/to customers, and certificated liabilities	–	–
Provisions	0	2
Subordinated capital	–	2
Deferred tax liabilities	**565**	**764**

(58) Other liabilities

€ mn	31 Dec 2017	31 Dec 2016
Liabilities from outstanding invoices	10	10
Deferred income	16	15
Liabilities from other taxes	17	17
Trade payables (LaC)	18	30
Other liabilities (LaC)	64	55
Total	**125**	**127**

(59) Subordinated capital

€ mn	31 Dec 2017	31 Dec 2016
Subordinated liabilities	1,060	1,122
Profit-participation certificates	12	50
Silent participations	193	194
Total	**1,265**	**1,366**

The € -101 million change in subordinated capital comprises € -116 million in cash interest and principal payments and € 15 million in non-cash fair-value changes and interest accruals.

(60) Equity

€ mn	31 Dec 2017	31 Dec 2016
Subscribed capital	180	180
Capital reserves	721	721
Retained earnings	1,798	1,734
AT1 bond	300	300
Other reserves		
Reserve from remeasurements of defined benefit plans	-91	-100
Revaluation reserve	24	29
Hedging reserves	-1	17
Currency translation reserves	-9	6
Non-controlling interests	2	242
Total	**2,924**	**3,129**

Subscribed capital

Aareal Bank AG's subscribed capital amounted to € 180 million as at the reporting date (2016: € 180 million). It is divided into 59,857,221 notional no-par value shares ("unit shares") with a notional value of € 3 per share. The shares are bearer shares. Each share carries one vote. There are no pre-emptive rights or constraints with respect to dividend payouts.

Treasury shares

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

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

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

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

Authorised capital

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

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

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

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

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

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

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

The authorised capital has not been utilised.

Conditional capital

Based on a resolution passed by the General Meeting on 21 May 2014, the Management Board was authorised to issue, on one or more occasions until 20 May 2019, profit-participation rights with a limited or unlimited term for contribution in cash or in kind in a total nominal amount of € 1,000,000,000. If the profit-participation rights are not issued against contribution in kind, they may be linked to a conversion right for the holder or creditor. Conversion rights may only be issued for the Company's no-par value bearer shares with a proportionate share in the Company's share capital of € 89,785,830. The issue of profit-participation rights may also be effected by domestic or foreign companies in which the Company either directly or indirectly holds a majority interest. In this case, the Company, subject to Supervisory Board approval, may guarantee such issues as well as to issue shares on its own to fulfil the conversion rights. Subject to the approval of the Supervisory Board, the Management Board may exclude shareholders' pre-emptive rights in relation to the profit-participation rights in certain cases.

The purpose of the authorisation passed by the Annual General Meeting on 21 May 2014 is to create Tier 1 capital that is eligible for regulatory purposes; it also provides for the issue of profit-participation rights with conversion obligations. It is in accordance with the various structuring alternatives for Additional Tier 1 capital instruments, pursuant to the Capital Requirements Regulation. For instance, a conversion obligation may be provided for if the Bank falls short of certain capital ratios (to be defined in the terms of convertible profit-participation certificates) or other financial indicators; conversion is required, in the opinion of the Company's Management Board and Supervisory Board, to safeguard the Company's continued existence; or if conversion is instructed by a supervisory authority within the scope of its powers.

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

The new shares will be issued at the conversion price to be set as defined in the resolution passed by the General Meeting on 21 May 2014.

To date, the Conditional Capital has not yet been utilised.

Capital reserves

The capital reserves contain premiums received upon the issuance of shares. Costs incurred within the framework of a capital increase reduce capital reserves.

Retained earnings

Retained earnings are comprised of statutory reserves (pursuant to section 150 of the AktG) of € 5 million (2016: € 5 million) and of other retained earnings of € 1,793 million (2016: € 1,729 million).

Additional Tier 1 bond (AT1 bond)

On 13 November 2014, the Management Board issued notes in an aggregate nominal amount of € 300 million with a denomination of € 200,000 and an initial interest rate of 7.625 %, based on the authorisation granted by the Annual General Meeting on 21 May 2014.

The notes bear interest of 7.625 % per annum from the interest commencement date to 30 April 2020. The rate of interest for any interest period commencing on or after 30 April 2020 shall be equal to the reference rate (one-year EUR swap rate) determined on the relevant interest determination date plus a margin of 7.18 % per annum.

The notes constitute unsecured and subordinated obligations of the issuer.

Upon the occurrence of a trigger event, the redemption amount and the principal amount of each note shall be reduced by the amount of the relevant write-down. The write-down shall be effected pro rata with all other Additional Tier 1 instruments within the meaning of the CRR, the terms of which provide for a write-down upon the occurrence of the trigger event. A trigger event occurs if the Common Equity Tier 1 capital ratio, pursuant to Article 92 (1) (a) CRR or a successor provision, and determined on a consolidated basis, falls below 7.0 %. After a write-down has been effected, the principal amount and the redemption amount of each note, unless previously redeemed or repurchased and cancelled, may be written up in each of the financial years of the issuer subsequent to such write-down until the full initial principal amount has been reached.

The notes may be redeemed, in whole but not in part, at any time at the option of the issuer, subject to the prior consent of the competent supervisory authority, upon not less than 30 and not more than 60 days' prior notice of redemption at their redemption amount (taking into account a potential write-down) together with interest accrued until the redemption date (to the extent that interest payment is not cancelled or ruled out in accordance with the terms and conditions of the notes), when the tax or regulatory reasons set out in the terms and conditions of the notes apply. The issuer may also redeem the notes, in whole but not in part, at any time, subject to the prior consent of the competent supervisory authority, upon not less than 30 days' notice of redemption with effect as at 30 April 2020 for the first time and, thereafter, with effect as at each interest payment date at their redemption amount together with interest (if any) accrued to the redemption date.

Revaluation surplus

The revaluation surplus comprises effects from fair value measurement of financial instruments of the measurement category "Available for sale (AfS)".

Non-controlling interests

Due to the repayment of the Capital Funding Trust in the first quarter 2017, non-controlling interests were reduced to € 2 million (31 December 2016: € 242 million).

Distributions

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

In addition, on 30 April 2018, the Management Board will resolve on a distribution in relation to the AT1 instruments, pursuant to the terms and conditions of the notes.

Notes to Financial Instruments

A detailed description of the system in place at Aareal Bank AG to measure, limit, and manage risks throughout Aareal Bank Group is presented in the risk report as part of the management report. The disclosures on the description and the extent of the risks arising from financial instruments in accordance with IFRS 7 are included (in part) in the risk report.

(61) Net results of financial instruments by category

The following overview shows the net gains or net losses from financial instruments in accordance with the classification of financial assets and financial liabilities (from which the results are generated) in the measurement categories in accordance with IAS 39:

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Result from loans and receivables	-84	-102
Result from held-to-maturity investments	0	0
Result from financial instruments held for trading	7	19
Result from assets designated as at fair value through profit or loss	–	0
Result from assets available for sale	-13	58
of which: directly recognised in equity	-13	-4
Result from financial guarantee contracts	1	8

In the current reporting period, there were no measurement gains or losses from available-for-sale assets reclassified from equity to the income statement. In the previous year, the result from assets available for sale included income from the sale of all shares in Aareal Bank's wholly-owned subsidiary Aqvatrium. The net result on hedge accounting amounted to € -7 million in the year under review (2016: € 0 million). The result from currency translation amounted to € 7 million in the year under review (2016: € 0 million).

The net results include measurement gains and losses, realised gains/losses on disposal, subsequent recoveries on loans and advances previously written off in relation to all financial instruments of the respective category. The result from financial instruments held for trading also includes interest and dividends as well as commissions from held-for-trading financial instruments. The hedge result from hedged items is aggregated with the hedge result from derivative hedging instruments in one line item and, similarly to the result from currency translation, shown separately.

(62) Impairment losses on financial assets

The following overview shows the impairment losses recognised for financial assets by measurement category during the year under review:

€ mn	1 Jan - 31 Dec 2017	1 Jan - 31 Dec 2016
Loans and advances to customers (LaR)	174	171
Non-trading assets (AfS)	–	–
Other assets (LaR)	0	0
Total	**174**	**171**

(63) Fair value hierarchy in accordance with IFRS 13

All financial instruments for which a fair value is disclosed have to be allocated to one of the levels of the fair value hierarchy in accordance with IFRS 13. The classification into the individual hierarchy levels is based on the inputs used for fair value measurement. A description of the fair value hierarchy is included in Note (5) "Determination of fair value" in the section on accounting policies.

Determination of the fair value for financial instruments carried at fair value in the statement of financial position

Non-trading assets available for sale:
Fixed-income securities and equity instruments for which qualified market prices are available on or shortly before the reporting date are allocated to Level 1 of the fair value hierarchy.

In case of fixed-income securities or equities for which no qualified market price is available, the fair value is determined on the basis of comparable market prices to the extent possible. To this end, quoted prices on active markets for largely identical securities or quoted prices on inactive markets for identical or similar securities are used by adjusting the last available market price or the current fair value of another largely identical instrument, to take into account any changes in risk or new information known as at the measurement date. In the absence of comparable market prices for securities, they are measured through an analysis of future payments using the fully-capitalised earnings value approach, where the inputs are based on observable market data. These approaches include the discounted cash flow (DCF) method which is used to determine the present value of contractual cash flows until the expected end of the term. The present value is determined based on the benchmark curve applicable for the relevant market, taking into account mark-ups based on credit quality and liquidity. The valuation model used for options included in the transaction is the commonly used Black-Scholes model or appropriate numerical procedures. These valuation models exclusively include inputs observable in the market, so that the securities concerned are allocated to Level 2 of the fair value hierarchy. In case the fair value of unlisted equity instruments cannot be determined reliably, the instruments are accounted for using cost.

Loans and advances to customers held for trading:
Property financing entered into with the intention of re-selling them in the near term due to syndication requirements are measured using the discounted cash flow method for the purpose of the determination of fair value. Discounting of future cash flows of a transaction is based on transaction-specific risk-adjusted

interest rates. These are derived on the basis of a virtually risk-free market interest rate for each currency depending on the relevant term, taking into account add-ons for risks specific to the counterparty as well as credit costs. In the case of loans subject to fixed interest rates, the contractually agreed payments are used as future cash flows. The future cash flows for floating-rate loans are derived using the future forward interest rates, taking into account the relevant spread for customer-specific terms and conditions. The Bank further developed its methodology for determining fair value during the year under review.

Positive and negative market value of derivative hedging instruments as well as from derivatives held for trading:

Exchange-traded derivatives are measured at their quoted market price and allocated to Level I of the fair value hierarchy. Aareal Bank currently does not hold any listed derivatives in its portfolio.

The fair value of OTC derivatives included in the trading portfolio as well as of OTC hedging derivatives is determined on the basis of sector-specific standardised measurement models, such as the present value method or option pricing models. These techniques are based on inputs quoted on active markets, such as interest rates, yield curves and credit spreads. The fair value of foreign exchange forwards is generally based on current forward exchange rates quoted on active markets. These derivatives are allocated to Level 2 of the fair value hierarchy.

The carrying amounts of financial instruments held by Aareal Bank Group which are reported at fair value in the statement of financial position are presented in the following table according to the three-tier fair value hierarchy pursuant to IFRS 13.72 et seq. The presentation is made for each class of financial instrument:

31 December 2017

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Loans and advances to customers held for trading	**196**	**–**	**–**	**196**
Positive market value of derivative hedging instruments	**1,926**	**–**	**1,926**	**–**
Assets held for trading	**327**	**–**	**327**	**–**
Trading derivatives	327	–	327	–
Non-trading assets available for sale	**5,424**	**5,422**	**–**	**2**
Fixed-income securities	5,422	5,422	–	–
Equities/funds	0	0	–	–
Equity investments	2	–	–	2
Negative market value of derivative hedging instruments	**1,479**	**–**	**1,479**	**–**
Liabilities held for trading	**224**	**–**	**224**	**–**
Trading derivatives	224	–	224	–

31 December 2016

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Loans and advances to customers held for trading	**–**	**–**	**–**	**–**
Positive market value of derivative hedging instruments	**2,481**	**–**	**2,481**	**–**
Assets held for trading	**502**	**–**	**502**	**–**
Trading derivatives	502	–	502	–
Non-trading assets available for sale	**5,948**	**5,918**	**30**	**–**
Fixed-income securities	5,947	5,917	30	–
Equities/funds	1	1	–	–
Equity investments	–	–	–	–
Negative market value of derivative hedging instruments	**2,529**	**–**	**2,529**	**–**
Liabilities held for trading	**652**	**–**	**652**	**–**
Trading derivatives	652	–	652	–

During the financial year 2017, € 30 million in fixed-income securities of the AfS category were reclassified from Level 2 to Level 1 (2016: € –). There was no reclassification of fixed-income securities of the same category from Level 1 to Level 2 in the reporting year (2016: € –). The end of the reporting period is relevant for reclassification.

The fair values of financial instruments recognised at fair value in the statement of financial position that are assigned to Level 3 of the fair value hierarchy amounted to € 196 million, representing additions during the period under review: The associated instruments are loans and advances to customers classified as held for trading where the add-ons for risks specific to the counterparty represent material inputs not observable on the market. An increase/decrease by 1 % would lead to a decrease/increase of the fair value of loans and advances to customers of the hft category by approximately € 2 million.

Determination of the fair value for financial instruments carried at amortised cost in the statement of financial position

Cash on hand and balances with central banks:

Cash funds are recognised at the IFRS carrying amount, which is considered an appropriate fair value.

Loans and advances to banks and customers classified as "Loans and receivables" as well as liabilities to banks and customers measured at amortised cost:

The property finance portfolio included in loans and advances to customers of the "Loans and receivables" category is measured using the discounted cash flow method for the purpose of the determination of fair value. Discounting of future cash flows of a transaction is based on transaction-specific risk-adjusted interest rates. These are derived on the basis of a virtually risk-free market interest rate for each currency depending on the relevant term, taking into account add-ons for risks specific to the counterparty as well as credit costs. In the case of loans subject to fixed interest rates, the contractually agreed payments are used as future cash flows. The future cash flows for floating-rate loans are derived using the future forward interest rates, taking into account the relevant spread for customer-specific terms and conditions.

Amortised cost is an adequate estimate of fair value for short-term money market transactions, current account balances and other short-term receivables and liabilities included in these classes. Quoted market prices are normally not available for promissory note loans of the ”Loans and receivables” category. Therefore, they are measured through discounting the future cash flows using the currency-specific benchmark curve. The liquidity and creditworthiness components are taken into account using issuer-specific spreads.

Registered profit-participation certificates of the ”Liabilities measured at amortised cost” category which are backed through assets (covered issues) are also measured using the discounted cash flow method on the basis of the benchmark curve. In addition, we take into account quoted covered bond spreads. Future contractual cash flows of uncovered issues are discounted using an interest rate adequate for Aareal Bank.

Generally, there are no quoted market prices available for the products included in loans and advances, and liabilities to banks and customers. They are allocated either to Level 2 or Level 3 of the fair value hierarchy, depending on the inputs included in the measurement model.

Non-trading assets of the ”Loans and receivables” and ”Held to maturity” categories:
These classes include fixed-income bonds and debt securities whose fair value is determined following the same procedure for available-for-sale non-trading assets, based on prices on active markets or valuation methods such as the discounted cash flow method; they are classified accordingly into the fair value hierarchy. They are allocated either to Level 1 or Level 2 of the fair value hierarchy, depending on whether or not sufficient qualified market prices are observable as at the reporting date.

Certificated liabilities measured at amortised cost:
Unless prices on active markets are available, the fair value for bearer securities is determined in accordance with the procedure used for registered securities, with a distinction being made between covered and uncovered issues. To the extent that quoted market prices are available for securities issued by Aareal Bank, such securities are allocated to Level 1 of the fair value hierarchy. Securities for which there are no active market prices are allocated to Level 2 since the valuation methods do not use inputs not observable in the market.

Subordinated capital equity measured at amortised cost:
Subordinated promissory note loans, subordinated bearer debt securities as well as other hybrid instruments of the ”Liabilities measured at amortised cost” category are also measured on the basis of the present value method using market-based credit quality premiums with respect to the relevant benchmark curves. If quoted prices on active markets are available, such prices are used as the fair value. Subordinated securities not actively traded in the market are allocated either to Level 2 or Level 3 of the fair value hierarchy, depending on the inputs included in the measurement model.

The market values of financial instruments held by Aareal Bank Group which are reported at amortised cost in the statement of financial position are presented in the following table according to the three-tier fair value hierarchy pursuant to IFRS 13.72 et seq. The presentation is made for each class of financial instrument.

31 December 2017

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Cash on hand and balances with central banks	**2,081**	**–**	**2,081**	**–**
Loans and advances to banks (loans and receivables)	**785**	**–**	**782**	**3**
Money market receivables from banks	717	–	717	0
Promissory note loans to banks	63	–	63	–
Other receivables from banks	5	–	2	3
Loans and advances to customers (loans and receivables)	**27,717**	**–**	**1,411**	**26,306**
Property loans to customers	24,794	–	1	24,793
Money market receivables from customers	9	–	6	3
Promissory note loans to customers	1,405	–	1,404	1
Other receivables from customers	1,509	–	–	1,509
Non-trading assets (loans and receivables)	**2,732**	**2,012**	**720**	**–**
Fixed-income securities	2,732	2,012	720	–
Non-trading assets held to maturity	**292**	**292**	**–**	**–**
Fixed-income securities	292	292	–	–
Liabilities to banks measured at amortised cost	**1,934**	**–**	**1,876**	**58**
Money market liabilities to banks	999	–	999	–
Registered mortgage Pfandbriefe to banks	584	–	584	–
Registered Public Sector Pfandbriefe to banks	60	–	60	–
Promissory note loans to banks	267	–	211	56
Other liabilities to banks	24	–	22	2
Liabilities to customers measured at amortised cost	**25,916**	**–**	**16,925**	**8,991**
Money market liabilities to customers	12,994	–	4,003	8,991
Registered mortgage Pfandbriefe to customers	5,216	–	5,216	–
Registered Public Sector Pfandbriefe to customers	2,511	–	2,511	–
Promissory note loans to customers	5,195	–	5,195	–
Other liabilities to customers	0	–	0	–
Certificated liabilities measured at amortised cost	**7,663**	**513**	**7,150**	**–**
Bearer mortgage Pfandbriefe	5,357	513	4,844	–
Bearer public-sector Pfandbriefe	45	–	45	–
Other debt securities	2,261	–	2,261	–
Subordinated capital measured at amortised cost	**1,358**	**340**	**815**	**203**

31 December 2016

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Cash on hand and balances with central banks	**1,786**	**–**	**1,786**	**–**
Loans and advances to banks (loans and receivables)	**1,590**	**–**	**1,590**	**–**
Money market receivables from banks	1,468	–	1,468	–
Promissory note loans to banks	122	–	122	–
Other receivables from banks	–	–	–	–
Loans and advances to customers (loans and receivables)	**32,697**	**–**	**1,533**	**31,164**
Property loans to customers	28,201	–	0	28,201
Money market receivables from customers	977	–	9	968
Promissory note loans to customers	1,525	–	1,524	1
Other receivables from customers	1,994	–	–	1,994
Non-trading assets (loans and receivables)	**3,144**	**2,323**	**821**	**–**
Fixed-income securities	3,144	2,323	821	–
Non-trading assets held to maturity	**525**	**525**	**–**	**–**
Fixed-income securities	525	525	–	–
Liabilities to banks measured at amortised cost	**1,719**	**–**	**1,655**	**64**
Money market liabilities to banks	808	–	808	–
Registered mortgage Pfandbriefe to banks	505	–	505	–
Registered Public Sector Pfandbriefe to banks	21	–	21	–
Promissory note loans to banks	361	–	297	64
Other liabilities to banks	24	–	24	–
Liabilities to customers measured at amortised cost	**29,040**	**–**	**20,134**	**8,906**
Money market liabilities to customers	13,724	–	4,818	8,906
Registered mortgage Pfandbriefe to customers	6,139	–	6,139	–
Registered Public Sector Pfandbriefe to customers	2,979	–	2,979	–
Promissory note loans to customers	6,197	–	6,197	–
Other liabilities to customers	1	–	1	–
Certificated liabilities measured at amortised cost	**8,361**	**519**	**7,842**	**–**
Bearer mortgage Pfandbriefe	5,990	519	5,471	–
Bearer public-sector Pfandbriefe	45	–	45	–
Other debt securities	2,326	–	2,326	–
Subordinated capital measured at amortised cost	**1,424**	**331**	**841**	**252**

(64) Comparison of carrying amounts and fair values of the financial instruments

The fair values of financial instruments are compared with their carrying amounts in the following table. The presentation is made for each class of financial instrument:

€ mn	31 Dec 2017 Carrying amount	31 Dec 2017 Fair value	31 Dec 2016 Carrying amount	31 Dec 2016 Fair value
Cash on hand and balances with central banks (LaR)	2,081	2,081	1,786	1,786
Loans and advances to banks (LaR)	779	785	1,583	1,590
Loans and advances to customers (LaR)	27,109	27,717	30,649	32,697
Non-trading assets (LaR)	2,823	2,732	3,259	3,144
Total loans and receivables	**32,792**	**33,315**	**37,277**	**39,217**
Loans and advances to customers held for trading	**196**	**196**	**–**	**–**
Non-trading assets held to maturity	**290**	**292**	**522**	**525**
Non-trading assets available for sale	**5,424**	**5,424**	**5,948**	**5,948**
Positive fair values of derivative hedging instruments	**1,926**	**1,926**	**2,481**	**2,481**
Assets held for trading	**327**	**327**	**502**	**502**
Liabilities to banks (LaC)	1,914	1,934	1,703	1,719
Liabilities to customers (LaC)	25,765	25,916	29,077	29,040
Certificated liabilities (LaC)	7,594	7,663	8,346	8,361
Subordinated capital (LaC)	1,265	1,358	1,366	1,424
Total liabilities measured at amortised cost	**36,538**	**36,871**	**40,492**	**40,544**
Negative market values of derivative hedging instruments	**1,479**	**1,479**	**2,529**	**2,529**
Liabilities held for trading	**224**	**224**	**652**	**652**

(65) Credit quality of financial assets

The following overview (p. 153) shows the credit quality of Aareal Bank Group's financial assets by separately disclosing assets neither past due nor impaired, past due assets and impaired assets. The presentation is based on carrying amounts.

€ mn	31 Dec 2017	31 Dec 016
Financial assets neither past due nor impaired		
Loans and advances to banks	779	1,583
Loans and advances to customers	26,611	29,685
Positive market value of derivative hedging instruments	1,926	2,481
Trading assets	327	502
Non-trading assets (LaR)	2,823	3,259
Non-trading assets (AfS)	5,424	5,949
Non-trading assets (HtM)	290	522
Other assets	88	88
Total	**38,268**	**44,069**
Financial assets that are past due but not impaired		
Loans and advances to customers	64	153
Other assets	–	0
Total	**64**	**153**
Financial assets subject to specific valuation allowances		
Loans and advances to customers	1,170	1,365
Other assets	5	5
Total	**1,175**	**1,370**

Information about the recoverability of financial assets neither past due nor impaired are provided in the Risk Report in the section on credit risks. An analysis of the financial assets that are past due and impaired is included in the other disclosures in the Notes.

Please refer to the presentation of the items of the statement of financial position in the section "Notes to the statement of financial position" for information on maximum credit risk exposure since the carrying amount corresponds to the maximum credit risk exposure of Aareal Bank as at the balance sheet date. The collateral received is described in the Risk Report.

At Aareal Bank, property loans were subjected to contractual adjustments due to financial difficulties of the borrower, in order to secure the repayment of the exposure. Due to a better comparability, Aareal Bank has used the EBA definition in the year under review, which means that contractual adjustments of property loans already impaired have to be disclosed as well. The comparative figures were adjusted accordingly. The portfolio of financings, adjusted during the reporting year and the previous years, totalled € 835 million on 31 December 2017 (2016: € 608 million). In the financial year 2017, no loans (2016: loans in the amount of € 25 million) were removed from intensified handling or handling of problem loans due to re-ageing after the end of a two-year period of good conduct. Moreover, loans with a carrying amount of € 103 million (2016: € 50 million) were discharged or terminated through realisation of collateral. In the year under review, the volume of financings that were subject to adjustments to be made due to financial difficulties of the borrower amounted to € 328 million (2016: € 159 million). There were increases in the carrying amounts in relation to existing exposures, by a total of € 2 million (2016: decreases of € 14 million).

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

The following overviews show the amount of property loans past due but not impaired within the category "Loans and advances to customers (LaR)".[1)]

Breakdown by region:

31 December 2017

€ mn	Past due more than 9 days up to 1 month	Past due more than 1 month up to 3 months	Past due more than 3 months up to 6 months	Past due more than 6 months up to 1 year	Past due more than 1 year	Total as at 31 Dec 2017
Regions						
Germany	5	1	0	1	3	10
Western Europe	–	–	–	–	–	–
Northern Europe	–	–	–	–	1	1
Southern Europe	0	8	0	8	37	53
Eastern Europe	–	–	–	–	–	–
Total	**5**	**9**	**0**	**9**	**41**	**64**

31 December 2016

€ mn	Past due more than 9 days up to 1 month	Past due more than 1 month up to 3 months	Past due more than 3 months up to 6 months	Past due more than 6 months up to 1 year	Past due more than 1 year	Total as at 31 Dec 2016
Regions						
Germany	1	0	0	12	15	28
Western Europe	0	–	31	–	–	31
Northern Europe	–	–	–	–	–	–
Southern Europe	19	0	–	21	54	94
Eastern Europe	–	–	–	–	–	–
Total	**20**	**0**	**31**	**33**	**69**	**153**

[1)] The figures shown are past-due, non-impaired assets that are at least ten days overdue with a minimum amount of € 100 and 2.5 % of the commitment.

Breakdown by borrower group

31 December 2017

€ mn	Past due more than 9 days up to 1 month	Past due more than 1 month up to 3 months	Past due more than 3 months up to 6 months	Past due more than 6 months up to 1 year	Past due more than 1 year	Total as at 31 Dec 2017
Borrower groups						
Companies	5	8	–	8	39	**60**
Private individuals	0	1	0	1	2	**4**
Other	–	0	–	–	0	**0**
Total	**5**	**9**	**0**	**9**	**41**	**64**

31 December 2016

€ mn	Past due more than 9 days up to 1 month	Past due more than 1 month up to 3 months	Past due more than 3 months up to 6 months	Past due more than 6 months up to 1 year	Past due more than 1 year	Total as at 31 Dec 2016
Borrower groups						
Companies	19	0	31	33	67	**150**
Private individuals	1	0	–	0	2	**3**
Other	–	–	–	–	0	**0**
Total	**20**	**0**	**31**	**33**	**69**	**153**

The past due financial assets were not impaired due to collateral provided.

On the reporting date, the amount of loans and advances of the "Other assets" category did not include any receivables that were past due but not impaired (2016: € 0 million). There were no other financial assets past due but not impaired on the reporting date.

(67) Impaired financial assets

The following overviews indicate the amount of impaired property loans, together with the related allowance for credit losses.

Breakdown by region

31 December 2017

€ mn	Impaired property financings before allowance for credit losses	Balance of specific valuation allowances	Balance of provisions for the lending business
Regions			
Germany	21	4	2
Western Europe	188	63	–
Northern Europe	57	25	–
Southern Europe	777	304	–
Eastern Europe	107	51	–
North America	20	12	–
Total	**1,170**	**459**	**2**

31 December 2016

€ mn	Impaired property financings before allowance for credit losses	Balance of specific valuation allowances	Balance of provisions for the lending business
Regions			
Germany	27	6	3
Western Europe	193	40	–
Northern Europe	82	47	–
Southern Europe	919	284	–
Eastern Europe	120	49	–
North America	24	9	–
Total	**1,365**	**435**	**3**

Breakdown by borrower group

31 December 2017

€ mn	Impaired property financings before allowance for credit losses	Balance of specific valuation allowance	Balance of provisions for the lending business	Changes of specific valuation allowances and specific provisions for the lending business recognised in profit or loss	Direct write-offs
Borrower groups					
Companies	1,168	458	2	80	43
Private individuals	2	1	–	0	0
Other	0	0	0	0	–
Total	**1,170**	**459**	**2**	**80**	**43**

31 December 2016

€ mn	Impaired property financings before allowance for credit losses	Balance of specific valuation allowance	Balance of provisions for the lending business	Changes of specific valuation allowances and specific provisions for the lending business recognised in profit or loss	Direct write-offs
Borrower groups					
Companies	1,363	435	2	77	19
Private individuals	2	0	1	0	0
Other	0	0	0	0	0
Total	**1,365**	**435**	**3**	**77**	**19**

As at the reporting date, the amount of portfolio-based valuation allowances for recognised items was € 81 million (2016: € 119 million) and for financial guarantees and loan commitments € 2 million (2016: € 2 million). Reversals of portfolio-based valuation allowances, which are recognised through profit or loss, amounted to € 38 million (2016: net reversals of € 1 million) in the year under review.

Payments on loans and advances previously written off amounted to € 39 million in the year under review (2016: € 30 million).

The amount of impaired receivables of the "Other assets" category as at the reporting date was € 5 million (2016: € 5 million). The related impairment allowance amounts to € 4 million (2016: € 3 million).

In the financial year 2017, no assets were acquired within the context of the realisation of collateral (2016: € 220 million).

(68) Reclassification of financial assets

In 2008 and 2009, Aareal Bank Group made use of the possibility to reclassify financial assets into another measurement category, in accordance with IAS 39.50A et seq.

The following table is a comparison of the carrying amounts and the fair values of the reclassified securities and also shows the measurement effects which would have arisen without reclassification in the current financial year and in the previous year:

	Reclassified assets, total				Results from fair value measurement without reclassification			
€ mn	Carrying amount at the reporting date 31 Dec 2017	Fair value at the reporting date 31 Dec 2017	Carrying amount (previous year) 31 Dec 2016	Fair value (previous year) 31 Dec 2016	Effect on the income statement 1 Jan - 31 Dec 2017	Effect on the revaluation surplus 1 Jan - 31 Dec 2017	Effect on the income statement 1 Jan - 31 Dec 2016	Effect on the revaluation surplus 1 Jan - 31 Dec 2016
from AfS to LaR	**2,629**	**2,533**	**3,044**	**2,921**	**–**	**5**	**–**	**-51**
Asset-backed securities	–	–	–	–	–	–	–	-1
Senior unsecured bank bonds	20	20	46	47	–	-2	–	-4
Covered bank bonds	111	112	237	239	–	-5	–	-4
Public-sector issuers	2,498	2,401	2,761	2,635	–	12	–	-42
from HfT to LaR	**–**	**–**	**–**	**–**	**–**	**–**	**-6**	**–**
Asset-backed securities	–	–	–	–	–	–	-6	–
Total	**2,629**	**2,533**	**3,044**	**2,921**	**–**	**5**	**-6**	**-51**

As in the previous year, no impairment losses had to be recognised for the reclassified financial assets in 2017. No gains were realised upon disposal of reclassified securities (2016: gain of € 5 million). Interest income from reclassified assets amounted to € 83 million (2016: € 90 million) in the year under review. Interest income, including current interest from derivatives used to hedge economic market price risks, amounted to € 1 million (2016: € 7 million).

(69) Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount is presented in the statement of financial position when currently there is a legally enforceable right to set off the recognised amounts, and when the Bank intends either to settle on a net basis – or to realise the asset and settle the liability simultaneously.

The following overviews show whether and to what extent financial instruments were actually offset as at the current reporting date. The tables also include disclosures on financial instruments that are part of an enforceable master netting or similar arrangement that do not meet the criteria for offsetting in the statement of financial position.

Financial assets as at 31 December 2017

€ mn	Gross carrying amounts of recognised financial assets	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial liabilities which were not subject to offsetting	Collateral provided	Remaining net amount
Derivatives	2,212	–	2,212	1,094	983	135
Reverse repos	–	–	–	–	–	–
Total	**2,212**	**–**	**2,212**	**1,094**	**983**	**135**

Financial liabilities as at 31 December 2017

€ mn	Gross carrying amounts of recognised financial liabilities	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial assets which were not subject to offsetting	Collateral provided	Remaining net amount
Derivatives	1,645	–	1,645	1,094	551	–
Repos	–	–	–	–	–	–
Total	**1,645**	**–**	**1,645**	**1,094**	**551**	**–**

Financial assets as at 31 December 2016

€ mn	Gross carrying amounts of recognised financial assets	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial liabilities which were not subject to offsetting	Collateral provided	Remaining net amount
Derivatives	2,700	–	2,700	1,707	957	36
Reverse repos	–	–	–	–	–	–
Total	**2,700**	**–**	**2,700**	**1,707**	**957**	**36**

Financial liabilities as at 31 December 2016

€ mn	Gross carrying amounts of recognised financial liabilities	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial assets which were not subject to offsetting	Collateral provided	Remaining net amount
Derivatives	3,031	–	3,031	1,707	1,238	86
Repos	–	–	–	–	–	–
Total	**3,031**	**–**	**3,031**	**1,707**	**1,238**	**86**

To reduce counterparty risk, Aareal Bank Group concludes standardised master agreements for financial derivatives and securities repurchase agreements, such as the ISDA Master Agreement, the German Master Agreement on Financial Derivatives or the Master Agreement for Securities Repurchase Transactions. In addition, Aareal Bank enters into collateral agreements (Credit Support Annex to the ISDA Master Agreement and Collateral Annex to the German Master Agreement on Financial Derivatives) in which a mutual collateralisation of all claims between the contracting parties is agreed and which include netting arrangements.

The master agreements for financial derivatives used by Aareal Bank include netting arrangements at a single transaction level (so-called "payment netting"), which provide for a netting of payments when both parties need to make payments in the same currency on the same date, as set out in the contract. Aareal Bank does not offset financial derivatives according to the rules related to payment netting, as the transactions are not settled on a net basis. Aareal Bank Group has not entered into arrangements providing for netting of derivatives across several transactions.

For securities repurchase transactions (repo), depending on the counterparty, payment or delivery netting is made. In line with the rules set out in the master agreement for repo transactions, payments or deliveries of securities may be offset when both counterparties have to make payments in the same currency on the same date, or have to deliver securities of the same type. Transactions effected on the basis of the master agreement for repo transactions generally meet the offsetting requirements of IAS 32. Aareal Bank settles on a net basis in the case of transactions within the framework of GC pooling, which means that these transactions are offset in the statement of financial position.

(70) Assets provided or accepted as collateral

Assets provided as collateral

Aareal Bank Group has provided financial assets as collateral for its liabilities or contingent liabilities. The following overview shows the carrying amount of the collateral provided and the items of the statement of financial position in which they are reported.

€ mn	31 Dec 2017	31 Dec 2016
Loans and advances to banks	558	1.382
Non-trading assets	165	192
Total	**723**	**1,574**

The protection buyer has no right to sell or re-pledge any of financial assets pledged as collateral (2016: € –). There is a fully cash-collateralised and irrevocable payment obligation in the amount of € 14 million (2016: € 10 million) from the bank levy and also for the deposit guarantee scheme of German banks. Cash collateral is recognised as other assets.

Assets accepted as collateral

Aareal Bank Group accepts financial assets as collateral. These assets may be sold or pledged without the collateral owner being in default. No fixed-income securities had been accepted as collateral for repo transactions as at the balance sheet date (2016: € –).

Collateral is provided and accepted predominantly on the basis of standardised agreements on securities repurchase transactions and on the collateralisation of forward transactions.

(71) Transfer of financial assets without derecognition

Aareal Bank Group sells securities subject to a take-back requirement as borrower within the framework of genuine repurchase agreements. Within the scope of such agreements, securities were transferred to lenders without resulting in the securities being derecognised since Aareal Bank Group retains the substantial risks and rewards from the securities. The risks to which Aareal Bank Group is still exposed comprise the default risk, the interest rate risk and other price risks. The equivalent values received as hedges during the transfer of securities are accounted for as liabilities to banks, or liabilities to customers. Within the context of securities repurchase transactions, the unrestricted title and the unrestricted power of disposition is transferred to the lender upon delivery of the securities. The lender has the right to sell or pledge these securities, however, he is required to retransfer securities of the same type and in the same amount as at the repurchase date.

As in the previous year, no securities were part of repurchase agreements as at the balance sheet date.

(72) Derivative financial instruments

Aareal Bank Group enters into derivative financial instruments primarily in order to hedge market risks as well as for refinancing purposes. Derivatives which are designated for hedging purposes and meet the hedge accounting criteria are reported in the statement of financial position as derivative hedging instruments.

Derivatives classified as "Held for trading" are reported as "Assets or liabilities held for trading". They are also mainly used to hedge the economic market risk exposure. Spot and forward foreign exchange transactions are almost exclusively used within the context of refinancing. Credit derivatives are used to assume credit risks for the purpose of portfolio diversification.

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

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

Fair value hedges

Fair value hedges are entered into by Aareal Bank Group in order to hedge interest rate and currency risks inherent in securities, mortgage loans, promissory note loans, money market instruments, registered covered bonds (Namenspfandbriefe), certificated liabilities, and subordinated capital. Instruments used for fair value hedges comprise interest rate swaps as well as cross-currency swaps.

The following gains and losses result from fair value hedges in the year under review:

€ mn	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Result from hedging instruments	-103	-96
Result from hedged items	101	96
Total	**-2**	**0**

Cash flow hedges

Cash flow hedges are used within Aareal Bank Group exclusively to hedge future cash flows from variable-rate financial assets and liabilities.

The hedged portion of the cash flows from hedged items which are part of cash flow hedges is as follows:

Cash flows from hedged items – Cash flow hedges as at 31 December 2017

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Cash inflows and outflows from hedged assets (+/-)	-12	-31	-15	22	**-36**

Cash flows from hedged items – Cash flow hedges as at 31 December 2016

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Cash inflows and outflows from hedged assets (+/-)	-12	-32	-63	24	**-83**

In 2017, gains/losses determined as the effective portion of the hedge from derivatives included in cash flow hedges were recognised directly in equity at an amount of € -27 million (2016: gains of € 2 million).

An amount of € 0 million (2016: € 4 Mio. €) was transferred from the cash flow hedge reserve to net interest income.

An amount of € -5 million (2016: € 0 million) was recognised directly in profit or loss due to inefficiencies of cash flow hedges.

In addition, derivatives were entered into within Aareal Bank Group to hedge net investments in foreign operations. These derivatives are used to hedge the currency risk arising on translating the net assets of foreign Group companies to the Group's reporting currency (euro).

€ 0 million (2016: € 0 million) was recognised directly in the income statement as the ineffective portion of hedges of net investments in foreign operations.

Overview of market values of derivatives

The following table shows positive and negative market values (including pro-rata interest) of derivative financial instruments:

	Fair value as at 31 Dec 2017		Fair value as at 31 Dec 2016	
	positive	negative	positive	negative
€ mn				
Trading derivatives				
Interest rate instruments				
OTC products				
Interest rate swaps	241	184	456	401
Swaptions	–	0	–	0
Caps, floors	6	6	7	8
Total interest rate instruments	**247**	**190**	**463**	**409**
Currency-related instruments				
OTC products				
Spot and forward foreign exchange transactions	37	2	11	66
Cross-currency swaps	43	32	28	177
Total currency-related instruments	**80**	**34**	**39**	**243**
Total trading derivatives	**327**	**224**	**502**	**652**
Fair value hedge derivatives				
Interest rate instruments				
OTC products				
Interest rate swaps	1,385	1,312	2,194	1,948
Total interest rate instruments	**1,385**	**1,312**	**2,194**	**1,948**
Currency-related instruments				
OTC products				
Spot and forward foreign exchange transactions	–	–	–	–
Cross-currency swaps	530	152	258	564
Total currency-related instruments	**530**	**152**	**258**	**564**
Total derivatives from fair value hedges	**1,915**	**1,464**	**2,452**	**2,512**

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€ mn	Fair value as at 31 Dec 2017 positive	Fair value as at 31 Dec 2017 negative	Fair value as at 31 Dec 2016 positive	Fair value as at 31 Dec 2016 negative
Derivatives from cash flow hedges				
Currency-related instruments				
OTC products				
Cross-currency swaps	8	15	29	5
Total currency-related instruments	**8**	**15**	**29**	**5**
Total derivatives from cash flow hedges	**8**	**15**	**29**	**5**
Derivatives used as net investment hedges				
Currency-related instruments				
OTC products				
Cross-currency swaps	3	–	–	12
Total currency-related instruments	**3**	**–**	**–**	**12**
Total derivatives used as net investment hedges	**3**	**–**	**–**	**12**
Total	**2,253**	**1,703**	**2,983**	**3,181**

Derivate wurden mit folgenden Kontrahenten abgeschlossen:

€ mn	Fair value as at 31 Dec 2017 positive	Fair value as at 31 Dec 2017 negative	Fair value as at 31 Dec 2016 positive	Fair value as at 31 Dec 2016 negative
OECD banks	2,087	1,693	2,533	3,122
Companies and private individuals	166	10	450	59
Total	**2,253**	**1,703**	**2,983**	**3,181**

The following overview shows the cash flows of derivative financial instruments, based on the contractual maturity. The amounts shown in the table represent the contractually agreed future undiscounted cash flows. The procedure for measuring and monitoring liquidity risk is described in the Risk Report.

31 December 2017

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Interest rate instruments					
Interest rate swaps					
Cash inflows	161	430	1,360	417	2,368
Cash outflows	144	279	981	358	1,762
Swaptions					
Cash inflows	–	–	–	–	–
Cash outflows	–	–	0	–	0
Caps, floors					
Cash inflows	0	0	5	1	6
Cash outflows	0	0	5	1	6
Currency-related instruments					
Spot and forward foreign exchange transactions					
Cash inflows	2,870	341	–	–	3,211
Cash outflows	2,843	337	–	–	3,180
Cross-currency swaps					
Cash inflows	186	1,923	5,133	1,147	8,389
Cash outflows	231	2,032	4,967	1,068	8,298
Total cash inflows	**3,217**	**2,694**	**6,498**	**1,565**	**13,974**
Total cash outflows	**3,218**	**2,648**	**5,953**	**1,427**	**13,246**

31 December 2016

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Interest rate instruments					
Interest rate swaps					
Cash inflows	215	542	1,586	599	2,942
Cash outflows	180	373	1,141	460	2,154
Swaptions					
Cash inflows	–	–	–	–	–
Cash outflows	–	0	0	–	0
Caps, floors					
Cash inflows	0	1	5	1	7
Cash outflows	0	1	5	1	7

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€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Currency-related instruments					
Spot and forward foreign exchange transactions					
Cash inflows	2,690	261	104	–	3,055
Cash outflows	2,748	261	103	–	3,112
Cross-currency swaps					
Cash inflows	46	1,943	5,852	1,043	8,884
Cash outflows	77	2,260	6,344	1,004	9,685
Total cash inflows	**2,951**	**2,747**	**7,547**	**1,643**	**14,888**
Total cash outflows	**3,005**	**2,895**	**7,593**	**1,465**	**14,958**

(73) Day-one profit or loss

Aareal Bank Group has entered into transactions that were not effected on the principal market or the most advantageous market for the asset or liability concerned. In these cases the transaction price does not correspond to the fair value of the asset or liability, because the determination of the fair value using a valuation technique which assumes a transaction on a principal market results in a fair value that deviates from the transaction price. The financial instruments are carried at the transaction price upon initial recognition. The difference between the transaction price and the fair value measured based on the valuation model (the so-called day-one profit or loss) is amortised over the term of the transaction in the income statement, since the fair value of these financial instruments of the trading portfolio is determined using valuation models whose inputs are not fully based on observable market factors.

The table below shows the development of the day-one profit or loss during the year under review. The day-one profit or loss is recognised as an item to be deducted from the carrying amount of the respective underlying derivative position:

€ mn	2017	2016
Balance as at 1 January	**12**	**27**
Additions from new transactions	3	-1
Reversals through profit or loss in the period	9	14
Changes in basis of consolidation	–	–
Balance as at 31 December [1]	**6**	**12**

[1] Of which interest rate swaps in the amount of € 12 million (2016: € 19 million) and cross-currency interest rate swaps in the amount of € -6 million (2016: € -7 million)

(74) Maturities of financial liabilities

The following two overviews show the future undiscounted cash flows of non-derivative financial liabilities and of loan commitments.

Maturities as at 31 December 2017

€ mn	payable on demand	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Liabilities to banks	1,148	23	205	356	389	**2,121**
Liabilities to customers	7,324	3,525	3,489	5,450	8,821	**28,609**
Certificated liabilities	–	679	1,426	4,699	1,247	**8,051**
Subordinated capital	–	24	27	779	459	**1,289**
Financial guarantee contracts	122	–	–	–	2	**124**
Loan commitments	1,749	–	–	–	–	**1,749**

Maturities as at 31 December 2016

€ mn	payable on demand	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Liabilities to banks	832	64	97	395	389	**1,777**
Liabilities to customers	7,092	4,335	4,415	5,787	10,459	**32,088**
Certificated liabilities	–	280	2,260	4,607	1,593	**8,740**
Subordinated capital	–	39	47	654	922	**1,662**
Financial guarantee contracts	113	–	–	–	–	**113**
Loan commitments	1,333	–	–	–	–	**1,333**

The Risk Report includes a detailed description of the liquidity risk associated with financial liabilities.

Segment Reporting

(75) Operating segments of Aareal Bank

In the financial year 2017, segment reporting by Aareal Bank was prepared in accordance with IFRS 8 Operating Segments.

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

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

The **Structured Property Financing segment** comprises the property financing and refinancing activities. In this segment, Aareal Bank facilitates property investments for its domestic and international clients, and is active in this respect in Europe, North America and Asia. It offers commercial property financing solutions, especially for office buildings, hotels, retail, logistics and residential properties. Its particular strength lies in its success in combining local market expertise and sector-specific know-how. In addition to local experts, the Bank also has industry specialists at its disposal, to create financing packages for logistics properties, shopping centres and hotels. This enables Aareal Bank to offer tailor-made financing concepts that meet the special requirements of its national and international clients. What makes Aareal Bank special are its direct client relationships, which – in very many cases – it has maintained for many years.

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

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

We operate our IT system consultancy and related advisory services for the housing and commercial property sector through our Aareon AG subsidiary, which can call upon more than 60 years in the business. Aareon offers its customers reliable, pioneering solutions in the fields of consulting, software and services to optimise IT-supported business processes in the digital age. The ERP (Enterprise Resource Planning) systems, which are tailored to the needs of the respective market, may be supplemented by further digital solutions for purposes of process optimisation. The majority of these integrated systems forms the digital ecosystem "Aareon Smart World". It connects property companies with customers, employees and business partners as well as technical ”equipment” in apartments and buildings. Aareon Smart World can be used to restructure and optimise processes. The applications help to reduce costs, enable the creation of new business models by providing links between all participants and offer more ease-of-use in the dialogue between tenants and employees of the housing industry.

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

In its Housing Industry division, Aareal Bank offers its customers process optimisation, electronic banking and asset management. Aareal Bank distributes BK 01, the leading procedure in the German housing and property management sector for the automated settlement of mass payments. The procedure is integrated in licensed bookkeeping systems. Therefore, customers in Germany may process their payment transactions and account management from the administration software employed. Apart from the German residential and commercial property sector, the German energy and waste disposal industry is a second important customer group of the Bank's Housing Industry division. This enables the offer of further products, facilitating the cross-sector cooperation of target groups and realising synergy effects via end-to-end digital processes. The use of the payment transaction products of Aareal Bank generates deposits that contribute significantly to Aareal Bank Group's refinancing base. The interest rate contribution is reported in the segment's net commission income and then transferred to net interest income.

Income and expenses within Aareal Bank are predominantly attributable to transactions with third parties, and are directly allocated to the responsible business segment. Revenue from transactions between Aareal Bank's segments was not generated in a significant amount. Therefore, we elected not to distinguish between internal and external revenue in the following disclosures. Administrative expenses not directly attributable to any of the business segments are segmented in line with the internal cost allocation, based on the principle of causation.

The results of the business segments are determined by the operating profit as well as by the return on equity (RoE) and the cost/income ratio (CIR). RoE, which indicates a segment's profitability, is calculated as the ratio of the segment's operating result (after non-controlling interests and after AT1 interest) to the portion of equity allocated to that segment on average. The cost/income ratio – de-termined as the ratio of input to output of resources – is used as an indicator for the cost efficiency of business segments. Allocated equity is calculated in segment reporting for the first time on the basis of the advanced IRB Approach (AIRBA).

(76) Segment results

€ mn	Structured Property Financing 2017	Structured Property Financing 2016	Consulting/ Services 2017	Consulting/ Services 2016	Consolidation/ Reconciliation 2017	Consolidation/ Reconciliation 2016	Aareal Bank Group 2017	Aareal Bank Group 2016
Net interest income	646	716	0	0	-12	-15	634	701
Allowance for credit losses	82	97					82	97
Net interest income after allowance for credit losses	**564**	**619**	**0**	**0**	**-12**	**-15**	**552**	**604**
Net commission income	7	10	191	171	8	12	206	193
Net result on hedge accounting	-7	0					-7	0
Net trading income/expenses	14	19		0			14	19
Results from non-trading assets	0	66		1			0	67
Results from investments accounted for using the equity method				0				0
Administrative expenses [1]	296	346	220	204	-5	-3	511	547
Net other operating income/expenses	69	27	6	3	-1	0	74	30
Operating profit	**351**	**395**	**-23**	**-29**	**0**	**0**	**328**	**366**
Income taxes	123	143	-8	-11			115	132
Consolidated net income	**228**	**252**	**-15**	**-18**	**0**	**0**	**213**	**234**
Consolidated net income attributable to non-controlling interests	4	16	2	3			6	19
Consolidated net income attributable to shareholders of Aareal Bank AG	224	236	-17	-21	0	0	207	215
Allocated equity	1,724	1,553	165	143	627	763	2,516	2,459
Cost/income ratio (%)	40.5	41.2	111.9	116.4			55.5	54.1
RoE before taxes (in %) [2]	18.8	22.9	-15.4	-22.2			11.9	13.2
Employees (average)	**880**	**1,014**	**1,878**	**1,783**			**2,758**	**2,797**
Segment assets	**31,642**	**37,873**	**10,266**	**9,835**			**41,908**	**47,708**
Investments accounted for using the equity method	7	0					7	0
Segment investments	22	21	31	14			53	35
Segment depreciation/amortisation	15	16	12	11			27	27

[1] The provisions recognised for personnel measures in the amount of € 27 million resulting from the optimisation of processes and structures within the scope of the „Aareal 2020“ programme for the future were fully allocated to the Structured Property Financing segment.
[2] The allocation of earnings is based on the assumption that net interest payable on the AT1 bond is recognised on an accrual basis.

(77) Results by geographical region

€ mn	Germany 2017	Germany 2016	International 2017	International 2016	Consolidation/ Reconciliation 2017	Consolidation/ Reconciliation 2016	Aareal Bank Group 2017	Aareal Bank Group 2016
Net interest income	166	202	468	499			634	701
Allowance for credit losses	-28	-21	110	118			82	97
Net interest income after allowance for credit losses	**194**	**223**	**358**	**381**			**552**	**604**
Net commission income	132	125	74	68			206	193
Net result on hedge accounting	-5	0	-2	0			-7	0
Net trading income/expenses	11	19	3	0			14	19
Results from non-trading assets	0	1	0	66			0	67
Results from investments accounted for using the equity method				0				0
Administrative expenses	291	318	220	229			511	547
Net other operating income/expenses	63	40	11	-10			74	30
Operating profit	**104**	**90**	**224**	**276**			**328**	**366**
Allocated equity	628	604	1,261	1,092	627	763	2,516	2,459
Cost/income ratio (%)	79.3	82.1	39.7	36.7			55.5	54.1
RoE before taxes (%) [1]	15.5	13.1	16.0	22.5			11.9	13.2
Employees (average)	**1,650**	**1,687**	**1,108**	**1,110**			**2,758**	**2,797**

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

(78) Consulting/Services segment – reconciliation of the income statement

Reconciliation of the segment result from the income statement classification aligned to an industrial enterprise to a bank income statement classification (used for the purposes of segment reporting)

€ mn			Income statement classification – bank										
			Net interest income	Net commission income	Net trading income/expenses	Results from non-trading assets	Results from investments accounted for using the equity method	Administrative expenses	Net other operating income/expenses	Impairment of goodwill	**Operating profit**	Income taxes	**Segment result**
	2017		0	191				220	6		**-23**	-8	**-15**
	2016		0	171	0	1	0	204	3		**-29**	-11	**-18**
Income statement classification – industrial enterprise													
Sales revenue	2017	226		226									
	2016	206		206									
Own work capitalised	2017	4						4					
	2016	6						6					
Changes in inventory	2017												
	2016	0							0				
Other operating income	2017	7							7				
	2016	7			0	1			6				
Cost of materials purchased	2017	35		35									
	2016	35		35									
Staff expenses	2017	151						151					
	2016	144						144					
Depreciation, amortisation and impairment losses	2017	12						12					
	2016	11						11					
Result from investments accounted for using the equity method	2017												
	2016	0					0						
Other operating expenses	2017	62						61	1				
	2016	58						55	3				
Interest and similar income/expenses	2017	0	0										
	2016	0	0										
Operating profit	**2017**	**-23**	**0**	**191**	**0**		**0**	**220**	**6**				
	2016	**-29**	**0**	**171**	**0**	**1**	**0**	**204**	**3**				
Income taxes	2017	-8										-8	
	2016	-11										-11	
Segment result	**2017**	**-15**											
	2016	**-18**											

Remuneration Report

The remuneration report for the 2017 financial year contains detailed information on the remuneration of Aareal Bank AG Management Board members, together with the Bank's senior executives and its employees. As a significant institution, Aareal Bank publishes a description of its remuneration systems (qualitative disclosure) in the Group Annual Report for the financial year 2017 in accordance with section 16 (1) of the German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – "InstitutsVergV"), and Article 450 of Regulation (EU) No. 575/2013 (the Capital Requirements Regulation or "CRR"). The Supervisory Board and the Management Board carried out the annual review of the remuneration systems, involving the Human Resources division, the Remuneration Officer, and internal control units in line with their respective functions, and supported by external legal and remuneration advisors. External advisors were retained, amongst other things, for examining the appropriateness of remuneration systems, and remuneration for members of the Management Board and employees, as well as regarding the design of the Group-wide remuneration strategy. Quantitative disclosures on the remuneration of Management Board members, employees as well as senior executives required pursuant to Article 450 (2) of the CRR will be disclosed on Aareal Bank AG's homepage by the end of June.

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

(79) Remuneration system for the Management Board

Responsibilities and procedures of Aareal Bank AG regarding remuneration policies

The Supervisory Board determines the remuneration system, and the amount of remuneration for members of Aareal Bank AG's Management Board.

The Remuneration Control Committee (Vergütungskontrollausschuss) fulfils the requirements according to section 25d (12) of the German Banking Act (Kreditwesengesetz – "KWG") and section 15 of the InstitutsVergV. It held eight meetings throughout the 2017 financial year. The Supervisory Board of Aareal Bank AG discussed remuneration issues at five meetings during the 2017 financial year.

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

Success criteria and parameters

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

Performance-related remuneration

Remuneration parameters

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

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

All targets for Management Board members are integrated into the Bank's overall strategy and are geared towards achieving the objectives set out in the Bank's business and risk strategies. The targets comprise quantitative components and qualitative components, which are also related to non-financial parameters. Aareal Bank Group's overall performance is determined using the categories of consolidated operating profit / loss before taxes and risk-weighted assets.

The initial value of the performance-related remuneration may increase – depending on the Management Board member's degree of target achievement – up to a maximum of 150 % of the target value. If the overall target achievement level exceeds 150 %, the initial value of the performance-related remuneration will not increase any further (cap). Any negative deviations from targets will reduce performance-related remuneration. If the overall target achievement level is 0 %, no performance-related remuneration will be awarded for the financial year concerned. Unconscionable behaviour or behaviour in breach of duties cannot be balanced out by positive performance contributions in other areas and will automatically lead to an appropriate reduction in the variable remuneration. The Supervisory Board is entitled to increase or decrease the overall target achievement level by up to 20 %, applying reasonable discretion, in the event of any material, specified external or internal non-recurring effects, provided that the upper limit of 150 % for overall target achievement must not be exceeded. The variable remuneration generally depends on the Supervisory Board's decision to provide for the applicable financial year an amount (mathematically) sufficient for all variable remuneration components to be paid out in accordance with section 45 (2) sentence 1 no. 5a of the KWG and section 7 of the InstitutsVergV.

Retention of variable remuneration components and penalty criteria

To ensure that the remuneration system provides long-term incentives, the initial value for variable remuneration – as determined according to the principles set out above – is awarded at the end of the financial year, according to the following principles:

- 20 % of the variable remuneration is disbursed as a cash bonus after the Supervisory Board has determined the overall target achievement level.

- A further 20 % of the variable remuneration is awarded as a share bonus subject to a holding period (and forms part of the share-based bonus plan), in the form of virtual shares, also after the Supervisory Board has determined the overall target achievement level.

- 30 % of the variable remuneration is retained (cash deferral), and disbursed in cash – pro rata temporis – over a defined retention period.
- The remaining 30 % of variable remuneration is credited, as a cash amount, to a virtual account maintained on behalf of each Management Board member, and forms part of the share deferral plan.

With regard to the portion of performance-related remuneration that is deferred initially as a cash deferral or a share deferral, the Supervisory Board makes a decision regarding the granting of one third of the amount, as well as the associated interest, in the three years following the determination of the performance-related remuneration (retention period). Starting with performance-related remuneration for the 2018 financial year, the retention period will be extended to five years. Until the end of the retention period, there is no right to the relevant remuneration components. Once the deferred remuneration components for Management Board members are vested, the cash deferral is paid out in cash and the share deferral is converted into virtual shares, subject to a two-year (starting with variable remuneration for the 2018 financial year: one-year) holding period.

In making its determination about the amount to be awarded, the Supervisory Board particularly takes into account any negative aspects of the Management Board member's performance, that of the division he / she is responsible for, as well as any weakness in the performance of Aareal Bank Group (ex-post risk adjustment). A negative individual performance contribution is deemed to be present, for example, in the event of breaches of the Code of Conduct and / or of Compliance guidelines, conduct that damages the Bank's reputation, or in the event of other misconduct which would justify a termination for good cause. Ex-post risk adjustment also involves a retrospective review as to whether the performance contributions assumed at the time of determining the initial value of performance-related remuneration are proven to be sustainable (backtesting). The Supervisory Board decides upon any adjustments to variable remuneration, according to its own best judgment, based on a recommendation by the Remuneration Control Committee. If any retained performance-related remuneration components are not awarded, or only in part, the remaining sum is forfeited, i. e. it is not carried forward into subsequent years. Moreover, an award of the deferred variable remuneration components will not be made insofar and for so long as the German Federal Financial Supervisory Authority ("BaFin") forbids this according to section 45 (2) sentence 1 nos. 5a and 6 of the KWG. The entitlement no longer exists if BaFin so orders by way of a final and conclusive decision pursuant to section 45 (5) sentences 5 to 8 of the KWG.

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

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

Share Bonus Plan

The portion of the variable remuneration which is subject to the share bonus plan will be converted into an equivalent number of virtual shares and credited to the beneficiary. The calculation of the number of virtual shares is henceforth based on the weighted average price on the basis of five (Xetra®) exchange trading days after publication of the preliminary results for the respective financial year (subscription price). The date of publication of the preliminary results is used as the reference date. The virtual shares so determined are paid into a virtual account and are automatically and without delay converted into a cash amount and paid out following the Supervisory Board meeting which resolves to accept the annual financial statements for the third financial year (starting with performance-related remuneration for the 2018 financial year: the first financial year) following the financial year for which the virtual shares were granted ("holding period"). The conversion will be effected using the weighted average price calculated on the basis of the five (Xetra®) exchange trading days following the publication of the preliminary results for the year preceding the payout. Since the 2013 financial year, the payout amount of the share bonus of a given financial year may vary depending on the share price development and has been limited to a maximum of 300 % of the agreed initial value (ceiling).

Share Deferral Plan

The portion of the variable remuneration subject to the Share Deferral Plan is credited to the beneficiary. This credit, however, does not convey an entitlement or a claim regarding a later payout or grant of virtual shares. In the three years (starting with variable remuneration for the 2018 financial year: five years) following the credit (retention period), the Supervisory Board decides whether in each case one third (starting with variable remuneration for the 2018 financial year: one fifth) of the share deferral should be converted.

The question as to whether a third of the virtual shares is converted and, if so, in which amount, is based on the principles set out above (refer to the section on Retention of variable remuneration components and penalty criteria). In particular, the Supervisory Board checks the application of the penalty rules provided. Equivalent provisions to the share bonus plan are applied in the calculation of the amount of the virtual shares – except for the holding period, which is reduced from three years to two years (starting with variable remuneration for the 2018 financial year: one year). The ceiling value is applicable for the conversion of the virtual shares which were granted for the 2013 financial year and the following financial years, with the proviso that the payout amount following the conversion of the virtual shares of a tranche into a cash payment must not exceed 300 % of the share deferral (30 % of the initial value of variable remuneration) set for the respective financial year (which may have been reduced following the application of a penalty rule or as a result of an instruction by BaFin).

Remuneration

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

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

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

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

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

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

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

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

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

[1] Minimum amount of the remuneration component granted in the year under review.
[2] Maximum amount of the remuneration component granted in the year under review.
[3] Christof Winkelmann was appointed to the Management Board on 1 July 2016.

The following table shows the remuneration disbursed in the year under review, as defined in sections 4.2.4 and 4.2.5 of the German Corporate Governance Code. It also outlines disbursements under variable remuneration components, which expired during the year under review:

Remuneration paid	Hermann J. Merkens Chairman of the Management Board		Dagmar Knopek		Christiane Kunisch-Wolff[1]		Thomas Ortmanns	
	2017	2016	2017	2016	2017	2016	2017	2016
€								
Fixed remuneration	1,300,000	1,300,000	880,000	880,000	704,000	561,244	880,000	880,000
Ancillary benefits	39,557	38,511	32,605	41,449	27,922	27,595	55,260	35,945
Total	**1,339,557**	**1,338,511**	**912,605**	**921,449**	**731,922**	**588,839**	**935,260**	**915,945**
Variable remuneration based on a single-year assessment	377,720	299,544	212,320	212,640	135,309	–	213,600	211,360
Variable remuneration based on a multiple-year assessment	–	–	–	–	–	–	–	–
Cash deferral 2013 (April 2017)	112,727	–	65,757	–	–	–	112,727	–
Cash deferral 2014 (April 2017)	103,030	–	102,785	–	–	–	102,215	–
Cash deferral 2015 (April 2017)	150,686	–	106,969	–	–	–	106,325	–
Share bonus 2013 (April 2017)	239,867	–	139,922	–	–	–	239,867	–
Share deferral 2011 (April 2017)	–	–	–	–	–	–	–	–
Share deferral 2012 (April 2017)	222,358	–	–	–	–	–	222,358	–
Share deferral 2013 (April 2017)	121,816	–	71,060	–	–	–	121,816	–

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

Remuneration paid	**Hermann J. Merkens Chairman of the Management Board**		**Dagmar Knopek**		**Christiane Kunisch-Wolff** [1]		**Thomas Ortmanns**	
	2017	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
€								
Cash deferral 2012 (April 2016)	–	104,797	–	–	–	–	–	104,797
Cash deferral 2013 (April 2016)	–	110,985	–	64,741	–	–	–	110,985
Cash deferral 2014 (April 2016)	–	102,111	–	101,869	–	–	–	101,304
Share bonus 2012 (May 2016)	–	328,146	–	–	–	–	–	328,146
Share deferral 2011 (April 2016)	–	–	–	–	–	–	–	–
Share deferral 2012 (April 2016)	–	167,896	–	–	–	–	–	167,896
Dividends	101,276	73,961	63,848	38,522	7,595	–	82,271	68,575
Total	**1,429,480**	**1,187,440**	**762,661**	**417,772**	**142,904**	**–**	**1,201,179**	**1,093,063**
Benefit expense	726,347	1,032,350	399,791	526,355	697,851	51,707	544,137	725,906
Total remuneration	**3,495,384**	**3,558,301**	**2,075,057**	**1,865,576**	**1,572,677**	**640,546**	**2,680,576**	**2,734,914**

Remuneration paid	**Christof Winkelmann** [2]		**Dr Wolf Schumacher** [3]		**Dirk Große Wördemann** [4]	
	2017	**2016**	**2017**	**2016**	**2017**	**2016**
€						
Fixed remuneration	704,000	352,000	–	–	–	–
Ancillary benefits	24,062	12,125	–	90	–	–
Total	**728,062**	**364,125**	**–**	**90**	**–**	**–**
Variable remuneration based on a single-year assessment	85,120	–	–	275,940	–	–
Variable remuneration based on a multiple-year assessment	–	–	–	–	–	–
Cash deferral 2013 (April 2017)	–	–	190,184	–	–	–
Cash deferral 2014 (April 2017)	–	–	179,875	–	–	–
Cash deferral 2015 (April 2017)	–	–	138,812	–	–	–
Share bonus 2013 (April 2017)	–	–	404,684	–	–	–
Share deferral 2011 (April 2017)	–	–	–	–	238,390	–
Share deferral 2012 (April 2017)	–	–	375,143	–	180,523	–
Share deferral 2013 (April 2017)	–	–	205,519	–	–	–
Cash deferral 2012 (April 2016)	–	–	–	176,804	–	85,080
Cash deferral 2013 (April 2016)	–	–	–	187,244	–	–
Cash deferral 2014 (April 2016)	–	–	–	178,270	–	–
Share bonus 2012 (May 2016)	–	–	–	553,620	–	266,409
Share deferral 2011 (April 2016)	–	–	–	–	–	179,144
Share deferral 2012 (April 2016)	–	–	–	283,260	–	136,308
Dividends	4,778	–	111,251	111,776	10,369	27,954
Total	**89,898**	**–**	**1,605,468**	**1,766,914**	**429,282**	**694,895**
Benefit expense	663,349	66,747	–	–	–	–
Total remuneration	**1,481,309**	**430,872**	**1,605,468**	**1,767,004**	**429,282**	**694,895**

[1] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.
[2] Christof Winkelmann was appointed to the Management Board on 1 July 2016.
[3] Dr Wolf Schumacher resigned with effect from 30 September 2015.
[4] Dirk Große Wördemann resigned with effect from 31 May 2013.

In accordance with German commercial law, the following table shows fixed and other remuneration for members of the Management Board as well as the total target achievement amounts of variable remuneration, determined by the Supervisory Board as follows:

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

[1] The deferrals shown are subject to the criteria on retention of variable remuneration components and penalty criteria, as set out above.
[2] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016. [3] Christof Winkelmann was appointed to the Management Board on 1 July 2016.

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

The following table shows the portion of the variable component attributable to share-based payment arrangements as well as the corresponding number of virtual shares granted in 2017/2016:

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

[1] The stated number of virtual shares granted for 2017 is a preliminary figure, based on the price of Aareal Bank AG's share on 31 December 2017 (€ 37.73). The final conversion rate may only be determined after publication of preliminary results for 2017. The stated number of virtual shares granted for 2016 differs slightly from the previous year's figure since the former was calculated using a final conversion rate of € 35.63.
[2] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.
[3] Christof Winkelmann was appointed to the Management Board on 1 July 2016.

Ancillary benefits

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

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

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

Pensions, retirement benefits and severance pay

The benefit regulations as agreed in the service contract apply to the members of the Management Board. Management Board members who were appointed prior to 1 January 2013 are entitled to claim pension benefits upon completion of their 60th year of age. For members of the Management Board who were appointed [on or] after 1 January 2013, claims arise upon completion of their 62nd year of age. In the event of permanent disability, a Management Board member may be entitled to claim benefits prior to turning 60 or 62, respectively.

	2017			2016		
€ 000's	Pension claims p.a.[1]	Balance of pension obligations (DBO) as at 31 Dec 2017	Increase of pension obligations (DBO) in 2017	Pension claims p.a.[1]	Balance of pension obligations (DBO) as at 31 Dec 2016	Increase of pension obligations (DBO) in 2016
Hermann J. Merkens	285	6,422	726	265	5,696	1,032
Dagmar Knopek	113	2,021	400	125	1,621	526
Christiane Kunisch-Wolff[2]	116	750	698	–	52	52
Thomas Ortmanns	267	5,735	544	254	5,191	726
Christof Winkelmann[3]	113	730	663	–	67	67
Total	**894**	**15,658**	**3,031**	**644**	**12,627**	**2,403**

[1] Pension claims are calculated based on the earliest possible pension payment.
[2] Christiane Kunisch-Wolff was appointed to the Management Board on 15 March 2016.
[3] Christof Winkelmann was appointed to the Management Board on 1 July 2016.

The pension claims are adjusted to take account of the development of standard wages within the private banking sector as from the beginning of actual payments of pensions, to the extent that these are based on defined benefit plans. If the payments refer to defined contribution plans, the guaranteed amount is adjusted by 1 % p.a. The pension paid to widows amounts to 60 % of the pension of the member of the Management Board, while pensions to half-orphans and orphans amount to 10 % and not more than 25 %, respectively. Service cost incurred in the 2017 financial year in connection with the pension claims of members of the Management Board totalled € 2.8 million (2016: € 1.8 million). The pension obligations for current members of the Management Board as well as for former members of the Management Board and their surviving dependants increased by € 2.4 million in the year under review (2016: € 3.0 million). The total amount of pension obligations was € 48.7 million (2016: € 46.4 million). Of that amount, € 33.1 million related to former members of the Management Board and their surviving dependants (2016: € 33.8 million). Payments to former Management Board members of Aareal Bank AG and their surviving dependants totalled € 0.8 million (2016: € 0.9 million).

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

In the case of a termination of a Management Board position due to a change of control, the following provisions are applicable: in the case of a compulsory loss of a Management Board position, the Management Board members are to be paid the fixed remuneration component, the performance-related remuneration as well as the contractually-agreed benefits for the remainder of the term of the contract. The performance-related remuneration is subject to the above-mentioned conditions; that is, in particular the deferral periods, the holding periods and the penalty rules are applicable. In addition, the extent to which sectional and individual targets were achieved on average during the last three years prior to the termination of the Management Board position will be used as a basis to determine the target achievement level for the remaining term of the contract. In the case of a voluntary termination of the Management Board position following a change of control, the members of the Management Board merely receive the fixed remuneration and the contractually agreed benefits. In this case, there is no entitlement to the variable remuneration component.

The total amount of payments in the case of termination due to a change of control is limited to 150% of the severance cap of an employment contract, in accordance with section 4.2.3. of the Code.

(80) Remuneration system for senior executives and employees

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

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

Cornerstones of the risk analysis carried out

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

Aareal Bank carried out a risk analysis to identify risk takers in the financial year 2017, covering all employee groups below Management Board level, i.e. senior executives, non-tariff employees and tariff employees of Aareal Bank AG including its branches, representative offices and subsidiaries in Germany and abroad.

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

Remuneration model for risk takers

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

The Management Board decides on the total amount of the variable remuneration for employees at the end of the financial year in a formalised, transparent and conceivable process. This total amount also includes the variable remuneration components for risk takers. Variable remuneration is the sum of (i) a component related to Group performance, (ii) a component related to the performance of the organisational unit, and (iii) a component related to individual performance. The weighting of individual components differs for the various staff groups (depending on the level of seniority), with the respective weight applied for the purpose of determining variable remuneration:

- Group component (between 25 % and 35 %);
- Organisational unit component (between 15 % and 25 %);
- Individual component (between 40 % and 60 %).

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

The target achievement for the Group component is the product of individual target achievements for operating profit before taxes (OPbT) and risk-weighted assets (RWA) and is capped at 150 %. If one or both of the target achievements are zero (OPbT or RWA), target achievement for the Group component will also be zero. Target values for the parameters OPbT and RWA are agreed between the Management and Supervisory Boards and defined based on the Group's medium-term planning. Ceilings are set for the parameters for OPbT and RWA along with the establishment of target figures. If the ceiling for operating profit before taxes is reached or exceeded, target achievement is capped at 150 %. If the ceiling for risk-weighted assets is reached or exceeded, target achievement is capped at 125 % If the floor for operating profit before taxes is achieved or undershot, target achievement for the Group component will be 0 %.

The performance of the organisational unit for divisions allocated to Sales and of the Treasury division is measured using the Structured Property Financing segment result (OPbT and RWA). The performance of the organisational unit for the Bank's Housing Industry division is measured using the "Consulting / Services" segment result (OPbT). The performance of the organisational unit for organisational divisions allocated to the Staff and Corporate Services or to Credit Management divisions, and of the Operations division, is measured as a corporate centre using the cost target of the relevant division.

The Group component and the target achievement by the organisational unit are each measured collectively and capped at a maximum target achievement level of 150 %.

The individual component is determined according to performance and is derived from the appraisal given to an executive staff member by his manager and the achievement by the staff member of individually-agreed targets. Where the individual component is measured with a zero rating, this will set the entire variable remuneration to zero. The aggregate component related to individual performance of all risk takers is capped at 125 %.

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

The determination of the variable remuneration (total incentive) for risk takers takes into account the Group's overall profit, the individual employee's performance contribution as well as the performance contribution of the organisational unit. The target for risk takers whose activities can clearly be allocated to a single business segment shall be assigned as the pro-rata share of their business segment (Structured Property Financing or Consulting/Services) in the operating profit before taxes. Risk takers whose activities can be allocated to staff and corporate services divisions, or to Credit Management, shall be assigned as target the cost-reduction target of the respective division.

Risk takers' variable remuneration consists of four components:

- cash component,
- share component,
- restricted cash award and
- restricted virtual share award.

The amount of the contractually agreed individual variable remuneration (target total incentives) of a risk taker is limited to 50 % of the fixed remuneration; in case of certain sales functions, it is limited to 100 % of the fixed remuneration following a resolution of the Annual General Meeting pursuant to section 25a (5) of the KWG. This ensures that the variable remuneration of an individual employee does not exceed 100 % of his/her fixed remuneration (or in the case of certain international sales functions, the ratio of 1:2 is respected) if a target achievement of 200 % is achieved.

Risk takers of the second-tier management level are entitled to receive 40 % of the individual total incentives immediately at the end of the reference period (other risk takers: 60 %). The immediate entitlement refers to an amount of 50 % to the cash component, which shall be disbursed in the year following the end of the reference period, and to an amount of 50 % to the share component, which consists of virtual shares entitled to dividends (and forming the ground for cash disbursement claims). However, such cash amounts may only be disbursed after a two-year holding period. The payout amount corresponds to the weighted average price of Aareal Bank AG shares on Xetra® (as shown on Bloomberg) on the five exchange trading days following the publication of the preliminary results for the financial year preceding the payout date. The ceiling value is applicable for the conversion of the virtual shares which were granted for the 2014 financial year and the following financial years, with the proviso that the payout amount following the conversion of the virtual shares of a tranche (plus dividends) into a cash payment must not exceed 300 % of the share component of a given financial year.

An option right shall be given to the risk taker regarding the actual payout date; after the end of the holding period and after the regular payout date, the risk taker may determine further payout dates within a period of three years.

Risk takers of the second-tier management level shall initially be promised (but not granted) 60%, other risk takers 40 %, of their individual total incentives. 50 % thereof relates to the restricted cash award, which shall be disbursed in equal proportions over a three-year period (interest shall be calculated pro rata temporis) (cash deferral). The remaining 50 % will be included in the restricted virtual share award (share deferral), representing virtual shares entitled to dividends in form of a share component. The risk taker is entitled to receive one third of his claims after one, two and three years, respectively; the earliest possible payout of each tranche takes place after a holding period of at least one year after creation of the entitlement. An option right will be given to the risk taker regarding the actual payout date of each tranche; after the end of the holding period and after the regular payout date, the risk taker may determine further payout dates within a period of three years for each tranche. The payout amount of a tranche is limited to 300 % of the share deferral promised (but not granted) to the risk taker for the respective year under evaluation. The payout amount is calculated based on the number of virtual shares and the corresponding share price (= weighted average price of Aareal Bank AG shares on Xetra® (as shown on Bloomberg) on the five exchange trading days following the publication of the preliminary results for the financial year preceding the first/second/third payout year).

Regarding the creation of entitlements of deferred portions of the variable remuneration, i.e. the tranches of the cash deferral including accrued interest and the tranches of the share deferral including virtual dividends, penalty rules have to be considered. For the purpose of these regulations, a penalty-triggering event shall be defined as a negative performance contribution of the risk taker him/herself, his/her organisational unit or a negative overall performance of the institution or Aareal Bank Group, which may result in a reduction or cancellation of the deferred portions of the variable remuneration. For the purpose of these regulations, a risk taker's negative performance contribution is to be assumed, for instance, if serious breaches of duty and/or performance deficiencies are discovered, which lead to the performance contributions – which were initially assumed to be positive – being later shown to have not been sustained (backtesting). Serious breaches of duty could be, for instance, misconduct giving rise to an extraordinary termination of the employment relationship with the risk taker, a breach of the hedging ban or violations of other fundamental regulations, such as the Code of Conduct or compliance guidelines.

(81) Remuneration governance

Remuneration Control Committee

The Remuneration Control Committee supports the Supervisory Board, according to section 15 of the InstitutsVergV in conjunction with section 25d (12) of the KWG, regarding the appropriate structuring of remuneration systems for Management Board members, as well as for the supervision of the remuneration systems for employees. One of the duties of the Remuneration Control Committee is to monitor the remuneration systems' influence on the risk, capital, and liquidity situation of Aareal Bank – and to ensure an appropriate alignment of the business, risk and remuneration strategies. The Remuneration Control Committee also monitors the appropriateness of the remuneration systems, responds to Supervisory Board enquiries, and reports on the appropriateness of the remuneration system's structure at least once a year by producing a remuneration report. The Remuneration Control Committee shall be convened whenever necessary, but at least four times a year. The composition of the Remuneration Control Committee is outlined in more detail in the chapter "Report of the Supervisory Board / Description of Management Board and Supervisory Board work processes".

Risk Committee

The Risk Committee verifies whether the incentives created by the remuneration system take the Company's risk, capital and liquidity structure into account, as well as the probability and timing of income. The Remuneration Control Committee's duties remain unaffected.

Remuneration Officer

Aareal Bank has appointed a Remuneration Officer, to carry out duties in accordance with section 24 of the InstitutsVergV. These duties include supporting the Supervisory Board and the Remuneration Control Committee in structuring and monitoring the remuneration system. The Remuneration Officer is obliged to respond to queries of the Remuneration Control Committee's Chairman. The Remuneration Officer reports on the appropriate structure of the remuneration systems in the form of a remuneration report at least once a year. Due to the responsibility of monitoring the appropriateness of the remuneration systems on a continuing basis, the Remuneration Officer is being included in the conceptional new drafting (and future development), as well as in the application of the remuneration systems. In particular, the Remuneration Officer plays an active part in the transparent and conceivable process for the determination of the total amount available for variable remuneration, the annual review of penalty rules, the regularly carried out (at least spot checks) review of appropriate compliance structures, the monitoring of the hedging ban (and potential violations), the drafting of the annual remuneration report (pursuant to section 16 of the InstitutsVergV in connection with art. 450 of the CRR) as well as the review of the risk taker analysis.

(82) Remuneration of the Supervisory Board

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

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

The fixed remuneration is € 50,000 p.a. for each Supervisory Board member. The Chairman of the Supervisory Board shall receive three times this amount, while the deputy shall receive one and a half times as much as a normal member. The fixed remuneration is increased for each membership in a committee (with the exception of the Committee for Urgent Decisions, which is part of the Risk Committee). This additional fixed remuneration amounts to € 20,000 p.a. for membership of the Risk Committee and the Audit Committee; fixed remuneration is increased by € 40,000 p.a. for the chairmanship of one of these committees. The additional fixed remuneration amounts to € 15,000 p.a. for membership of the other Supervisory Board committees; fixed remuneration is increased by € 30,000 p.a. for the chairmanship of one of these committees.

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

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

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

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

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

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

The members of the Supervisory Board did not provide any consulting or agency services, or any other personal services in 2017. Therefore, no additional remuneration was paid.

(83) Additional disclosure on share-based remuneration

Valuation model and valuation assumptions

The obligations resulting from all of the described share-based payment arrangements as at the balance sheet date correspond to the remuneration granted, discounted to the balance sheet date. The discount period corresponds to the period from the balance sheet date to the earliest exercise or payout date per plan and per tranche. The discount is based on the Euribor swap rate applicable as at the relevant balance sheet date, depending on the term.

Amount of cash-settled share-based payment transactions

The total amount of outstanding virtual shares in relation to the above-mentioned share-based payment arrangements changed as follows:

	2017	2016
Quantity (number)		
Balance (outstanding) at 1 January	**688,668**	**670,965**
Granted during the reporting period	226,777	282,221
Expired during the reporting period	–	–
Exercised during the reporting period	223,899	264,518
Balance (outstanding) at 31 December	**691,546**	**688,668**
of which: exercisable	–	–

The fair value of the virtual shares granted during the reporting period amounted to € 8.6 million (2016: € 10.1 million) as at the balance sheet date.

The virtual shares exercised during the reporting period were converted at a weighted average price of the Aareal Bank AG share of € 35.61 (2016: € 27.71).

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

Impact on financial performance

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

€	2017	2016
Hermann J. Merkens	1,018,900	1,424,186
Dagmar Knopek	593,432	842,891
Christiane Kunisch-Wolff [1]	413,174	338,273
Thomas Ortmanns	604,019	946,738
Christof Winkelmann [2]	410,542	212,800

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

In addition, € 0.1 million (2016: € 0.7 million) was expensed for former members of the Management Board.

The intrinsic value of the virtual shares exercisable at the reporting date amounted to € 0.0 million (2016: € 0.0 million), since there were no exercisable virtual shares at that date. The obligation from share-based payment transactions as at 31 December 2017 amounted to € 35.8 million (2016: € 34.9 million). It is reported in the statement of financial position in the line item "Provisions".

Remuneration for key executives

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

Total remuneration of executives in key positions is analysed below:

€ 000's	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Short-term benefits	7,214	6,685
Post-employment benefits	3,031	2,403
Other long-term benefits	1,577	1,538
Termination benefits	–	–
Share-based remuneration	2,628	2,560
Total	**14,450**	**13,186**

Provisions for pension obligations concerning key executives totalled € 15.7 million as at 31 December 2017 (31 December 2016: € 12.6 million).

Other Notes

(84) Assets and liabilities in foreign currency

Foreign currency assets

€ mn	31 Dec 2017	31 Dec 2016
USD	10,851	11,120
GBP	4,019	4,112
SEK	538	841
CHF	458	477
DKK	411	436
JPY	0	0
Other	742	404
Total	**17,019**	**17,390**

Foreign currency liabilities

€ mn	31 Dec 2017	31 Dec 2016
USD	10,829	11,197
GBP	3,932	4,025
SEK	518	822
CHF	454	474
DKK	436	471
JPY	0	0
Other	746	393
Total	**16,915**	**17,382**

(85) Subordinated assets

In the event of insolvency or liquidation of the issuer, subordinated assets are those subordinate to the claims of all other creditors. There were no subordinated assets in the financial year 2017 (2016: € 2 million).

(86) Leases

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or a series of payments the right to use an asset for an agreed period of time. In accordance with IAS 17, leases where a material part of risks and rewards incidental to ownership of the leased assets remains with the lessor are classified as operating leases. Where substantially all risks and rewards are transferred to the lessee, the lease is classified as a finance lease. The provisions of IFRIC 4 were complied with as regards the application of IAS 17. Aareal Bank Group acts both as lessor and lessee. All rental contracts are classified as operating leases. They mainly refer to rented or let property.

Properties leased by the Group are reported under other assets.

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

Maturity of minimum lease payments under operating leases

€ mn	31 Dec 2017	31 Dec 2016
Aareal Bank Group as lessee		
up to 1 year	13	15
longer than 1 year, and up to 5 years	34	38
longer than 5 years	11	15
Total minimum lease payments	**58**	**68**
Aareal Bank Group as lessor		
up to 1 year	13	18
longer than 1 year, and up to 5 years	35	45
longer than 5 years	16	25
Total minimum lease payments	**64**	**88**

In the financial year, lease payments of € 14 million (2016: € 15 million) were recognised as expenses.

(87) Contingent liabilities and loan commitments

€ mn	31 Dec 2017	31 Dec 2016
Contingent liabilities	124	114
Loan commitments	1,749	1,333
of which: irrevocable	1,355	901

Contingent liabilities include irrevocable payment obligations regarding the bank levy and the liability to the deposit guarantee scheme of German banks. These and the values reported under loan commitments given represent the maximum default risk to which Aareal Bank Group is exposed at the end of the reporting period.

Furthermore, the Bank is involved in legal disputes. Based on a legal analysis, successful outcome of these disputes is more likely than not. Essentially, these are legal disputes with borrowers (or former borrowers) who claim damages against the Bank. These are included in the table above, with a probability-weighted amount of € 51 million (2016: € 49 million), but have not been recognised as liabilities. We estimate the maximum default risk in the low triple-digit million range. The duration of proceedings depends on the complexity of each individual litigation, and the legal remedies available in each case. Likewise, the final amount in the event of defeat may vary considerably, depending upon the duration of proceedings and the legal remedies. Refunds of litigation costs are possible. Accordingly, the recognition of contingent liabilities is also subject to estimation uncertainties.

(88) Consolidated Statement of Cash Flows

Aareal Bank Group's statement of cash flows records cash flows pertaining to the areas of operating activities, investing activities and financing activities for the period under review. The starting point of the consolidated statement of cash flows is the amount of cash and cash equivalents, consisting of cash on hand, balances with central banks as well as public-sector debt instruments and bills of exchange eligible for refinancing at central banks.

The definition of the term "operating activities" is consistent with the composition of the operating profit in the statement of comprehensive income. Cash flows from investing activities include proceeds from and payments in relation to property and equipment, non-trading assets and investment properties. Cash flows from financing activities include cash flows from transactions with providers of equity capital.

(89) Regulatory capital and capital management

As regards meeting minimum capital ratios, Aareal Bank Group has to comply with the capital adequacy requirements set out in the Capital Requirements Regulation (CRR), the Capital Requirements Directive (CRD IV), the German Banking Act (Kreditwesengesetz, KWG) and the German Solvency Regulation (SolvV) pursuant to Basel III. This requires the Bank to maintain own funds including capital conservation buffers of at least 9.25 % of its risk-weighted assets (total capital ratio). Risk-weighted assets had to be backed by Tier 1 capital of at least 7.25 % (Tier 1 ratio). Compliance with the capital requirements has to be reported to the competent supervisory authorities on a quarterly basis. The capital requirements were complied with at all times during the reporting period.

The SREP total capital requirement of Aareal Bank Group as at year-end was 9.75 %. It comprises the minimum own funds requirement of 8 % pursuant to Article 92 (1) of Regulation (EU) No. 575/2013 of the European Parliament and of the Council as well as a Pillar 2 Requirement (P2R) of 1.75 % which has to be complied with at any time and has to consist of Common Equity Tier 1 (CET 1) in its entirety.

The objective of capital management within Aareal Bank Group is compliance with the legal minimum capital requirements, ensuring that internally targeted capital ratios are achieved, taking into account the full implementation of Basel III requirements, as well as the provision of a sufficient capital cushion to ensure, at any time, the Group's capacity to act. Funds are allocated to the individual business segments within the framework of capital management, aiming at optimising the return on equity.

Subject to further regulatory changes, Aareal Bank considers a target CET1 ratio (post-finalisation of Basel III – so-called "Basel IV") of around 12.5 % to be appropriate. These ratios are considerably above the legal minimum requirements. Compliance with the minimum requirements is planned to be ensured through the generation of profits, an active dividend policy, optimisation of the capital structure, and an efficient management of risk assets.

Within the context of capital management, projections are made on a regular basis showing the changes of the individual capital components and risk-weighted assets, as well as the resulting capital ratios. This is reported regularly within the framework of management reporting. The strategic allocation of capital to the individual business segments is incorporated in the Group's annual overall planning process.

Aareal Bank Group's regulatory capital is composed of the following:

€ mn	31 Dec 2017[1)]	31 Dec 2016
Tier 1 capital (T1)		
Subscribed capital and capital reserves	900	899
Eligible retained earnings	1,580	1,562
Accumulated other comprehensive income	-50	-76
Amounts to be deducted from CET 1 capital	-125	-34
Sum total of Common Equity Tier (CET 1)	2,305	2,351
AT1 bond	300	300
Silent participations	–	108
Other	–	145
Amounts to be deducted from Additional Tier 1 capital	-5	-8
Sum total of Additional Tier 1 (AT1) capital	295	545
Sum total of Tier 1 capital (T1)	**2,600**	**2,896**
Tier 2 (T2) capital		
Silent participations	–	72
Subordinated liabilities	886	930
Profit-participation certificates	1	4
Other	51	97
Amounts to be deducted from Tier 2 capital	-2	-5
Sum total of Tier 2 capital (T2)	**936**	**1,098**
Total capital (TC)	**3,536**	**3,994**

1) After confirmation of Aareal Bank AG's financial statements for 2017. The calculation of regulatory capital takes into account the Management Board's proposal for the appropriation of profits for the financial year 2017. The appropriation of profits is subject to approval by the Annual General Meeting.

The regulatory measurement of risk-weighted assets (RWA) in the area of credit risks is based on both the Advanced Internal Ratings Based Approach (AIRBA) and on the standardised approach (CRSA). RWA as at 31 December 2017 can be analysed as follows:

€ mn	EAD	Risk-weighted assets (RWA)			Regulatory capital requirements	EAD	RWA	Regulatory capital requirements
		AIRBA	CRSA	Total				
	31 Dec 2017	31 Dec 2017	31 Dec 2017	31 Dec 2017	31 Dec 2017	31 Dec 2016	31 Dec 2016	31 Dec 2016
Credit risks	**44,141**	**8,577**	**1,432**	**10,009**	**801**	**48,844**	**12,394**	**991**
Companies	27,539	6,400	778	7,178	574	30,094	9,478	758
Institutions	3,065	376	14	390	31	3,819	431	34
Public-sector entities	11,664	0	21	21	2	12,795	22	2
Other	1,873	1,801	619	2,420	194	2,136	2,463	197
Market price risks				**134**	**11**		**122**	**10**
Credit Valuation Adjustment				**209**	**17**		**254**	**20**
Operational risks				**1,433**	**114**		**1,770**	**142**
Total	**44,141**	**8,577**	**1,432**	**11,785**	**943**	**48,844**	**14,540**	**1,163**

(90) Related party disclosures in accordance with IAS 24

The group of related parties of Aareal Bank Group (see Note (83) "Remuneration for key executives") comprises the members of management or supervisory bodies and close members of these persons' families. The group of companies related to Aareal Bank Group consists of the companies set out in Note 98 "List of Shareholdings" as well as the companies attributable to the related persons within the meaning of IAS 24.9 (b)(vi).

The following list provides an overview of the balances of existing transactions with related parties:

€ mn	31 Dec 2017	31 Dec 2016
Management Board	–	–
Supervisory Board	–	0
Other related parties	76	0
Total	**76**	**0**

The item "Other related parties" includes a loan of € 18 million which was provided to our investee Mount Street Group Limited on an arm's length basis. Furthermore, it includes a restructured loan of € 58 million extended to our joint venture Rive Defense S.A.S.

In addition, there were no further significant transactions within the meaning of IAS 24.

(91) Events after the reporting date

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

(92) Contingencies

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

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

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

As at 31 December 2017, we were aware of the following shareholders holding a share in the voting rights of at least 3 % pursuant to section 33 (1) of the WpHG:

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

1) Direct and indirect holdings of voting rights

(94) Declaration of Compliance in accordance with Section 161 of the AktG

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

(95) Employees

The number of Aareal Bank Group employees[1)] at 31 December 2017 is shown below:

	31 Dec 2017	31 Dec 2016
End-of-year numbers		
Salaried employees	2,644	2,566
Executives	156	162
Total	**2,800**	**2,728**
of which: Part-time employees	544	503

The annual average number of Aareal Bank Group employees in 2017[2)] is shown below:

	1 Jan-31 Dec 2017	1 Jan-31 Dec 2016
Yearly average		
Salaried employees	2,600	2,633
Executives	158	164
Total	**2,758**	**2,797**
of which: Part-time employees	531	514

1) This number does not include 57 employees of the hotel business (31 December 2016: 56 employees).
2) This number does not include 198 employees of the hotel business (31 December 2016: 175 employees).

(96) Nature and extent of interests in unconsolidated structured entities

In accordance with IFRS 12.24, the nature and extent of interests in unconsolidated structured entities as well as the nature of, and changes in, the risks associated with such interests have to be disclosed in the annual report. An interest in a structured entity arises from a contractual and non-contractual involvement which entitles the Group to receive variable returns from the relevant activities of the structured entity. Examples for this are equity or debt instruments of structured entities or the provision of financing, collateral and guarantees to structured entities.

Structured entities are companies where voting rights or similar rights are not the dominant factor to assess control of the company. The relevant activities of structured entities are directed by means of contractual arrangements; any voting rights relate to administrative tasks only. Structured entities are characterised by features or attributes such as restricted activities, a narrow and well-defined objective and/or insufficient equity. In addition, structured entities may relate to financings in the form of multiple contractually linked instruments to investors that create concentrations of credit or other risks. Examples of structured entities are securitisation vehicles, asset-backed financings and some investment funds.

Aareal Bank Group interacts with structured entities such as open-ended property funds and leased property companies. The Group's business relationships are restricted to the provision of financings to structured entities in the form of loans or guarantees. The leased property companies were established by third parties for the financing of particular transactions and have the legal form of a German private limited company with a limited liability company as general partner (GmbH & Co KG) where Aareal Bank Group holds marginal interests in some cases. In the year under review and the previous year, Aareal Bank Group did not provide any non-contractual support for unconsolidated structured entities.

The following table shows the carrying amounts of assets and liabilities recognised by Aareal Bank Group as at the reporting date as well as the existing off-balance sheet risk exposures that relate to unconsolidated structured entities. The carrying amounts of the assets and off-balance sheet items correspond to the Group's maximum loss exposure from interests in unconsolidated structured entities (without taking into account collateral). The size of the structured entities was determined on the basis of the net fund assets for open-ended property funds and of total assets for leased property companies.

31 December 2017

€ mn	Open-ended property funds	Leased property companies	Total
Assets	**270**	**29**	**299**
Loans and advances to customers	270	29	**299**
Liabilities	–	–	–
Off-balance sheet risk exposures	–	–	–
Size range of structured units	**€ 104 million – € 5,908 million**	**€ 10 million – € 28 million**	

31 December 2016

€ mn	Open-ended property funds	Leased property companies	Total
Assets	**446**	**37**	**483**
Loans and advances to customers	446	37	**483**
Liabilities	–	–	–
Off-balance sheet risk exposures	–	–	–
Size range of structured units	**€ 63 million – € 5,741 million**	**€ 15 million – € 50 million**	

(97) Country-by-Country Reporting

The disclosure requirements refer to information on registered office, revenue, profit or loss, taxes on profit or loss, received government assistance as well as wage and salary earners of Aareal Bank AG, together with its foreign branches and domestic and foreign subsidiaries included in the reporting entity-structure, prior to consolidation.

For this purpose, the Bank's entities – subsidiaries as well as Aareal Bank AG's foreign branches – are allocated to our two business segments, Structured Property Financing and Consulting/Services.

Aareal Bank defines the branch offices' operating profit, which is used as a proxy for revenue, as the sum of the following consolidated income statement items (in accordance with IFRSs):

- net interest income before allowance for credit losses;
- net commission income;
- net result on hedge accounting;
- net trading income / expenses;
- results from non-trading assets;
- results from investments accounted for using the equity method; and
- net other operating income / expenses.

Taxes disclosed are tax expenses in accordance with IFRSs.

The number of wage and salary earners relates to average full-time equivalent staff employed during the financial year.

The following overview shows all countries where Aareal Bank AG has offices, including foreign branches and subsidiaries. Please refer to the list of shareholdings as regards the allocation of individual subsidiaries to the relevant country of domicile. Aareal Bank AG's foreign branches are located in France, Ireland, Italy, Poland, Sweden and the UK.

2017

	Revenues	Profit/loss before taxes	Taxes on profit or loss	Number of wage and salary earners
	€ mn	€ mn	€ mn	Full-time equivalents
Structured Property Financing segment	**724**	**351**	**123**	**1,024**
Belgium	0	0	–	–
France	7	3	2	5
Germany	554	248	113	932
Ireland	4	2	0	2
Italy	58	22	-1	31
Poland	10	7	1	6
Singapore	2	0	0	5
Spain	2	2	0	-
Sweden	4	2	0	3
United Kingdom	6	3	1	7
USA	82	63	7	33
Consolidation	-5	-1	–	–
Consulting/Services segment	**197**	**-23**	**-8**	**1,382**
France	30	5	1	177
Germany	108	-33	-11	752
Netherlands	36	6	1	252
Norway	1	0	–	8
Sweden	10	-1	0	79
United Kingdom	12	0	0	114
Consolidation	–	–	1	–
Total	**921**	**328**	**115**	**2,406**

Government assistance was not received in the financial year 2017.

Aareal Bank Group's return on assets, calculated as the ratio of net profit to total assets, was 0.49 % as at the record date.

2016

	Revenues	Profit/loss before taxes	Taxes on profit or loss	Number of wage and salary earners
	€ mn	€ mn	€ mn	Full-time equivalents
Structured Property Financing segment	**837**	**395**	**143**	**1,017**
Belgium	4	3	–	–
France	6	2	2	6
Germany	613	266	128	917
Ireland	9	2	2	7
Italy	51	6	5	31
Poland	11	8	2	6

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	Revenues	Profit/loss before taxes	Taxes on profit or loss	Number of wage and salary earners
	€ mn	€ mn	€ mn	Full-time equivalents
Singapore	2	0	–	5
Spain	-1	-1	0	–
Sweden	67	64	1	5
United Kingdom	8	4	2	7
USA	69	41	1	33
Consolidation	-2	–	–	–
Consulting/Services segment	**173**	**-29**	**-11**	**1,396**
France	20	4	2	170
Germany	106	-41	-14	819
Netherlands	24	5	1	217
Norway	–	–	–	7
Sweden	11	1	0	78
United Kingdom	12	2	–	105
Consolidation	–	–	–	–
Total	**1,010**	**366**	**132**	**2,413**

(98) List of shareholdings

The list of shareholdings is disclosed pursuant to section 313 (2) of the HGB. The disclosures in relation to the companies' equity and earnings are retrieved from the financial statements based on the respective local financial reporting principles.

31 December 2017

No.	Company name	Registered office	Shareholding	Equity	Results
			%	€ mn	€ mn
1	Aareal Bank AG	Wiesbaden			
	I. Fully-consolidated subsidiaries				
2	1st Touch Ltd.	Southampton	100.0	GBP 2.7 mn	GBP -0.5 mn [2]
3	Aareal Bank Asia Ltd.	Singapore	100.0	SGD 16.9 mn	SGD -0.5 mn [1]
4	Aareal Beteiligungen AG	Frankfurt	100.0	227.8	0.0 [3]
5	Aareal Capital Corporation	Wilmington	100.0	USD 252.4 mn	USD 33.0 mn [1]
6	Aareal Estate AG	Wiesbaden	100.0	2.5	0.0 [3]
7	Aareal First Financial Solutions AG	Mainz	100.0	3.2	0.0 [3]
8	Aareal Gesellschaft für Beteiligungen und Grundbesitz Erste mbH & Co. KG	Wiesbaden	94.9	2.5	0.1 [1]
9	Aareal Holding Realty LP	Wilmington	99.8	USD 205.6 mn	USD -0.5 mn [4]
10	Aareal Immobilien Beteiligungen GmbH	Wiesbaden	100.0	456.8	0.0 [3]
11	Aareal Valuation GmbH	Wiesbaden	100.0	0.5	0.0 [3]

[1] Preliminary figures as at 31 December 2017; [2] Equity and results as at 31 December 2016;
[3] Profit and loss transfer agreement / control and profit transfer agreement; [4] Disclosures in accordance with IFRSs; [5] n/a = no data

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No.	Company name	Registered office	Shareholding	Equity	Results
			%	€ mn	€ mn
12	Aareon AG	Mainz	100.0	112.0	17.2
13	Aareon Deutschland GmbH	Mainz	100.0	33.9	0.0 [3]
14	Aareon France S.A.S.	Meudon-la Forêt	100.0	8.4	2.4 [2]
15	Aareon Immobilien Projekt GmbH	Dortmund	100.0	0.7	0.0 [3]
16	Aareon International Solutions GmbH	Mainz	100.0	0.0	0.0
17	Aareon Nederland B.V.	Emmen	100.0	23.7	1.9 [2]
18	Aareon Norge AS	Oslo	100.0	NOK 0.3 mn	NOK -2.3 mn [2]
19	Aareon Sverige AB	Mölndal	100.0	SEK 33.7 mn	SEK 10.4 mn [2]
20	Aareon UK Ltd.	Coventry	100.0	GBP 4.7 mn	GBP 0.9 mn [2]
21	Anfield Portfolio GmbH & Co. KG	Mainz	100.0	0.0	0.0
22	Anfield Verwaltungs GmbH	Mainz	100.0	0.0	0.0
23	BauContact Immobilien GmbH	Wiesbaden	100.0	5.1	0.5
24	BauGrund Immobilien-Management GmbH	Bonn	100.0	0.5	0.0 [3]
25	BauGrund Solida Immobilien GmbH	Frankfurt	100.0	0.1	0.0
26	BauGrund TVG GmbH	Munich	100.0	0.1	0.0 [1]
27	BauSecura Versicherungsmakler GmbH	Hamburg	51.0	3.4	3.3 [1]
28	BVG – Grundstücks- und Verwertungsgesellschaft mit beschränkter Haftung	Frankfurt	100.0	217.3	0.0 [3]
29	DBB Inka	Dusseldorf	100.0	101.2	-0.1
30	Deutsche Bau- und Grundstücks-Aktiengesellschaft	Berlin	100.0	1.5	0.1 [1]
31	Deutsche Structured Finance GmbH	Wiesbaden	100.0	6.0	-0.2 [1]
32	DSF Flugzeugportfolio GmbH	Wiesbaden	100.0	0.0	0.0 [3]
33	Esplanade Realty LP	Wilmington	100.0	USD 27.0 mn	USD 1.7 mn [4]
34	Facilitor B.V.	Enschede	100.0	0.4	0.7 [2]
35	FIRE B.V.	Utrecht	60.0	0.1	0.0 [2]
36	GEV Besitzgesellschaft mbH	Wiesbaden	100.0	30.0	0.0 [3]
37	GEV Beteiligungsgesellschaft mbH	Wiesbaden	100.0	0.1	0.0
38	GVN-Grundstücks- und Vermögensverwaltungs-gesellschaft mit beschränkter Haftung	Frankfurt	100.0	0.5	0.0 [3]
39	IV Beteiligungsgesellschaft für Immobilieninvestitionen mbH	Wiesbaden	100.0	2.4	0.1 [1]
40	Izalco Spain S.L.	Madrid	100.0	9.2	-1.0 [1]
41	Jomo S.p.r.l.	Brussels	100.0	44.0	0.0 [1]
42	Kalshoven Automation B.V.	Amsterdam	100.0	3.0	0.4 [2]
43	La Sessola Holding GmbH	Wiesbaden	100.0	86.6	0.0 [1]
44	La Sessola S.r.l.	Rome	100.0	116.3	-5.8 [1]
45	La Sessola Service S.r.l.	Rome	100.0	3.3	0.1 [1]
46	Manager Realty LLC	Wilmington	100.0	USD 0.0 mn	USD 0.0 mn [4]
47	Mercadea S.r.l.	Rome	100.0	7.2	0.2 [1]
48	Mirante S.r.l.	Rome	100.0	10.3	-0.9 [1]
49	mse Augsburg GmbH	Augsburg	100.0	0.3	0.0 [2]
50	mse Immobiliensoftware GmbH	Hamburg	100.0	0.7	0.3 [2]
51	mse RELion GmbH	Augsburg	100.0	0.1	0.0 [2]
52	Northpark Realty LP	Wilmington	100.0	USD 92.3 mn	USD 6.0 mn [4]

[1] Preliminary figures as at 31 December 2017; [2] Equity and results as at 31 December 2016;
[3] Profit and loss transfer agreement / control and profit transfer agreement; [4] Disclosures in accordance with IFRSs; [5] n/a = no data

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No.	Company name	Registered office	Shareholding	Equity	Results
			%	€ mn	€ mn
53	Participation Achte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 [3]
54	Participation Elfte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 [3]
55	Participation Neunte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 [3]
56	Participation Zehnte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 [3]
57	phi-Consulting GmbH	Bochum	100.0	2.0	0.6
58	Real Verwaltungsgesellschaft mbH	Schönefeld	100.0	29.2	1.5 [1]
59	Sedum Grundstücksverwaltungsgesellschaft mbH & Co.Vermietungs KG	Wiesbaden	94.9	-4.2	-1.7 [1]
60	SG2ALL B.V.	Huizen	100.0	0.6	0.2 [2]
61	SoftS IT Solutions AG	Wiesbaden	100.0	0.5	-0.5 [1]
62	Square DMS B.V.	Grathem	100.0	1.0	0.6 [2]
63	Terrain-Aktiengesellschaft Herzogpark	Wiesbaden	100.0	4.7	0.0 [3]
64	Terrain Beteiligungen GmbH	Wiesbaden	94.0	54.8	4.5 [1]
65	Westdeutsche Immobilien Servicing AG	Mainz	100.0	50.1	0.0 [3]
66	WP Galleria Realty LP	Wilmington	100.0	USD 94.5 mn	USD 4.4 mn [4]
	II. Joint Arrangements				
67	Konsortium BauGrund/TREUREAL	Bonn	50.0	0.0	-0.1 [1]
68	Rive Defénse S.A.S.	Paris	50.0	-116.0	-10.9 [2]
	III. Associates				
69	DSF PP Justizzentrum Thüringen GmbH & Co. KG	Frankfurt	48.4	0.4	0.0 [2]
70	Mount Street Group Limited	London	20.0	n/a	n/a [5]
71	Mount Street US Group LLP	Wilmington	20.0	n/a	n/a [5]
72	Westhafen Haus GmbH & Co. Projektentwicklungs KG	Frankfurt	25.0	-0.2	0.0 [2]
73	Westhafen-Gelände Frankfurt am Main GbR	Frankfurt	33.3	0.0	0.0 [2]

[1] Preliminary figures as at 31 December 2017; [2] Equity and results as at 31 December 2016;
[3] Profit and loss transfer agreement / control and profit transfer agreement; [4] Disclosures in accordance with IFRSs; [5] n / a = no data

(99) Executive Bodies of Aareal Bank AG

The members of the Management Board and the Supervisory Board disclose their offices held, in accordance with the requirements set out in section 285 of the HGB and Article 435 (2) of Regulation (EU) No 575/2013, in conjunction with the EBA Guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013 (EBA/GL/2016/11) and the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2017/12).

Supervisory Board

Marija Korsch, Chairman of the Supervisory Board **Former partner of Bankhaus Metzler seel. Sohn & Co. Holding AG**	
Aareal Bank AG	Chairman of the Supervisory Board
Just Software AG	Member of the Supervisory Board
(Non-commercial mandates)	
FAZIT – Stiftung Gemeinnützige Verlagsgesellschaft mbH	Shareholder and member of the Advisory Board
Städelsches Kunstinstitut und Städtische Galerie	Member of the Administration
Gesellschaft der Freunde der Alten Oper Frankfurt e.V.	Deputy Chairman of the Management Board
Stiftung Centrale für private Fürsorge	Chairman of the Management Board

Prof. Dr Stephan Schüller, Deputy Chairman of the Supervisory Board **Spokesman of the General Partners of Bankhaus Lampe KG**	
Aareal Bank AG	Deputy Chairman of the Supervisory Board
DePfa Holding Verwaltungsgesellschaft mbH (liquidation planned)	Deputy Chairman of the Supervisory Board (not active)
Howaldt & Co. Investmentaktiengesellschaft TGV	Chairman of the Supervisory Board
(Offices held at subsidiaries of Bankhaus Lampe KG)	
Lampe Equity Management GmbH	Chairman of the Supervisory Board

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

Thomas Hawel* **Aareon Deutschland GmbH**	
Aareal Bank AG	Member of the Supervisory Board
Aareon Deutschland GmbH	Deputy Chairman of the Supervisory Board

Dieter Kirsch* **Aareal Bank AG**	
Aareal Bank AG	Member of the Supervisory Board

Richard Peters **President and Chairman of the Management Board of Versorgungsanstalt des Bundes und der Länder**	
Aareal Bank AG	Member of the Supervisory Board
DePfa Holding Verwaltungsgesellschaft mbH (liquidation planned)	Member of the Supervisory Board (not active)

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

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(Non-commercial mandates)	
EAPSPI (European Association of Public Sector Pension Institutions)	Member of the Board of Directors
VBLV e.V.	Chairman of the Management Board

Dr Hans-Werner Rhein **German Lawyer (Rechtsanwalt)**	
Aareal Bank AG	Member of the Supervisory Board
Deutsche Familienversicherung AG	Chairman of the Supervisory Board
Gothaer Allgemeine Versicherung AG	Member of the Supervisory Board
(Non-commercial mandates)	
Müller-Matthieu Stiftung	Chairman of the Management Board
ARIAS Deutschland e.V.	Chairman of the Management Board
St. Petri Stiftung, Hamburg	Member of the Management Board

Sylvia Seignette **Former CEO for Germany and Austria, Crédit Agricole CIB (formerly Calyon)**	
Aareal Bank AG	Member of the Supervisory Board

Elisabeth Stheeman **Senior Advisor (Berater), Bank of England, Prudential Regulation Authority**	
Aareal Bank AG	Member of the Supervisory Board
(Offices held at other listed companies)	
TLG Immobilien AG	Member of the Supervisory Board
Korian SA	Member of the Supervisory Board (since 22 June 2017)

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

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

Beate Wollmann* **Aareon Deutschland GmbH**	
Aareal Bank AG	Member of the Supervisory Board

* Employee representative member of the Supervisory Board of Aareal Bank AG
** The European Central Bank gave its consent to this office pursuant to section 25d (3) sentence 5 of the KWG.

Composition of Supervisory Board's committees

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

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

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

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

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

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

Management Board

Hermann Josef Merkens, Chairman of the Management Board
Finance & Controlling, Corporate Strategy, Project & Credit Portfolio Management, Corporate Communications, Investor Relations incl. Sustainability, Board Office, Human Resources, Legal, Audit

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

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

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

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

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

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

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

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

(Offices held at companies of Aareal Bank Group)		
Aareal Bank Asia Limited	Chairman of the Board of Directors	
Aareal Capital Corporation	Member of the Board of Directors	since 1 January 2017
La Sessola Service S.r.l.	Member of the Management Board	
La Sessola S.r.l.	Member of the Management Board	

* formerly Westdeutsche ImmobilienBank AG

Responsibility Statement

To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Group Management Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal opportunities and risks associated with the expected development of the Group.

Wiesbaden, 5 March 2018

The Management Board

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

Thomas Ortmanns **Christof Winkelmann**

Independent Auditors' Report

To Aareal Bank AG, Wiesbaden

Report on the Audit of the Consolidated Financial Statements and of the Group Management Report

Audit Opinions

We have audited the consolidated financial statements of Aareal Bank AG, Wiesbaden, and its subsidiaries (the Group), which comprise the statement of financial position as at 31 December 2017, the statement of comprehensive income, the statement of changes in equity and the statement of cash flows for the financial year from 1 January to 31 December 2017, and notes to the consolidated financial statements, including a summary of significant accounting policies. In addition, we have audited the group management report of Aareal Bank AG for the financial year from 1 January to 31 December 2017. We have not audited the content of the statement on corporate governance pursuant to § [Article] 289f HGB [Handelsgesetzbuch: German Commercial Code] and § 315d HGB in accordance with the German legal requirements.

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

- the accompanying consolidated financial statements comply, in all material respects, with the IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315e Abs. [paragraph] 1 HGB and, in compliance with these requirements, give a true and fair view of the assets, liabilities, and financial position of the Group as of 31 December 2017, and of its financial performance for the financial year from 1 January to 31 December 2017, and

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

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

Basis for the Audit Opinions

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

Key Audit Matters in the Audit of the Consolidated Financial Statements

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

In our view, the matters of most significance in our audit were as follows:

❶ Recoverability of the Italian mortgage loan portfolio
❷ Recoverability of properties acquired from previous loan exposures as reported in the property, plant and equipment and other assets balance sheet items

Our presentation of these key audit matters has been structured as follows:

① Matter and issue
② Audit approach and findings
③ Reference to further information

❶ Recoverability of the Italian mortgage loan portfolio

① In the consolidated financial statements of Aareal Bank AG, loans and advances to customers in the amount of € 2.8 billion that are secured by properties in Italy (hereinafter "Italian mortgage loan portfolio") are reported as of 31 December 2017. As of 31 December 2017, the allowances for credit losses (specific valuation allowances and portfolio impairment allowances) for the Italian mortgage loan portfolio amounts to a total of € 312 million. Italy's difficult macroeconomic situation has in past years led to a decline in real estate prices and transaction volumes as well as, in part, to financial difficulties and restructuring proceedings for Aareal Bank AG's borrowers. The realisation period of the properties on which the portfolio is based generally takes a number of years depending on their size, location and type. Aareal Bank AG analyzes the financial circumstances of borrowers using, inter alia, the annual financial statements, business plans and rent rolls provided, and generally examines the market values of the associated collateral at least once a year. In the majority of cases, Aareal Bank AG obtains external valuations to determine the market values of the properties pledged as collateral. Property market values are calculated by the appraisers in each case as the present values of future cash flows using the discounted cash flow method or determined on the basis of floor area-related comparative values, with the appraisers deriving the assumptions about future cash flows that can be generated by the property using the information and business plans provided by the borrowers. If it is found when assessing the borrower that there has been a default within the meaning of the regulatory requirements and the income from the collateral is expected to be insufficient, the Company applies a specific valuation allowance. When determining the risk allowances for the Italian mortgage loan portfolio, the executive directors make assumptions concerning realisation and completion. Since even relatively small changes in these assumptions have a significant influence on the associated collateral value and the measurements are subject to uncertainties in this regard, this matter was of particular significance during our audit.

② As part of our audit we evaluated, inter alia, the existing documents relating to the financial circumstances and the recoverability of the pledged collateral in a risk-focused sample of exposures. We evaluated the valuations performed by the appraisers in terms of their suitability, up-to-dateness and methodology, as well as the transparency of the value calculation. At the same time, we gained an understanding of the original data, value parameters and assumptions on which the valuations were based, evaluated these critically and assessed whether they were within a justifiable range. In specific cases, we carried out our own property inspections.

In addition, we based our assessment of the executive directors' assumptions concerning realisation and completion on general and sector-specific market expectations as well as on documentation and explanations from the executive directors about expected cash inflows and outflows. Furthermore, we examined the relevant credit processes in the Aareal Bank AG's internal control in terms of the appropriateness of their design and tested their effectiveness. Taking account of the information available, we conclude that the assumptions made by the executive directors for testing the impairment of the Italian mortgage loan portfolio and the processes implemented are appropriate.

③ The Company's disclosures regarding the risk allowances for the Italian mortgage loan portfolio are contained in notes 10, 28 and 40 in the notes to the consolidated financial statements.

❷ Recoverability of properties acquired from previous loan exposures as reported in the property, plant and equipment and other assets balance sheet items

① In the consolidated financial statements of Aareal Bank AG, properties acquired from previous loan exposures were reported as of 31 December 2017 in the amount of € 127 million in the property and equipment balance sheet line item in accordance with IAS 16 Property, Plant and Equipment and in the amount of € 203 million under the other assets balance sheet line item in accordance with IAS 2 Inventories. The properties were acquired by Aareal Bank AG through fully consolidated real estate special purpose entities. Aareal Bank AG tests the properties acquired from former credit exposures at least once a year for impairment using external valuations. The market values of the properties are calculated in each case as the present values of future cash flows using the discounted cash flow method or determined on the basis of floor area-related comparative values, with the appraisers deriving the assumptions about future cash flows using the information and projections provided by the executive directors. In addition, the executive directors make assumptions about leasing and marketing. Since even relatively small changes in these assumptions have a significant influence on the market values of the properties and the measurements are therefore subject to uncertainties, this matter was of particular significance during our audit.

② As part of our audit, we particularly evaluated the valuations performed by the external appraisers in terms of their up-to-dateness and methodology, as well as the transparency of the value calculation. At the same time we gained an understanding of the original data, value parameters and assumptions on which the valuations were based, evaluated these critically and assessed whether they were within a justifiable range. In this context we involved our own real estate experts. In specific cases, we carried out our own property inspections. In addition, we based our assessment of the leasing and marketing assumptions made by the executive directors on, inter alia, a comparison with general and sector-specific market expectations as well as on documentation and explanations from the executive directors about expected cash flows. Furthermore, we evaluated the classification of the properties and, therewith, the respective accounting policies to be applied under IAS 2 and IAS 16. Taking account of the information available, we conclude that the assumptions made by the executive directors for testing the impairment of the properties acquired from former exposures and the classifications applied are appropriate.

③ We refer to the Company's disclosures on property, plant and equipment and other assets contained in notes 16, 18, 46 and 49 in the notes to the consolidated financial statements.

Other Information

The executive directors are responsible for the other information. The other information comprises the statement on corporate governance pursuant to § 289f HGB and § 315d HGB, which we obtained prior to the date of our auditor's report.

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

The separate non-financial report pursuant to § 289b Abs. 3 HGB and § 315b Abs. 3 HGB is expected to be made available to us after the date of the auditor's report.

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

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

- is materially inconsistent with the consolidated financial statements, with the group management report or our knowledge obtained in the audit, or

- otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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

The executive directors are responsible for the preparation of the consolidated financial statements that comply, in all material respects, with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB and that the consolidated financial statements, in compliance with these requirements, give a true and fair view of the assets, liabilities, financial position, and financial performance of the Group. In addition the executive directors are responsible for such internal control as they have determined necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the executive directors are responsible for assessing the Group's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting unless there is an intention to liquidate the Group or to cease operations, or there is no realistic alternative but to do so.

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

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

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

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

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

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

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

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

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

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

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements present the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Group in compliance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express audit opinions on the consolidated financial statements and on the group management report. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinions.

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

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

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

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

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

Other Legal and Regulatory Requirements

Further Information pursuant to Article 10 of the EU Audit Regulation

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

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

German Public Auditor Responsible for the Engagement

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

Frankfurt / Main, 6 March 2018

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

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

Responsible and transparent corporate governance is of great importance to Aareal Bank AG, and is considered the essence of prudent commercial conduct by both the Management Board and the Supervisory Board.

Transparency

Corporate Governance Statement pursuant to Sections 289f and 315d of the German Commercial Code (HGB) / Corporate Governance Report

Declaration of Compliance in Accordance with Section 161 of the AktG

Aareal Bank AG has complied with the recommendations of the Government Commission "German Corporate Governance Code" (as amended and published in the German Federal Gazette on 24 April 2017) – except for the two restrictions set out below – since the last Declaration of Compliance was issued in December 2016; and will continue to do so, subject to the same restrictions.

In accordance with section 4.2.3 (2) sentence 6 of the German Corporate Governance Code (the "Code"), the amount of Management Board compensation shall be capped, both overall and for variable remuneration components. In March 2014, against the background of changed regulatory requirements, and based upon a proposal by the Remuneration Control Committee, the Supervisory Board approved a new remuneration system for members of the Management Board, with effect from 1 January 2014. The new remuneration system complies with the recommendation in section 4.2.3 (2) sentence 6 of the Code. In this connection, a maximum amount ("cap") was resolved for the variable, performance-related remuneration component of the Management Board – for the 2013 financial year, and for subsequent financial years. As the only exception, no cap applies to virtual shares granted for the 2012 financial year or earlier financial years, or to virtual shares still to be granted under applicable rules governing the deferral of variable remuneration components. However, such virtual shares will be settled and disbursed for the last time in 2018, after expiry of the retention period and any applicable holding or blocking periods, based on the weighted average price (Xetra®) of the five exchange trading days following the expiry of the period.

Pursuant to section 25d of the German Banking Act (Kreditwesengesetz – "KWG"), the Executive and Nomination Committee of Aareal Bank AG's Supervisory Board is required to assume additional tasks which are not supposed to be prepared by shareholder representatives on the Supervisory Board alone. Hence, the Executive and Nomination Committee also includes employee representative members, in contravention of the recommendation in section 5.3.3 of the Code. However, the Committee will ensure that the nomination of candidates for election by the Annual General Meeting will be determined exclusively by shareholder representatives on the Committee.

Wiesbaden, December 2017

The Management Board

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

Thomas Ortmanns **Christof Winkelmann**

For the Supervisory Board

Marija Korsch (Chairman)

Corporate Governance at Aareal Bank Group

Aareal Bank Group is managed by the parent company Aareal Bank AG. Aareal Bank is a listed bank, which by virtue of being classified as significant, is supervised directly by the European Central Bank. Although we, the Management Board and the Supervisory Board of Aareal Bank AG, are required to observe a large number of specific corporate governance rules, our common understanding does not end with our compliance with these rules. We also discuss on a regular basis the application of voluntary standards that are recommended by the Code, the supervisory authorities, our shareholders or due to international best practice, or that arise for the Supervisory Board and the Management Board in their day-to-day work.

Our top priority is to act in the interests of the Company and hence to meet our responsibility to the employees, customers, shareholders, the public and the environment alike.

Disclosures regarding Corporate Governance standards

To discharge its responsibility, the corporate governance is guided by legal and regulatory rules, as well as by a comprehensive set of internal rules and regulations, which provide concrete guidance on the conduct and processing of the Bank's business, in line with our ethical responsibility. All members of staff have access to these documents, via common internal communications channels such as the Bank's Intranet.

Sustainability approach

Contributing to sustainable economic development is a priority for Aareal Bank Group. As a partner to the property industry, Aareal Bank Group is thus pursuing a business strategy appropriate to the requirements of the sector and the stakeholders. The Group is aware of the responsibility associated with its sustainability mission statement and the need to focus on the needs of society, and aims to preserve the foundations on which future generations can live and shape their lives.

The sustainability mission statement, which is supported by an integrated sustainability management system, underpins our sustainable corporate strategy, providing a summary of the corporate responsibility principles of Aareal Bank Group that are aligned with our objective of doing business sustainably:

- We think with a view to the future taking ethical, societal and ecological topics into account.
- We analyse trends holistically, evaluate the resulting opportunities and risks, and align our forward-looking sustainability programme with this.
- We focus on all relevant stakeholder groups, seek to engage in active dialogue with them in a variety of ways and show how we make use of the insights we have gained.
- We make sure that business decisions take account of ecological, social and governance factors and communicate our progress and the challenges we face transparently and credibly.
- We set priorities and implement our decisions, thereby reinforcing corporate sustainability values such as reliability, innovative ability, integrity and compliance, our appeal as an employer, and an emphasis on building and maintaining high-trust client relationships.

We orient ourselves on national and international frameworks, commit to initiatives or have joined organisations that represent generally accepted ethical standards and whose values we share. Relevant organisations here include:

- United Nations Global Compact
- International Labor Organization
- German Sustainability Code
- Diversity Charter
- Work-Care Balance Charter

At an organisational level, Aareal Bank Group has assigned responsibility for sustainability management to the Chairman of the Management Board. In this way, Aareal Bank Group emphasises the strategic importance of sustainability for its corporate philosophy and steers its practical implementation at the highest level. Established already in 2012, the Sustainability Committee supports the Management Board in the ongoing development of the sustainability programme and for coordinating the Group-wide sustainability activities. It includes representatives from all key divisions.

Further details can be found in the latest Sustainability Report: www.aareal-bank.com/en/responsibility/reporting-on-our-progress/sustainability-reporting/

Code of Conduct

We believe that the principles of integrity and responsible conduct must be observed by the members of the Management Board and the Supervisory Board, and by all our employees across the Company, regardless of their functions and duties. Our internal Code of Conduct therefore contains binding rules governing the legal and ethical conduct of employees vis-à-vis clients, business partners, and colleagues. Aareal Bank's efforts in this context are also motivated by the desire to affirm and further strengthen the confidence placed by stakeholders – our clients, investors, and staff: (www.aareal-bank.com/fileadmin/DAM_Content/Konzern/dokumente/Code_of_Conduct_en.pdf).

Principles of diversity

The Management Board and the Supervisory Board are openly committed to diversity throughout the entire Aareal Bank Group.

Aareal Bank defines diversity as:

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

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

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

Aareal Bank Group employs people from more than 30 different countries. At Aareal Bank's foreign locations, we take care to ensure that positions are primarily filled by local staff if possible. Aareal Bank Group attaches great importance to the equal treatment of women and men, whether in the context of filling vacant positions, with regard to continuous professional development, or in terms of remuneration. Specifically, any vacancies below senior executive level are generally published throughout the Company, in the form of job advertisements that all members of staff – male or female – may apply for. When setting the remuneration of employees, we do not differentiate by gender but rely exclusively on aspects such as qualification, professional experience or training.

In accordance with the German Act on Equal Participation of Men and Women in Executive Positions in the Private and Public Sector (Gesetz für die gleichberechtigte Teilhabe von Frauen und Männern an Führungspositionen in der Privatwirtschaft und im öffentlichen Dienst), the Management Board sets specific targets – including concrete implementation deadlines – for the share of women holding executive positions on the first two management levels below the Management Board of

Aareal Bank AG. The target female quota of 6.3 % set for the first management level below the Management Board was exceeded by 30 June 2017. The status quo of 13.5 % as at the deadline of 30 June 2017 is to be at least sustained until 30 June 2022. This share was achieved through internal promotions from the second to the first management level, among other things. However, at 21.1 % as at 30 June 2017, the objective of 21.4 % was missed by a fractional margin. The previous status quo is to be met or exceeded until 30 June 2022.

Across Aareal Bank Group, the share of women in executive positions stood at 21.5 % (Aareal Bank AG: 24.1 %; Aareon: 20.7 %) as at 31 December 2017, with women accounting for 37.4 % of Aareal Bank Group's entire workforce (Aareal Bank AG: 45.6 %; Aareon GmbH: 31.3 %).

Severely disabled persons made up 4.1 % of Aareal Bank's staff base in 2017. This employee group is represented in the Group's German entities by a disability representative.

In Germany, Aareal Bank and Aareon apply the German General Equal Treatment Act (Allgemeines Gleichbehandlungsgesetz – "AGG"), with specially-appointed AGG Officers overseeing compliance. Special AGG-related training measures are carried out for all employees. In the US, the employee manual contains rules designed to avoid harassment at the workplace ("Anti-Harassment Rules").

Management Board and Supervisory Board work processes

The Management Board

The Management Board is responsible for managing the Company and for its strategic orientation, material transactions and proper organisation. This also includes the implementation of effective monitoring systems. It focuses its business operations on the sustainable development of the Company. Its decisions incorporate the long-term consequences of its actions and are guided by the ethical principles of Aareal Bank Group (see relevant corporate governance principles).

The Supervisory Board

The Supervisory Board exercises its control using different instruments. On the one hand, it sets out the reporting requirements of the Management Board in its internal Rules of Procedure, to ensure comprehensive and prompt reporting. These reports include the financial reports prior to being published, the reports of Internal Audit, Risk Controlling and Compliance, as well as the external auditor's reports. It also determines the transactions of the Management Board in its internal Rules of Procedure, where its approval is required.

In selecting suitable members of the Management Board and their effective control, the Supervisory Board also contributes to the sustainable success of Aareal Bank Group in the interest of the investors, clients, employees and the public.

The Supervisory Board has established six committees in order to perform its supervisory duties in an efficient manner: the Executive and Nomination Committee, the Remuneration Control Committee, the Risk Committee, the Committee for Urgent Decisions, the Audit Committee, and the Technology and Innovation Committee. An overview of the respective committee members can be found in the Notes (99): www.aareal-bank.com/en/investors-portal/finance-information/financial-reports/archiv/2017/

Executive and Nomination Committee

The Executive and Nomination Committee prepares the plenary meetings of the Supervisory Board, together with proposed resolutions. The committee's area of responsibility also includes assessing the internal condition of the Group, and issues concerning personnel planning for the Management Board (also regarding the contracts with individual Management Board members, based on the remuneration system prepared by the Remuneration Control Committee and adopted by the plenary meeting of the Supervisory Board). The Executive and Nomination Committee compiles profiles defining the requirements for members of the Management Board and the Supervisory Board and supports the Supervisory Board in selecting suitable candidates. Based on an annual evaluation, it determines the extent to which the members of the Management Board or Supervisory Board have a need for further training, or whether other adjustments are required. Furthermore, the Executive and Nomination Committee discusses decision proposals regarding connected-party loans as well as other transactions between members of administrative, management and supervisory bodies and the Company or its subsidiaries.

The Executive and Nomination Committee, excluding the employee representatives, discusses the nomination of shareholder representatives for election by the Annual General Meeting.

Remuneration Control Committee

The Remuneration Control Committee monitors whether the structure of the remuneration systems for Management Board members and employees is appropriate, taking into account the impact of remuneration systems on Aareal Bank's overall risk profile. The Remuneration Control Committee prepares corresponding proposals concerning remuneration (including for members of the Management Board) for the plenary meeting of the Supervisory Board. The Remuneration Control Committee receives the information provided by Aareal Bank's Remuneration Officer, as well as the information on the remuneration system intended for disclosure.

Risk Committee

The Risk Committee deals with all material types of risk Aareal Bank is exposed to in its business activities. In addition to the plenary Supervisory Board, it is also the recipient of the risk reports (please refer to the Risk Report). The monitoring of credit risks also includes approving loans which, pursuant to the internal rules of procedure for the Management Board, require the approval of the Supervisory Board (see Committee for Urgent Decisions).

The committee is also responsible for reviewing the contents of the risk strategies in accordance with the MaRisk and preparing the corresponding resolutions of the Supervisory Board.

Committee for Urgent Decisions

The Committee for Urgent Decisions is a subcommittee of the Risk Committee. Its members are elected from amongst the members of the parent committee. The Committee for Urgent Decisions takes lending decisions which, pursuant to the internal rules of procedure for the Management Board, require Supervisory Board approval, and which are particularly urgent. Since the committee passes its resolutions by way of circulation, it does not hold any meetings. Any decisions taken between meetings of the Risk Committee are discussed at the subsequent meeting.

Audit Committee

The Audit Committee is concerned with all accounting issues, as well as regarding the audit of Aareal Bank AG and Aareal Bank Group. The committee is responsible for the preparation and conduct of the audit of the financial statements and the consolidated financial statements; it prepares the decisions to be taken by the Supervisory Board on the basis of the committee's analysis of the external auditors' reports. For this purpose, the committee reports to the plenary meeting of the Supervisory Board on the results of its analysis and the assessments derived. Preparing the audit of the financial statements also comprises the preparations for instructing the external auditors (by virtue of the corresponding resolution passed by the Annual General Meeting), verifying the independence of the external auditors, including the approval of permissible non-audit services, negotiating the auditors' fees, and determining focal points of the audit. The Audit Committee also discusses quarterly and half-yearly financial reports with the Management Board, and obtains the external auditors' report on their review of the half-yearly report. Furthermore, the Audit Committee is responsible for examining the projections submitted by the Management Board; the reports by Compliance and Internal Audit are addressed to the committee. The committee is also responsible for monitoring the effectiveness of the internal control and monitoring system.

Technology and Innovation Committee

The committee deals with issues concerning information technology used within the Company, and with issues related to IT products created and distributed by Aareal Bank Group entities.

Communications

Aareal Bank assigns great importance to extensive communications with all of the Bank's stakeholders. It has set itself the target of actively, transparently and openly communicating with all stakeholders, taking into account the interests of all stakeholders.

All press releases, ad-hoc disclosures, corporate presentations, as well as annual, sustainability and quarterly reports published by Aareal Bank are available on the Bank's website to any interested person, and may be downloaded from there. In addition, the financial calendar is updated regularly, and provides information about upcoming events.

Aareal Bank publishes details on the financial position and performance five times annually. On these occasions, the Management Board gives a personal account of results, within the scope of press and analysts'conferences, as well as issuing press releases.

All information can be found on Aareal Bank's website www.aareal-bank.com/en/investorenportal/

Relationship to shareholders

To facilitate direct communication, Aareal Bank has set up a separate division within its organisation, which serves as a first point of contact for shareholders, other investors and analysts. The contact persons in Investor Relations can be found on the Aareal Bank website www.aareal-bank.com/en/investors-portal/equity-investors/contact/

The Bank also holds an Annual General Meeting once a year. Shareholders are thus given the opportunity to actively participate in the development of the Company.

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

The Company's shareholders may submit statements or proposals in writing, by fax or e-mail, to the Company. They may also request to speak at the Annual General Meeting. The shareholders may also submit counter or supplemental motions to the agenda items at the Annual General Meeting, so that they participate in structuring and influencing the meeting. The Management Board and the Supervisory Board refer to shareholders' comments made during the general debate, or to motions submitted by shareholders in advance, to respond to questions, or to comment on other contributions.

We are not currently broadcasting parts of the Annual General Meeting on the internet, nor is it currently possible to give instructions or cast votes online. This is because the low level of acceptance of such a service amongst our shareholders would render the related efforts and costs excessive. Aareal Bank will continue to review demand for such a service on a regular basis.

Guidelines regarding the selection of members of the Management Board and the Supervisory Board

The Supervisory Board of Aareal Bank AG is satisfied that the Management Board and the Supervisory Board are adequately staffed, if all members are in a position to perform their duties (professional qualification), commit the time necessary to perform these and possess the integrity to be guided by the ethical principles of Aareal Bank when performing their duties (with respect to personal reliability, conflicts of interest, and independence). The composition of the Supervisory Board, in its entirety, shall facilitate cooperation and the widest possible diversity of opinions and knowledge (the concept of diversity).

The Supervisory Board has defined concrete requirements and processes to incorporate these criteria for the annual evaluation of Management Board and Supervisory Board members, as well as when selecting candidates each year for appointment to the Management Board, or for shareholder representatives to the Supervisory Board. The Supervisory Board has taken into account the legal requirements of the German Public Limited Companies Act (Aktiengesetz – "AktG"), the German Banking Act (Kreditwesengesetz – "KWG"), and of the German Corporate Governance Code when establishing these processes. The regulatory guidelines of the European Central Bank and the European banking supervision on adequacy and internal governance are also incorporated, as well as the corporate governance guidelines for proxy advisors that are relevant for Aareal Bank and key shareholders. Besides the Supervisory Board, the European Central Bank also reviews the suitability of the respective candidates prior to them taking up their duties, using the so-called fit&proper approach.

Personal reliability

The principles of personal reliability apply equally for all members of the Management Board and the Supervisory Board. All members of the Management Board and the Supervisory Board should demonstrate honesty, integrity and independence of mind. They should live by the ethical principles of Aareal Bank, as set out in the Code of Conduct, and commit sufficient time to perform their duties. The Supervisory Board calculates the time commitment of every member of the Management Board and the Supervisory Board, and reviews on an annual basis whether they also dedicate sufficient time to exercising the mandate. In this connection, the Supervisory Board takes care to ensure compliance with the requirements for the maximum number of additional offices, pursuant to sections 25c (2) and 25d (3) of the KWG.

Conflicts of interest & independence

Acting in the interests of the Company means being able to make significant judgements unbiased by considerations irrelevant to the matter at hand. The Supervisory Board therefore attaches particular importance to the handling and disclosure of conflicts of interest or potential conflicts of interest that could, for example, call into question the independence of the Supervisory Board.

In its Conflicts of Interest Policy, the Supervisory Board has laid down procedures on how to prevent or handle potential conflicts of interest affecting members of the Management Board or the Supervisory Board. Specifically, the Policy provides that individual Management Board and Supervisory Board members must establish transparency even where there is only a potential conflict of interest. The members of the Supervisory Board and the Management Board have declared in writing that no conflicts of interest pursuant to section 5.5.2 of the Code arose during the financial year under review. Any individual whose circumstances may give rise to a material conflict of interest cannot be considered as a candidate.

The Supervisory Board also determines when the independence of one of its members is not ensured and carries out an annual review of whether the independence of individual members is no longer ensured, or may be compromised.

This could be the case, for example, if the general limitation to members' maximum three terms of office on the Supervisory Board is soon to be exceeded. Each term of office starts with the election (or re-election) by the Annual General Meeting. The Supervisory Board aims for a scenario whereby at least 50 % of the employee representatives and each chairman of a committee and the Supervisory Board should be independent. At present, the Supervisory Board believes that all employee representatives (Marija Korsch, Richard Peters, Dr Hans Werner Rhein, Prof Stephan Schüller, Sylvia Seignette, Elisabeth Stheeman, Dietrich Voigtländer and Prof Hermann Wagner) are independent.

Professional qualification

Every member of an executive body must possess the knowledge, ability and experience to properly perform their duties. This means that they must at least be able to understand and assess the Company's material business activities and the associated material risks, the control and monitoring system established in this regard, as well as the corresponding accounting and financial reporting systems. This also requires being familiar with the underlying material legal requirements. The members of the Management Board are responsible for the duties of the entire Management Board as well as those of the sections assigned to them. Each member of the Supervisory Board must be in a position to perform the duties incumbent on the Supervisory Board in its entirety. If they chair a committee, they should have extensive expertise in the topics covered by the committee. The Chairman of the Audit Committee, for example, must be an expert on financial reporting issues and internal control and monitoring systems, while the Chairman of the Risk Committee must be an expert in managing and monitoring risks. Both committee chairmen may not hold the position of Chairman of the Supervisory Board.

The curricula vitae of the members of the Management Board:
https://www.aareal-bank.com/en/about-us/company-profile/the-management-board/
and the members of the Supervisory Board:
https://www.aareal-bank.com/en/about-us/company-profile/supervisory-board/
can be found on the website.

Concept of diversity

In principle, the Management Board and the Supervisory Board pursue the objective in their bodies of ensuring maximum variety with regard to gender, age, internationality and professional diversity. Where there are several suitable candidates, further selection takes these aspects into account, to draw together the broadest possible spectrum of different perceptions in the interest of making the best possible decision for Aareal Bank. The Management Board ensures that these aspects of diversity are also taken into consideration at the management levels it controls, to facilitate succession that is oriented on this concept of diversity (please refer to relevant management duties/diversity). The Supervisory Board has set individual objectives for the aforementioned diversity aspects, for both itself and the Management Board, the implementation of which it presents annually. It understands these objectives as being minimum objectives; there is no reason why they cannot be exceeded.

Gender diversity

In accordance with the German Act on Equal Participation of Men and Women in Executive Positions in the Private and Public Sector, the Supervisory Board sets specific targets – including concrete implementation deadlines – for the proportion of female members of the Supervisory Board and the Management Board. Likewise, the Management Board defines such targets for the first two management levels below the Board. The first implementation deadline was on 30 June 2017. As at that deadline and on 31 December, the proportion of female members of the Supervisory Board was 33.33 %, in line with the 30 % target. The minimum target figure for women on the Supervisory Board in the period between now and 30 June 2022 is 25 %. As at the deadline of 30 June 2017 and on 31 December, the proportion of female members of the Management Board was 40 %, thus exceeding the 25 % target. The minimum target figure for women on the Management Board in the period between now and 30 June 2022 is 20 %.

Age diversity

The Supervisory Board has set out targets for the age structure of the Management Board and the Supervisory Board, in order to safeguard the continuous development of both executive bodies. At the time of (re)election to the Supervisory Board, candidates should be less than 70 years old. Furthermore, the Supervisory Board should not consist exclusively of members who are older than 60 years. Members of the Management Board should not exceed the upper age limit of 65 years while serving on the Board. These objectives are currently met.

International profile

In addition, given Aareal Bank's international business activities, the Supervisory Board has set itself and the Management Board the goal of having the broadest possible international experience, which can be proven by foreign nationality or considerable professional experience gained in another country. 40 % of the members of the Management Board and 25 % of the members of the Supervisory Board bring such a background into their work.

Diversity of professional skills

The Supervisory Board pursues the objective of maximum professional diversity when selecting the members of the Management Board and the Supervisory Board. However, the demanding professional requirements for members of the management board and the supervisory board of so-called "significant credit institutions" limit the opportunities for achieving this objective: for instance, regulatory rules require in principle that the members of the Management Board have extensive experience in the lending business and in risk management. In accordance with section 100 (5) of the AktG, the Supervisory Board members in their entirety shall be familiar with the sector in which the Company operates. However, the Supervisory Board itself pursues the objective whereby not all members have gained the main part of their professional experience in a bank.

Annual evaluation of the suitability and performance

Compliance with the aforementioned guidelines is reviewed at least once a year or on an event-driven basis. The Executive and Nomination Committee is regularly supported by external experts.

The Executive and Nomination Committee assesses the suitability of the Management Board and the Supervisory Board in their entirety, as well as with regard to their individual members, and evaluates the structure, size, composition and performance of both bodies. Finally, the Committee advises on any recommendations made to the Supervisory Board in order to leverage the potential for improvement that has been identified.

In accordance with section 25d (4) of the AktG and section 5.4.5 of the Code, the Supervisory Board members regularly attend continuous professional development measures, and are supported to this effect by the Company. Furthermore, in its annual evaluation, the Executive and Nomination Committee assesses if further training will be required to meet future challenges or new provisions.

Composition of the Management Board and Supervisory Board

The members of the Supervisory Board and its committees, the respective Chairmen and members of the Management Board and their relevant areas of responsibility are presented in the Notes (99). As per the Supervisory Board's decision, the Management Board is comprised of five members. The Supervisory Board appoints one of the members to Chairman of the Management Board. In accordance with Aareal Bank AG's Memorandum and Articles of Association, the Supervisory Board consists of twelve members. Once elected by the Annual General Meeting, the members of the Supervisory Board elect a Chairman and two Deputy Chairmen from amongst them, for the duration of their term of office. In the financial year 2010, employee representatives were elected by the special negotiating body, a body representing employees following the merger of Aareal Bank France S.A. into its parent company Aareal Bank AG.

The committees typically comprise a minimum of four members, while the Audit Committee and the Risk Committee comprise six members. The Chairman of the Supervisory Board belongs to every committee and assumes the position of risk management expert in the Remuneration Control Committee. According to the provisions of section 5.3.2 of the Code as well as Aareal Bank's Guidelines for the selection of members of the Management Board and the Supervisory Board, the position of Chairman of the Audit Committee and the Risk Committee is held by independent experts. Additionally, care is also taken to avoid any interlinking of the committee members' positions, to ensure the mutual exchange of information.

Purchase or sale of the Company's shares

In 2017, members of the Company's executive bodies did not carry out any transactions involving the Company's shares, which would have required publication in accordance with the requirements of Article 19 of the EU Market Abuse Regulation (596/2014/EU), in conjunction with section 26 of the WpHG. At the end of the financial year, aggregate shareholdings of members of the Management and Supervisory Boards in the Company's shares were less than 1 % of the issued share capital of Aareal Bank AG.

Accounting policies

Aareal Bank AG prepares the Group's accounts in accordance with International Financial Reporting Standards (IFRSs). The single-entity financial statements of Aareal Bank AG are prepared in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – HGB). The Management Board prepares the financial statements and management reports of Aareal Bank AG and Aareal Bank Group. The external auditors submit their report on the audit of the financial statements and the consolidated financial statements to the Supervisory Board, which monitors its independence at the same time. The fees paid to the external auditors are shown in Note (34) to the financial statements. Permissible non-audit services provided by the external auditors must be approved beforehand by the Audit Committee of the Supervisory Board.

PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft (PwC), the auditors of the 2017 financial statements – as elected by the Annual General Meeting 2017 and instructed accordingly by the Supervisory Board – have exercised their audit activities under the management of Messrs Stefan Palm and Lukas Sierleja. In accordance with internal regulations, all employees of the external auditors, including the responsible partners and lead auditors, rotate their assignment to specific audit assignments on a regular basis – in this case, every five years.

Mr Palm, PwC's responsible partner, has audited Aareal Bank since 2013; Mr Sierleja, the responsible lead auditor, since 2016.

Report of the Supervisory Board of Aareal Bank AG, Wiesbaden

Dear shareholders,

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

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

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

Activities of the Plenary Meeting of the Supervisory Board

Six plenary meetings of the Supervisory Board were held during the year under review. During the meetings, the members of the Supervisory Board received reports and explanations from the members of the Management Board, and discussed these in detail. Dealing with the still challenging market environment, the large number of regulatory adjustments that are yet required and the implementation of the ”Aareal 2020” programme for the future were a focal point of the work and reporting in all scheduled meetings.

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

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

The focal points of the individual meetings are outlined below.

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

In the March meeting, the Supervisory Board concerned itself in detail with the financial statements and consolidated financial statements presented for the 2016 financial year, and with the auditors' report. The relevant facts were presented in the Supervisory Board report for the previous year. In addition, the proposal regarding the selection and subsequent appointment of the external auditor for the Annual General Meeting was discussed. This also included the scope and focal points of the audit for the 2017 financial year, as defined by the Supervisory Board. Upon recommendation of the Audit Committee, the Supervisory Board also agreed to subject the non-financial report for 2017 (required by law for the first time in the 2017 financial year) to an audit, to obtain limited assurance. Other issues covered during the March meeting included the preparations for the Annual General Meeting in May 2017. This meeting also discussed the annual reports submitted by Internal Audit and by the Compliance Officer. Remuneration issues were also addressed.

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

The meeting in June exclusively comprised an extensive discussion of Aareal Bank Group's strategy, during which the Supervisory Board intensely discussed strategic initiatives with the Management Board.

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

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

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

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

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

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

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

Activities of Supervisory Board Committees

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

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

The Risk Committee held four meetings during the year under review. The committee regularly discussed reports on the Bank's risk situation, which were submitted and explained by the Management Board. Having discussed the contents with the Management Board, these were duly noted and approved by the members of the committee. Besides credit and country risks, the committee concerned itself with market risks, liquidity risks, and operational risks. The committee was also engaged with the analysis of Aareal Bank's risk-bearing capacity and its capital ratios. Also, detailed reports were given regarding the Bank's liquidity status and management as well as its funding. Risks from existing investments, as well as all additional material risks were also presented. The committee also decided on any other transactions requiring the Supervisory Board's approval pursuant to the Company's Memorandum and Articles of Association or the internal rules of procedure.

The Management Board also submitted detailed reports to the committee, covering all markets in which the Bank is active in the property finance business, as well as supplementary reports regarding the Bank's investments in securities portfolios. The committee members discussed these reports and market views in detail, and also concerned themselves with the banking and regulatory environment.

The Committee for Urgent Decisions is a sub-committee of the Risk Committee. It approves loans subject to approval requirements by way of circulation. For this reason, it did not hold any meetings. Any decisions which were taken between meetings of the Risk Committee were presented again at the subsequent meeting, whereby the Management Board provided supplementary information on current implementation progress.

The Audit Committee held six meetings during the year under review. During its meeting in February 2017, the Audit Committee received and discussed the preliminary results for the 2016 financial year. During its March meeting, the committee received the external auditors' report on the 2016 financial year and discussed the results with the auditors in detail. The committee members discussed the contents of the audit reports provided; they formed their own judgement of the audit results on the basis of these reports, and by way of meetings held with the external auditors. In accordance with its duties under the Memorandum and Articles of Association, the Audit Committee also discussed the selection of external auditors and the focal aspects of the audit for 2017 during the same meeting.

During its meeting in May 2017, the Audit Committee also concerned itself with Aareal Bank Group's Sustainability Report and the audit undertaken to obtain limited assurance for this report. In accordance with the requirements of the German Corporate Governance Code, during its meetings in May, August and November 2017, the Audit Committee discussed with the Management Board the quarterly results to be published.

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

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

During its eight meetings, the Remuneration Control Committee discussed issues related to the Bank's remuneration systems and all related matters, fulfilling its original assignment. For this purpose, and to the extent considered necessary, external legal and remuneration advisors were retained to provide support. In addition to topics to be dealt with on a regular basis, the Remuneration Control Committee concerned itself with necessary adjustments of the remuneration systems due to amendments to the InstitutsVergV that came into effect on 3 August 2017. Moreover, the Remuneration Control Committee supported the Supervisory Board with all issues related to the remuneration of the Management Board. In particular, the committee provided support for determining the Management Board's targets for the current year, and for assessing target achievement by the Management Board, as a basis for determining variable remuneration for the members of the Management Board for the year 2017. As a rule, support was provided to the Supervisory Board by preparing the corresponding recommendations.

The Technology and Innovation Committee convened for four meetings, during which the committee discussed market trends, technological developments and innovation trends in detail, especially with a view to clients of the Consulting / Services segment. Potential business opportunities arising from the growing digitalisation of business processes – and how these can be put to use by Aareal Bank Group for its clients – were explained by the employees of subsidiaries responsible for the development, among other things. Another key aspect of the regular discussions was the realignment of the banking systems, against the background of numerous new requirements in terms of accounting, regulation, and IT security.

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

Member of the Supervisory Board	Number of meetings attended / number of meetings (plenary and committee meetings)		
Marija Korsch	33	of	33
Prof. Dr Stephan Schüller	25	of	25
York-Detlef Bülow*	24	of	25
Thomas Hawel*	10	of	10
Dieter Kirsch*	17	of	18
Richard Peters	21	of	21
Dr Hans-Werner Rhein	15	of	15
Sylvia Seignette	10	of	10
Elisabeth Stheeman	14	of	14
Hans-Dietrich Voigtländer	24	of	24
Prof. Dr Hermann Wagner	16	of	16
Beate Wollmann*	6	of	6

* Employee representative

Financial Statements and Consolidated Financial Statements

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

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

The financial statements and management report of Aareal Bank AG, prepared in accordance with the HGB, and the consolidated financial statements and the Group management report prepared in accordance with IFRSs, and the proposal of the Management Board regarding the appropriation of profit, and the audit reports, were all examined in detail. No objections were raised to the audit results. In its meeting on 22 March 2018, the Supervisory Board approved the results of the audit. The Supervisory Board approved the financial statements and Management Report of Aareal Bank AG, prepared in accordance with the HGB, together with the consolidated financial statements and the Group Management Report prepared in accordance with IFRSs, and thus confirmed the financial statements of Aareal Bank AG. The Supervisory Board examined and discussed with the Management Board its proposal regarding the appropriation of profit. On the basis of the discussion, the Supervisory Board endorsed the proposal for the appropriation of profit submitted by the Management Board.

Non-financial Report

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

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

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

Frankfurt / Main, March 2018

For the Supervisory Board

Marija Korsch

Marija Korsch (Chairman)

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Glossary

Accrued interest
Interest on debt securities (such as bonds, notes or Pfandbriefe) which has accrued since the last coupon payment date. When buying such a security, the buyer must pay accrued interest to the seller.

Ad-hoc disclosure
Pursuant to section 15 of the German Securities Trading Act (WpHG), issuers of securities are obliged to publish any information that may have an impact on the price of these securities without delay. This obligation is discharged using so-called "ad-hoc" disclosures which may relate to the issuer's financial position and performance, or to its general business operations. The ad-hoc disclosure obligation applies in Germany as well as in other major financial centres; it is designed to prevent insider trading.

Advanced Approach
Under the "Advanced Approach", banks having sufficiently developed procedures for internal capital allocation (subject to strict requirements concerning methodology and disclosure) are allowed to use their internal credit quality ratings for a given borrower, to assess the credit risk exposure of their portfolios.

Amortised cost
The amount at which a financial asset or financial liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation of any premium or discount, and minus any reduction for impairment or non-collectability.

Asset-backed securities
A special form of securitising payment claims in tradable securities that are structured by aggregating certain financial assets.

Associated enterprise (associate)
Enterprise which is accounted for in the consolidated financial statements using the equity method (as opposed to full or partial consolidation), over whose business or financial policies an entity included in the consolidated financial statements exercises significant influence.

Available for sale (AfS)
This IFRS measurement category denotes financial assets which are available for sale by an enterprise, and which are not receivables, financial instruments held for trading (HfT) or held-to-maturity (HtM) financial instruments. AfS financial instruments are predominantly fixed-income securities which the enterprise cannot (or does not intend to) hold until maturity. They can also be equity instruments without a final maturity date.

Basel III
"Basel III" denotes the regulatory framework for banks, promulgated by the Basel Committee on Banking Supervision at the Bank for International Settlements (BIS) with the objective of stabilising the banking sector.

Bonds
Generic term for fixed-income securities or debt securities.

Capital markets
The markets for any kind of medium- to long-term funds – in a narrower sense, generic term for supply and demand in securities.

Cash flow hedges
Using a swap transaction to hedge the risk of future variable-rate interest payments from an underlying on-balance sheet transaction.

Collateral
Rights granted to the Bank by the borrower to facilitate enforcing the Bank's claims in case of default. Collateral may be provided in the form of personal collateral (e.g. a guarantee) and impersonal collateral (e.g. a land charge). In principle, collateral reduces expected losses sustained by the Bank in the event of default.

Commercial Mortgage Backed Securities (CMBS)
Bonds backed by loans collateralised by commercial and multi-family properties.

Consolidated statement of cash flows
Statement showing the cash flows an enterprise has generated and used during a financial year, from its operating, investment and financing activities, also showing cash and cash equivalents at the beginning and end of the financial year.

Corporate Governance
Corporate Governance denotes the legal and factual framework for the management and governance of enterprises. The recommendations of the German Corporate Governance Code provide transparency and are designed to strengthen confidence in good and responsible corporate governance. They predominantly serve to protect shareholders' interests.

Cost/income ratio (CIR)
Financial indicator expressing the ratio of expenses to income within a given reporting period.

$$\text{CIR} = \frac{\text{Administrative expenses}}{\begin{array}{c}\text{Net interest income + net commission income}\\ \text{+ net result on hedge accounting + net trading income/}\\ \text{expenses + results from non-trading assets}\\ \text{+ results from investments accounted for using the}\\ \text{equity method + net income from investment properties}\\ \text{+ net other operating income/expenses}\end{array}}$$

Counterparty credit risk
Counterparty credit risk can be further distinguished into credit risk, counterparty risk, issuer risk and country risk; it denotes the potential loss in value which may be incurred as a result of the default (or deterioration of credit quality) of borrowing clients, issuers of promissory note loans or securities, or of counterparties to money market, securities or derivatives transactions.

Covered bonds
"Covered bonds" is a generic term for debt securities covered by collateral. In Germany,

covered bonds are mainly issued in the form of "Pfandbriefe" pursuant to the German Pfandbrief Act (PfandBG), which provides a legal framework for collateralisation (assets eligible for Pfandbrief cover include mortgages and public-sector loans).

Credit default swap (CDS)
Financial contract where the risk of a credit event specified in advance (such as insolvency, failure to pay, or deterioration of credit quality) is transferred from a protection buyer to a protection seller. The protection seller receives regular premium payments from the protection buyer in exchange for the assumption of credit risk, regardless of whether a credit event has actually occurred.

Debt security
Certificate whose issuer undertakes to repay the amount borrowed (plus current interest, or other form of performance) to the bearer.

Deferred taxes
Income taxes payable or receivable in the future, due to temporary differences between the carrying amounts of assets and liabilities in the IFRS statement of financial position and the tax accounts. At the time of recognition, deferred tax assets or liabilities do not yet constitute any actual claims on, or liabilities to the tax authorities.

Derivatives
Derivatives – which include all types of forwards, futures, options and swaps – are financial instruments whose value is derived from the price (and / or the price fluctuations) of an underlying instrument, such as equities, bonds or currencies.

Earnings per share
Financial indicator expressing the ratio of net income after non-controlling interest income to the average number of common shares outstanding.

$$\text{Earnings per share} = \frac{\text{Operating profit ./. income taxes ./. non-controlling interest income ./. AT1 coupon (net)}}{\text{Number of ordinary shares}}$$

EBIT margin

$$\text{EBIT margin} = \frac{\text{EBIT (operating profit before interest and taxes)}}{\text{Sales revenues}}$$

Effective interest method
Method for amortising the mark-up / markdown between cost and the nominal value (premium / discount), using the effective yield of a financial asset or liability.

Equity method
Method for measuring shareholdings in enterprises on whose business policy the reporting entity has significant influence ("associates"). When applying the equity method, the associate's pro-rata net income / loss is recognised in the carrying amount of the shareholding; any distributions are recognised via a corresponding pro-rata reduction in the carrying amount.

EURIBOR
European Interbank Offered Rate – the interest rate at which prime European banks offer euro deposits (with fixed terms of one week, and between one and twelve months) to one another.

Fair value
The fair value is the amount for which an asset can be exchanged (or a liability settled) between knowledgeable, willing parties in an arm's length transaction; this is often identical to the market price.

Fair value hedge
Using a swap to hedge the market risk of a balance sheet item with a fixed interest rate (e.g. a receivable or a security); this is measured at fair value.

Financial assets or liabilities at fair value through profit or loss (FVtPL)
Financial instruments assigned to this measurement category are carried at fair value, with the re-measurement recognised in income. A further differentiation is made within the category "Financial assets at fair value through profit or loss" into held for trading (HfT) and designated as at fair value through profit or loss (dFVtPL). Financial instruments are classified as "Held for trading" if they are acquired or incurred principally for the purpose of selling or repurchasing them in the near term, or if they are derivatives not designated within the scope of a recognised hedging relationship. Entities have the option to irrevocably designate financial instruments as at fair value, irrespective of any intention to trade (fair value option).

Financial instruments
Generic term for loans extended and other receivables, fixed-income securities, equities, shareholdings, liabilities, and derivatives.

Financial liabilities measured at amortised cost (LaC)
Financial liabilities not designated "at fair value through profit or los". These items are re-measured at amortised cost. Premiums and discounts are amortised over their term using relevant effective interest rates.

FX
Abbreviation for foreign exchange, referring to the FX market or the FX asset class.

German Accounting Standards
Recommendations for the application of (German) standards for consolidated financial statements, issued by the German Accounting Standards Board (GASB), a committee of the Accounting Standards Committee of Germany.

Goodwill
An asset representing the future economic benefits arising from other assets acquired in

a business combination that are not individually identified and separately recognised.

Hedge accounting
Concept describing the recognition (or other form of accounting) of two or more financial instruments, which together form a hedging relationship. In this context, the relationship between these contracts is based in the equal and opposite specification of contractual elements giving rise to risks (usually financial risks). Due to these specifications, such agreements can be used to partially or fully offset and neutralise risks. In the context of hedge accounting, one of the contracts involved (specifically, the contract establishing the risk(s) concerned) is referred to as the ”underlying transaction”, and the other contract (the one entered into to hedge the risk(s) of the underlying transaction) as the ”hedge transaction” or just ”hedge”.

Hedging
A strategy where a hedge is entered into in order to protect a position against the risk of unfavourable movements of prices or (interest) rates.

Held to maturity (HtM)
Financial assets with a fixed term as well as fixed or determinable payments acquired from a third party, where the reporting entity has the intention and the ability to hold such financial assets to maturity.

Impairment
An impairment occurs when the recoverable amount declines below the carrying amount. Impairment tests are required to be carried out for the purposes of determining allowance for credit losses.

International Accounting Standards (IASs)
Accounting standards issued by the International Accounting Standards Board (IASB), an international standard-setting body established by professional accountants' associations. The objective is to establish transparent, comparable international financial reporting standards.

International Financial Reporting Standards (IFRS / IFRSs)
IFRSs comprise International Accounting Standards (IASs) and interpretations issued by the Standing Interpretations Committee, as well as International Financial Reporting Standards (IFRSs) and related interpretations published by the International Accounting Standards Board (IASB).

LIBOR
London Interbank Offered Rate; the interest rate at which prime London banks offer deposits to one another.

Liquidity Coverage Ratio (LCR)
A Basel III indicator designed to assess liquidity risk.

Loan-to-value ratio
The ratio of loan amount to property value in the context of property loans.

MDAX®
The MDAX® mid-cap index comprises the shares of 50 companies from traditional sectors listed in Deutsche Börse's Prime Standard segment that, in terms of exchange turnover and market capitalisation, rank immediately below the companies included in the DAX® blue-chip index. The index is calculated on the basis of price data from Xetra®, the electronic trading system of the Frankfurt Stock Exchange.

Medium-Term Notes (MTNs)
Debt issuance programme used to issue unsecured debt securities at different points in time; the volume, currency and term (one to ten years) of each issue can be customised to the issuer's prevailing funding needs.

Minimum Requirements for Risk Management (MaRisk)
The Minimum Requirements for Risk Management in Banks (MaRisk) are binding requirements for the structure of risk management in German banks, as promulgated by the German Federal Financial Supervisory Authority (BaFin). Setting out the specifics of section 25a of the German Banking Act (KWG), BaFin has consolidated the previously-applicable Minimum Requirements for the Trading Activities of Credit Institutions (MaH), Minimum Requirements for the Internal Audit Function of Credit Institutions (MaIR) and Minimum Requirements for the Credit Business of Credit Institutions (MaK), updating and supplementing them in the process.

Nominal interest rate
Return of a security defined by reference to its nominal amount.

North American Free Trade Agreement (NAFTA)
North American free-trade agreement entered into between Canada, the US, and Mexico.

Option
The right to buy or sell a specific asset.

Over the counter (OTC)
Financial markets term for off-exchange trading between market participants.

Present value
The present value of a future cash flow, determined by discounting all future cash flows (inflows and outflows) to today's date.

Profit-participation certificate
Securitised profit-participation rights which may be issued by enterprises (regardless of their legal form) and listed in official (exchange) trading. Subject to certain conditions, profit-participation certificates may be eligible for inclusion in liable capital.

Public-Sector Pfandbriefe
Debt securities issued by Pfandbrief issuers (Pfandbrief banks), which are collateralised by claims against the public sector.

Rating
Risk assessment regarding a borrower (internal rating) or credit quality assessment regarding an issuer and its debt securities by a specialist rating agency (external rating).

Repurchase transaction (repo transaction)
Short-term money-market transaction collateralised by securities; in a repo, the owner of securities sells them and simultaneously agrees to repurchase the securities at a later point in time, at an agreed price.

Residential Mortgage Backed Securities (RMBS)
Bonds backed by loans collateralised against residential property.

Return on equity (RoE)
Financial indicator expressing the ratio of net income (or pre-tax profit, for example) to average equity over the period. RoE expresses the return on the capital employed by the company (and its owners/shareholders).

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

$$\text{RoE after taxes} = \frac{\text{Operating profit ./. income taxes ./. non-controlling interest income ./. AT1 coupon (net)}}{\text{Average equity (IFRS) excluding non-controlling interests, other reserves, AT1 bond, and dividends}}$$

Revaluation surplus
The revaluation surplus is used to recognise changes in the market value of securities and available-for-sale assets (and their deferred tax effects) directly in equity.

Reverse repo transaction
A repo transaction where the buyer of securities simultaneously agrees to sell the securities at a later point in time, at an agreed price.

Segment reporting
Breakdown of aggregate consolidated figures across individual segments, by type of activity (business segment) or by geographical location (region). The segment reporting permits conclusions regarding developments in the various segments, and their individual contribution to consolidated net income.

Solvency
A bank's capitalisation – literally, its ability to pay.

Swap
Generic term for contracts to exchange cash flows, such as the exchange of fixed-rate and variable-rate cash flows in the same currency (interest rate swap), or the exchange of cash flows and/or nominal amounts in different currencies (cross-currency swap).

Unwinding
The increase in a written-down receivable's present value over time, due to the fact that the receivable is being discounted at its original effective interest rate.

Value-at-risk (VaR)
Method to quantify risks: it measures the maximum potential future loss which will not be exceeded within a defined period, and given a certain probability.

Volatility
Volatility denotes the scope and intensity of fluctuations in the price of securities or currencies. Volatility is often calculated via the standard deviation of historical price data, or implied via a pricing formula. The higher the volatility, the riskier the respective investment.

Financial Calendar

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

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