LOCAL EXPERTISE
MEETS GLOBAL EXCELLENCE

2009

Aareal Bank AG – Annual Report 2009

Aareal Bank

Management Report

Business and environment

Group structure and business activities

Aareal Bank AG, whose shares are admitted to trading in the Regulated Market segment of the Frankfurt Stock Exchange and included in Deutsche Börse's mid-cap MDAX index, is the parent company of the Group. Aareal Bank Group offers financing, advisory and other services to the commercial property and institutional housing industries, and supports German and international clients as a financing partner and related service provider.

Aareal Bank is a member of the Association of German Banks (Bundesverband deutscher Banken – "BdB") and Association of German Pfandbrief Banks (Verband deutscher Pfandbriefbanken – "vdp").

Aareal Bank Group's business model is made up of two segments:

Structured Property Financing

The Structured Property Financing segment brings together all the property financing and refinancing activities.

In this segment, we are servicing domestic and international clients on their property projects in more than 25 countries. Aareal Bank is active in Europe, North America and Asia within the scope of its three-continent strategy. 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 us to offer tailor-made financing concepts that meet the special requirements of our international clients. Aareal Bank is characterised especially by its direct and long-standing relations with its clients.

Aareal Bank has established itself as an active issuer of Pfandbriefe, which account for a major share of it's long-term funding. The bank's track record as a Pfandbrief issuer is based on the combination of its sustainable business model, a deep understanding of the capital markets, and a top-quality cover assets pool. Aareal Bank also covers a wide range of refinancing tools, including promissory notes and debt securities, in order to cater for a broad investor base.

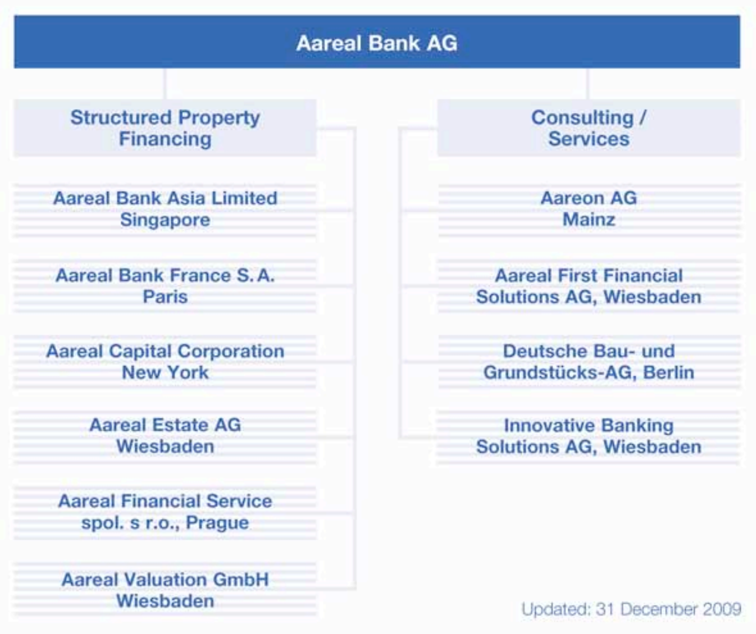
Consulting/Services

The Consulting/Services segment offers products and services for managing residential property portfolios and processing payment flows to the institutional housing industry. Within this segment, the subsidiary Aareon AG cooperates closely with the Institutional Housing Unit of the bank.

We operate the IT systems consultancy and related advisory services for the institutional housing industry through Aareon AG, which can boast more than 50 years experience. Aareon pursues a multi-product strategy that covers the requirements of all customer groups. The ERP product portfolio for efficient process structure comprises SAP-based solutions such as Blue Eagle, Wodis with the new Wodis Sigma product generation, as well as the established GES and WohnData solutions. This product range is combined with extensive advisory and integrated services, which support the networking of property companies and their business partners.

Through its Institutional Housing Unit, Aareal Bank operates automated mass payments systems for its institutional housing clients, which are integrated in their administrative processes. The settlement of payment transactions via Aareal Bank generates client deposits that contribute to the refinancing mix of the entire Group.

Group structure of Aareal Bank



Corporate management

Aareal Bank Group's management concept is focused on sustained company development. The standard is to create added value for our shareholders, clients and staff. The balanced orientation of our company management has paid off, especially against the background of the crisis affecting financial markets.

Aareal Bank Group is managed using indicator-based management tools that we have differentiated and structured specifically by segment.

In addition to the earnings and productivity management tools, and the risk management system described in the risk report, we also use capitalisation and profitability in particular as key indicators across the Group.

Our comprehensive risk management system is particularly important to company management. The specific tools used for this purpose are described in the Risk Report (starting on page 18).

Aareal Bank Group manages all Group entities (and their individual market price risk exposures) centrally. State-of-the-art methods are deployed to collate all information that is relevant for managing the Group, and to analyse such information in order to develop appropriate risk mitigation strategies. We also employ preview models for the balance sheet structure, liquidity and portfolio developments for strategic business and profit planning.

In addition to the business-related management tools, we also use additional instruments to optimise our organisation and processes. These include for example, a comprehensive cost management system, central management of project activities as well as personnel controlling.

Additional management tools and indicators are also used in the Structured Property Financing segment. Amongst other things, we use lending policies to manage the new lending business in this segment. These are lending standards applicable to specific products, property types and countries, whose compliance is monitored consistently within the scope of the lending process.

The property financing portfolio in its entirety is actively managed within Aareal Bank Group with the objective of optimising risk diversifications and profitability. In order to develop risk and return-oriented strategies for our portfolio, we evaluate market and business data, simulating appropriate strategies for our lending business and identifying a target on-balance sheet portfolio that is the object of Group planning. This facilitates early identification of market changes and allows us to react by taking adequate measures. Active portfolio management also ensures that we allocate our equity optimally to what are the most attractive products and regions from a risk/return perspective within the scope of our three-continent strategy. We observe maximum portfolio shares for individual countries, products and property types, thus guaranteeing a high degree of diversity within the portfolio, and avoiding risk concentrations.

Macroeconomic and industry-specific environment

Global business environment

At the beginning of the year, the global economic environment was defined by the relentless financial markets crisis and a sharp economic downturn. Although the financial markets stabilised significantly during the course of the year, the situation did not fully return to normal. The real economy also stabilised, showing initial signs of a recovery – albeit from very low levels indeed. Economic performance was clearly down year-on-year.

Financial markets crisis

The severe turmoil on financial markets, which were exacerbated again in September 2008 by the insolvency of the US investment bank Lehman Brothers, continued into 2009. Activities on the interbank markets came to a standstill due to the massive loss of confidence amongst banks, and risk premiums remained very high. Securitisation markets, which represented an important refinancing source for the banks before the financial markets crisis, remained virtually illiquid. The central banks reacted to the liquidity squeeze on the refinancing markets back in 2008, by providing the commercial banks with considerable amounts of liquidity. They continued to do so during 2009. Likewise, government support for the financial markets – and, by implication, for the economy at large – continued in many countries. At the start of the year in particular, many banks in the various countries utilised state support (in the form of recapitalisation or government guarantees) for new issues, or further increased the support measures.

So-called ”bad bank” schemes were created as another tool to combat the crisis affecting financial markets. In Germany, the legislator created the opportunity for banks to place non-performing assets with special purpose vehicles, the so-called ”bad banks”, at a haircut on the carrying amount. In return, the banks in question receive bonds from the SPV that are guaranteed by the German Financial Markets Stabilisation Fund (Sonderfonds Finanzmarktstabilisierung – SoFFin). The transferring banks must remain liable for losses incurred on the transferred securities until maturity. Another bad bank scheme launched by the German legislator – the so-called ”consolidation model” – allows the banks to spin off additional risk positions, as well as business segments that no longer fit the strategy. Very few banks have availed of the bad bank models in Germany to date. The US treasury launched its version of the bad bank model - the Public Private Investment Program (PPIP). The US launched a variety of programmes to support financial markets during the course of the crisis affecting the economy and financial markets.

The bad bank models aim to spread the losses arising from the banks' impaired assets over several years, thus providing the banks with initial relief and an opportunity for comprehensive balance sheet adjustment and restructuring.

Tensions on the financial markets eased in the course of the year and the situation stabilised. Banks were able to successfully place government guaranteed securities in particular. As the year progressed, it was also possible for the banks to issue non-government-guaranteed securities through to equities. Investors' propensity to assume risk picked up and the risk premiums on securities declined in line with the successful placement of issues on the primary market. Only a few state support measures for banks were launched or increased in the second half of the year. Following the success enjoyed by some banks – investment banks in particular – to raise capital on the capital market through equity issues, various banks – in the US initially, followed by Europe at a later stage – repaid the capital injections received from the governments as well as state guarantee commitments.

Although financial markets eased substantially after the extreme turbulence seen at the start of the year, the situation had not yet returned to normal. Securitisation markets for example, remained virtually unreceptive towards year-end, even though initial signs of easing were also emerging here. It must also be taken into consideration that the financial markets that were furnished with liquidity through central bank measures throughout the year, continued to receive support even at year-end.

The economy

Following the sharp downturn of the global economy in the course of 2008, economic activity continued to contract massively at the start of 2009. The global economy experienced the most severe global recession since the end of the second world war, which was defined by a considerable and abrupt collapse in production and global trade, plus rising unemployment. Many governments reacted to the recession in the last quarter of 2008 already, by implementing or announcing economic recovery programmes. Further high-volume economic recovery programmes were launched or stepped up in many countries in 2009.

ifo Global Economic Climate*

Source: ifo World Economic Survey (WES) IV/2009
* Arithmetic mean of the assessment of the current situation and expected developments

Following the massive collapse of the global economy in the first quarter of 2009, the downside trend showed signs of abating in the latter part of the year. This translated into moderate economic recovery in many countries in the second half of the year. Trend barometers such as the ifo business climate index improved. Industrial orders received and production rose again, and the slump in global trading experienced a revival. However, the upside trend started from a very low level so that economic activity remained well below pre-crisis levels.

Relief on the financial markets – supported by the significant supply of liquidity provided by central banks, and their expansive monetary policy – was a key factor driving the emerging recovery. The economic recovery programmes implemented by many countries also had a significant effect. The end of the previous dramatic stock reduction in the industry, which led to a contraction in production activity, was also of great importance.

Unemployment climbed over the year as a whole in the course of the economic crisis, albeit with major regional differences. Particularly high increases were seen in the Baltic region, Spain and the US, while unemployment rates in the Netherlands remained very low. The increases were comparatively moderate in Germany and Norway.

Inflation, monetary policy, interest rates and exchange rates

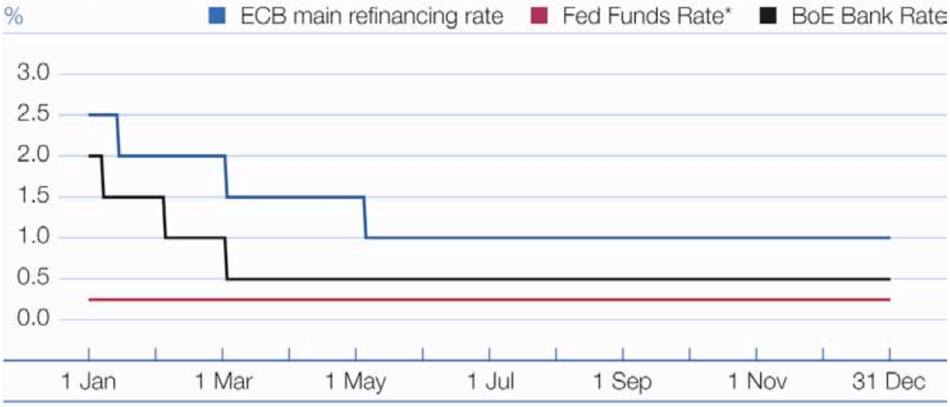
Inflation remained very low worldwide throughout the year and was even negative at times in many countries. Inflation was high in a few Eastern European countries only, such as Turkey or Romania. Low or negative inflation in part was brought about by the sharp drop in raw material prices since mid-2008, and reticent consumer demand. Inflation climbed slightly towards year-end, but remained very moderate all the same. This is primarily attributable to the fact that crude oil prices rose again.

Monetary policy was focused primarily on securing the commercial banks' refinancing capability and therefore stabilising the economic and financial system. The European Central Bank (ECB) adhered to its policy – adopted in the autumn of 2008 – of satisfying bank's liquidity requirements in full within the scope of fixed-rate repurchase transactions. At the end of June 2009, it extended the term for these refinancing operations from six to twelve months. The ECB also provided liquidity denominated in foreign currencies. Other central banks also increased the provision of liquidity to the commercial banks in the year under review. In order to expand the provision of liquidity further, the US Federal Reserve (Fed) and the Bank of England (BoE) also employed the expansive open market policy tool. Programmes to purchase securities from the commercial banks were set up within the scope of this tool. From July 2009 onwards, the ECB also began buying covered securities, albeit to a comparatively limited extent.

Given the low or even negative inflation in part, the central banks cut benchmark rates in order to stimulate the economy. The ECB cut its benchmark rate in several steps, from 2.5% at the start of the year to 1.0% in May, while the BoE cut its key rate from 2.0% at the start of the year to 0.5% in March. Thereafter, ECB and BoE benchmark rates remained unchanged during the remainder of 2009. The US Fed had already cut its key rate in December 2008 to a corridor of 0.0% to 0.25%, which remained unchanged last year. Other central banks around the world also cut their key rates. Very few central banks, such as in Australia and Norway, hiked their key rates again in the second half of the year, having cut them previously. As a consequence of the policy of low headline rates, short-term euro, pound sterling and US dollar interest rates fell significantly during the course of the year. Developments at the long end were less uniform. Long-term pound sterling and US$ interest rates rose, while euro rates at year-end were almost unchanged compared with the start of the year.

The annual growth rates of the M2 and M3 money supply aggregates in euro fell continuously during 2009. This is probably attributable, on the one hand, to statistical basis effects in conjunction with the heightened financial markets crisis in autumn 2008. On the other hand, the steep yield curve represented an incentive to transfer funds into longer-term investments and securities. As the crisis affecting financial markets intensified in autumn 2008, central bank balance sheets expanded sharply, reflecting their efforts to furnish the markets with liquidity. This trend did not persist further in 2009. Total assets in the Eurosystem (which comprises the ECB and all national central banks participating in the euro) fell, while remaining virtually constant in the Federal Reserve System in the USA.

Key interest rates 2009

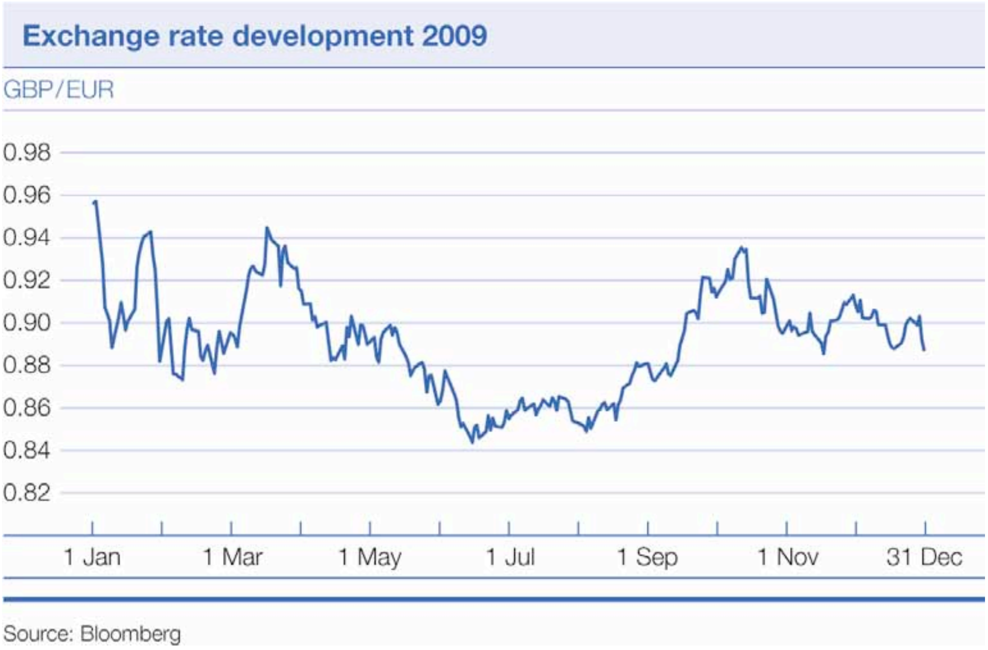


*The upper level of the corridor for the Fed Funds rate was set at 0.0 to 0.25 %.
Sources: ECB, Fed, BoE

The euro depreciated sharply against the US dollar from the start of the year into March. This was followed by a long period of euro appreciation, until the euro depreciated again until the beginning of December. At year-end, the euro/US dollar exchange rate was slightly higher than at the start of the year. The performance of the euro relative to pound sterling was more volatile. Following strong fluctuations at the beginning of the year, the euro weakened against pound sterling. Having reached its low in early summer, the exchange rate rose again before falling again somewhat as of mid-October. At year-end, the euro/pound sterling exchange rate was lower than at the start of the year.

Exchange rate development 2009

Source: Bloomberg



Global commercial property markets

The global crisis affecting financial markets and the economy also had an impact on the performance of commercial property markets.

As a consequence of the recession, rents worldwide were under pressure across all types of commercial property. At the same time, greater incentives for tenants for example, in the form of rent-free periods or tenants' improvements at the landlords' expense resulted in lower returns on the properties. In the course of the economic downturn, which led to a reluctant stance with regard to travel as well as cost savings on business travel, earnings from hotels also fell. Variable rents that are dependant on sales revenue or rental shares of retail properties were also affected by hesitant consumption.

The return requirements of commercial property investors were unchanged from the previous year and continued to rise. However, this trend came to an end in many places as of the middle of the year and yields stabilised. In fact, yields on first-rate properties fell in some markets, such as the commercial property markets in economic centres in the UK, although they remained higher than before the outbreak of the crisis. The rise in investors' return requirements at the start of the year as well as falling rents in many markets drove down commercial property prices.

2009 transaction volumes on the commercial property markets fell again substantially over the previous year in all regions. Transaction volumes in 2008 were already considerably lower than in the record years of 2006 and 2007. The virtual collapse in investment activity was due to the depressed sentiment, the general economic downturn in conjunction with the uncertainty surrounding future rental income plus the gap between the buyers' and sellers' price perceptions. While buyers waited for favourable opportunities to enter the market, many potential sellers – especially of well-rented properties – were not prepared to accept a price mark-down. This also led to a lack of adequate properties on offer. The property investment climate also improved in line with the stabilisation and cautious recovery of the global economy. This combined with the high yields should have increased the transaction volumes somewhat in the second half of the year. Nonetheless, they remained at a low level compared with the previous year and were roughly at 2003 levels. The share of investment activities in Asia and Europe increased at the expense of North America.

Economic and commercial property market development in the individual regions

Western Europe

Due to its high export share, the German economy was hit particularly hard by the severe slump in global trade. Economic output in Germany for the year as a whole fell by around 5.0%. The sharp decline occurred especially in the first quarter, while the economy stabilised as of the second quarter and picked up from a low level. The rise in unemployment in Germany was moderate compared with other European countries. Regulations governing the short-term allowance, which were utilised heavily, as well as various forms of reducing working hours played a significant role here.

Economic output in France fell by around 2.3% in the year 2009 as a whole, but revived again as of the second quarter. Economic output in Switzerland fell by around 1.7%.

The Benelux states also had to endure considerably lower economic output, which was down roughly 3.1% in Belgium, 4.0% in the Netherlands and 4.1% in Luxembourg. Unemployment in the Netherlands remained low with a comparatively moderate increase. Inflation in Europe was low. The annual rate of inflation in the euro zone was 0.9% at year-end.

The British economy was burdened by the traditionally high significance of the financial services industry to the creation of value in the UK. Gross domestic product fell by around 4.7% for the full-year 2009. Unlike most of the other Western European countries, the revival here was minimal in the second half of the year.

Developments on the markets for office property in Western Europe were defined by rising vacancy ratios and significant pressure on rents with remarkable regional differences. There was a profound drop in top rents in London, which were adversely affected by the significance of the financial services. Other British locations were also affected by pressure on rents, albeit to a lesser extent. Top office rents also fell in Brussels, Lyon and Paris. Top office rents in Luxembourg and the economic centres of the Netherlands were down slightly to stable in relative terms. Top office rents also fell in Germany in Düsseldorf, Hamburg and Munich. The fall was particularly pronounced in Berlin, while top office rents remained stable in Frankfurt. Developments in Switzerland were inconsistent. While top office rents in Geneva rose slightly, they fell in Zurich. The vacancy ratios rose across the board in the big Western European cities. They were particularly high at year-end in Great Britain's secondary districts such as Manchester and Birmingham, and particularly low on the other hand in Luxembourg or Lyon.

Top retail property rents were more stable than for office property. Once again, British locations such as the City of London or Manchester, were hit hardest by the fall in rents. By contrast, top rents in the first-class locations in Belgium, Germany, the Netherlands and Switzerland remained almost stable. The situation in France was somewhat more differentiated. Top rents for retail properties in Paris were stable, compared with a decline in Lille and Lyon. On the other hand, retail property rents in less favourable locations or of only average quality came under greater pressure. This trend also applied to logistics properties. The top rents for logistics properties remained stable in the main locations in France, Germany, Switzerland and the Netherlands – expect for Amsterdam, where top rents fell – or rose slightly as in Berlin or Rotterdam. However, top rents fell in Brussels and in British locations such as Birmingham, Edinburgh and Manchester.

The volume of new rental agreements was very low across all three property types. The determination of top rents therefore depends more on new individual rental agreements compared with times when a large number of new agreements would have been concluded, and are therefore subject to major inaccuracies.

In Western Europe, returns on hotel properties came under significant pressure owing to lower room prices and often as a result of lower booking ratios. The London hotel market was one of the few markets to feature a slight rise in booking ratios, to over 80%: occupancy levels were thus high compared with the other European capitals. The British hotel market benefited from the pound sterling, which was weaker compared with previous years. However, falling room prices also impacted on the London hotel market, with lower average returns per room. Falling booking ratios – together with lower room prices – led to a fall in the average return per room in Berlin and Munich. The average return per room in the Paris and Amsterdam hotel markets were also down as a result of falling booking ratios and room prices.

The previous year's trend of rising investment yields for the different types of property remained intact at the start of the year, therefore exercising pressure on the selling prices. Yields for first-rate commercial property stabilised or even fell somewhat in the latter half of the year in Western European countries. The decline in yields for first-rate properties was particularly pronounced on most markets in the British economic centres. Top rents for office properties in the most important locations of France and Germany were down slightly to stable. From a full-year perspective, they were unchanged in Switzerland and Belgium, while they increased slightly in the Netherlands. Yields on top rents for retail properties were down slightly on the previous year for Western European locations, such as Lyon, or rose moderately for example, in Amsterdam. On the other hand, yields on logistics properties increased almost across the board. The British locations were an exception, with falling yields.

It must be noted that these trends apply to first-rate properties. Yields on properties in peripheral locations or of weaker quality were higher, and the difference between them and first-rate properties has widened.

Southern Europe

As a consequence of the slump in the previously buoyant construction activity and the drop in residential property prices, Spain experienced a sharp drop in domestic investment and consumer demand. Gross domestic product declined by approx. 3.6%, and unemployment soared to almost 20%. In Italy, where economic growth rates were already negative the year before, gross domestic product even contracted by around 4.8%.

Top rents on the market for office property in Madrid and Barcelona fell sharply. Top rents in the Italian office property locations of Rome and Milan fell too, albeit to a lesser extent. Vacancy ratios rose in both countries. Top retail rents also fell sharply in Madrid and Barcelona, while remaining constant in Milan and Rome. Top rents for logistics properties fell in both countries. The Italian locations were also more robust here than in Spain. Lower booking ratios and room prices resulted in significant declines in the average returns per room on the hotel market in Barcelona.

The returns on investment rose in both countries, leading to price declines. However, yields increased moderately in Italy. The rise in yields was more pronounced in Spain.

Northern Europe

The decline in economic output varied greatly in Northern Europe. Norway featured the lowest decline with around 1.1%. Gross domestic product in Denmark, whose economy was already burdened by the fall in residential property prices last year, fell by around 4.8%. The decline in Sweden was around 4.3% and roughly 7.6% in Finland. Similar to Germany, Finland was also burdened by the sharp collapse in global trading, which led to a significant decline in Finish exports.

Following a considerable increase in top rents for office property in Oslo in recent years, these fell substantially in 2009. Top office rents in Copenhagen, Helsinki, Stockholm and Gothenburg were also down, albeit to a lesser extent. Top rents for retail property in Oslo posted the greatest decline. Top rents in the retail segment were also down in Copenhagen, compared with Stockholm and Helsinki, where they remained constant. Top rents for logistics properties also posted a decline. This was particularly relevant to Helsinki and Oslo, followed by Copenhagen, while top rents in Stockholm were virtually unchanged.

The returns on investment on Northern European commercial property markets rose initially. They stabilised in the course of the year, as in other countries. Falling yields were reported for top-quality properties on the retail market in Oslo, while they remained virtually unchanged or rose on the other important Northern European commercial property markets.

Central and Eastern European Countries (CEE)

Economic development varied greatly in Central and Eastern Europe. Poland was the only European country to have recorded positive economic growth (around 1.5%) last year. Economic output in the Czech Republic and Slovakia contracted by around 4.0% and 5.1% respectively, and by more than 7% in Romania. After the high growth rates of previous years, domestic investment and consumer demand in Russia fell significantly and economic output shrank by around 8.8%. The Russian economy stabilised as of the second half of the year, though at a low level. The economy slumped quite severely in the Baltic region, with falling gross domestic products of around 14.5% in Estonia, 17.7% in Latvia and 15.2% in Lithuania. Turkey had negative economic growth of around 5.9%.

Having risen sharply in recent years, top office rents in Moscow collapsed during 2009. Top office rents also fell quite considerably in Warsaw, too. Even though the fall in rents was less pronounced in Bucharest, Prague and Istanbul, it was still considerable. The vacancy ratios increased in all locations. The highest vacancy ratio was recorded in Moscow at around 20%, and the lowest in Warsaw at just over 7%.

A very significant drop in top rents for retail property was recorded in Bucharest, Warsaw and Moscow. The decline in top rents for retail properties was comparatively moderate in Prague. Numerous landlords and tenants of shopping centres in Turkey agreed to set binding currency translation prices for rents, owing to the temporary depreciation of the Turkish lira. Although the rents are payable in the local currency, they are often oriented on a euro- or US dollar-denominated value. This had resulted in a significant haircut on rental income denominated in euro or US dollar, even though the actual rental contracts were not reduced in the local currency.

Top rents for logistics properties in the various Central and Eastern European locations fell, too. Moscow recorded the greatest decline. The logistics market is not yet as well-developed in Turkey. Declines in top rents were also reported here for 2009. In the hotel sector, the average return per room contracted significantly in Moscow and Prague. The decline was not as great in Warsaw.

Investment yields rose in Central and Eastern European locations, as the situation stabilised in the second half of the year. The most significant increases were in Moscow and Bucharest, which also recorded the highest yields, followed by Istanbul. The rise in yields as well as their level was less marked in Prague and Warsaw. The rise in yields at the start of the year in conjunction with the falling rents led to significant downside pressure on the prices.

North America (NAFTA states)

The sharp downtrend in the US economy from the end of the previous year persisted into the start of 2009. The revival during the course of the year started from a low level. Economic output fell by around 2.5% for the year as a whole. The massive economic recovery programme of some US$ 787 billion that was passed in February 2009 contributed to the revival. This together with tax shortfalls as a consequence of the economic crisis drove up the budget deficit. Unemployment continued to rise from last year and at around 10%, reached the highest level of the last 25 years. Consumer prices in the USA fell at times during the year under review, but rose year-on-year in the last two months.

The Canadian and Mexican economies are closely linked to that of the USA. Economic output in Canada contracted by around 2.5%, while Mexico, where the economy was also adversely affected by the spread of 'swine flu', suffered a decline of around 6.8%.

The economic crisis also impacted on North America's market for office property. The number of new rentals fell as well as rents themselves, while the vacancy ratios rose. It is striking that the national average for vacancy ratios in the US were considerably higher than in Canada. Office vacancy ratios in the USA were particularly high in Detroit, New Jersey and Dallas. They were comparatively low in New York, even though they had risen quite substantially there too. Office rents fell in almost all leading locations of the USA and Canada. Besides the decline in contract rents, tenant incentives, for example in the form of rent free periods, played an ever-growing role. This resulted in the additional effect of falling real rents. Retail property rents in the USA also fell, while the average vacancy ratio increased. Falling rental income and rising vacancy ratios were also evident in logistics properties in the USA.

On a nationwide average, booking ratios and room prices in the American and Canadian hotel market decreased, leading to considerable discounts on the return per room. Concerns about ”swine flu” in Mexico drove down the average return per room significantly.

The volume of commercial property transactions collapsed in North America. The price perceptions of potential buyers and sellers were poles apart here too. As investors' yield expectations went up, rental income dropped – combined with a lack of transaction activity, this led to a marked decline in prices.

Asia/Pacific

The Asian economic area was sucked into the global recession in the second half of 2008 and the start of 2009, especially as a result of the collapse in global trade. The East Asian economies recovered earlier and to a greater extent than other regions. The development was driven by China, with economic growth on around 8.7% that almost reached the previous year's level. The driving forces were China's expansive fiscal and monetary policy, together with the increasingly important domestic demand. Another factor that had a positive impact on the entire region is that the banks in East Asia were affected by the financial markets crisis to a much lesser extent than their North American and European peers. Singapore's economy benefited from the momentum generated by the Chinese economy. A strong recovery followed the sharp downturn at the start of the year, so that economic output fell by around 2.1% for the year as a whole. Although gross domestic product in Japan shrank by around 5.3%, a revival was also evident here during the course of the year. China and Japan's annual average inflation rate was negative, while average annual inflation in Singapore remained almost constant.

Rents for top class offices in China's most important and heavily populated cities – Shanghai and Beijing – fell in the course of the year. Top rents for offices slumped in Singapore. However, the first signs of stability were evident in individual first-rate locations towards the end of the year. Top rents also fell significantly on the Tokyo office property market. The fall in rents was accompanied by rising vacancies. The highest vacancy ratios were in China, with values of more than 20% in Beijing and around 15% in Shanghai. The office property markets in Singapore and Tokyo featured considerably lower vacancy ratios of over 4% and 5% respectively – albeit rising, too. Rents for retail properties fell in Tokyo, Singapore, Beijing and Shanghai, whereby an upward trend in top rents was evident again in Shanghai in the second half of the year and in Singapore in the last quarter. The logistics market in East Asia was unable to escape the general trend of falling rents. Rents fell in all of the four observed locations of Tokyo, Singapore, Shanghai and Beijing in the course of the year.

As a consequence of the economic crisis, booking ratios and the average return per room were down in the East Asian hotel markets as well. Tokyo was the only significant East Asian hotel market to buck the general trend and show a positive performance and a rise in the average return per room. By contrast, the decline in the average return per room in Beijing was very substantial. However, it must be taken into account that the Beijing hotel market benefited from the Olympic Games the year before.

In Asia, transaction volumes for commercial property was very high compared with other regions and a clear uptrend was evident early on. The marked price decline at the start of the year as a consequence of falling rents and higher return requirements was followed by improved prices and lower return requirements in the latter part of the year. The opportunities created for Chinese insurers to invest in commercial property as of October 2009 is interesting in relation to future investment demand. This was not permissible to date.

Summary

Aareal Bank AG integrated its property financing and refinancing activities in the Structured Property Financing segment. As in previous years, we have reacted to the developments outlined in the previous section with early, intensive monitoring, close client and property management, as well as implementing measures for minimising any losses. The success of these measures in the financial year under review as well as in previous years is reflected in our appropriate allowance for credit losses, which was within our target corridor forecasted for 2009.

Results of operations

Aareal Bank AG boosted its operating profit after loan loss provisions by 24%, to € 52 million (2008: € 42 million) for the 2009 financial year – which, like 2008, was characterised by the ongoing financial markets crisis.

The aggregate of net interest income and net commission income amounted to € 398 million. Whilst interest income from lending and money market transactions declined by € 432 million, interest income from securities increased by € 25 million. Interest expenses were down by € 348 million. The € 28 million year-on-year decline in net commission income was primarily due to expenses (comprising commitment and guarantee fees) for the support provided by the German Financial Markets Stabilisation Fund (SoFFin).

The net trading result was positive, at € 2 million. The previous year's negative balance of € 48 million reflected the valuation of securities in the trading portfolio, in a market environment burdened by the financial markets crisis.

Administrative expenses (including depreciation and amortisation of intangible and tangible fixed assets), which had already been reduced by € 10 million to € 230 million during the previous year, were reduced by a further € 6 million, to € 224 million for the financial year under review, reflecting strict cost discipline. Personnel expenses accounted for € 4 million of the reduction in expenses, with the remaining € 2 million attributable to other administrative expenses.

Net operating income and expenses amounted to € 1 million, down € 19 million year-on-year. The net figure includes € 6 million in project expenditure for utilising capitalisation support from SoFFin. The previous year's figure of € 20 million was dominated by payments received from Deutsche Interhotel GmbH & Co. KG, and by income from interest on tax back-payments pursuant to section 233a of the German Tax Code.

The balance of provisions for loan losses and the result from securities held as liquidity reserve was -€ 125 million (2008: -€ 202 million). This figure includes expenditure for specific and general loan loss provisions. Securities held as liquidity reserve were revalued strictly at the lower of cost or market; the item also includes gains and losses realised on this portfolio.

Net other income and expenses of –€ 20.7 million comprised essentially the € 22 million (2008: € 72 million) transfer to reserves pursuant to section 340g of the German Commercial Code (Handelsgesetzbuch – "HGB"). In addition to results contributed by subsidiaries, and the valuation of those subsidiaries, this item also includes results from investment securities.

Taking into account a tax liability of € 29 million (2008: tax refund claim of € 22 million), the bank posted net income of € 2 million (2008: € 4 million).

Net assets and financial position

Net assets

Net assets are dominated by property financing business and securities investments. As at 31 December 2009, the securities portfolio amounted to € 14.0 billion, invested in a high-quality portfolio of securities, predominantly comprising public-sector issues, as well as covered bonds and bank bonds. A minor part of Aareal Bank's portfolio (with a nominal value of less than € 600 million) is invested in a primarily European ABS portfolio. Assets are financed by deposits from the institutional housing industry, from institutional money-market investors, unsecured issues, promissory note loans and Pfandbrief issues.

During the first quarter of 2009, the bank reclassified securities (particularly public-sector issues, as well as bank bonds) with an aggregate nominal value of € 3.8 billion to the investment portfolio, due to its intention to hold these securities for a longer term.

Aareal Bank AG's total assets as at 31 December 2009 amounted to € 41.7 billion, after € 42.5 billion as at 31 December 2008.

Property financing portfolio

Portfolio structure

As at 31 December 2009, the property financing portfolio totalled € 20.2 billion (previous year-end: € 20.8 billion).

The regional allocation of the portfolio by region and continent only changed slightly in 2009 compared with the previous year-end. There was a small drop in the proportion of the portfolio held in Germany.

The allocation of the portfolio by property type remained more or less unchanged during the year under review.

Portfolio development

The following factors dominated the performance of the property financing portfolio during the reporting year.

Repayments include all types of scheduled and unscheduled principal payments by customers. There was a significant fall in repayments to the property finance portfolio in 2009 compared with the previous year.

This development can be attributed to the sharp fall in investment activity on the property markets. Moreover, Aareal Bank AG also adopted a selective approach to new business in 2009, continuing to focus on existing customers. As a result, there was a considerable increase in the loan extension rate among existing clients, as well as a clear fall in unscheduled repayments over the course of 2009.

A portion of the property financing portfolio is denominated in foreign currencies. Consequently, fluctuating exchange rates impact on the value of the portfolio in euros. The portfolio volume was affected by significant fluctuations in some exchange rates against the euro during 2009, in particular the US dollar, the Canadian dollar and pound sterling. The year-end euro exchange rate against the US dollar was slightly higher than at the beginning of the year, which had a slightly negative impact on the portfolio volume.

The portfolio of loans included in mortgage cover continued to rise during the year under review. As at 31 December 2008 it totalled € 7.5 billion. By 31 December 2009, this figure had risen by around € 700 million to € 8.2 billion, which is a rise of roughly 9%. On this basis Aareal Bank can further consolidate its position as a major Pfandbrief issuer and is increasing Pfandbrief refinancing as a proportion of total long-term funding.

The secondary market – the market for the syndication and securitisation of commercial property finance – remained difficult during the past financial year due to the ongoing financial markets crisis and resulting reticence on the part of market participants. As a result, only a small number of new syndications was implemented through our international network of partner banks in the 2009 reporting period (2008: € 0.5 billion). As was also the case with regard to lending business, secondary market activities were focused on extending loan arrangements and looking after existing syndication transactions.

No securitisations were carried out during the reporting period.

Financial position

Customer deposits

As part of our activities on the money market, we generate deposits from institutional housing industry clients, and from institutional investors. Deposits from the institutional housing industry were largely stable during the reporting period, amounting to € 3.8 billion as at 31 December 2009. Deposits from institutional investors increased over the same period, totalling € 4.3 billion as at 31 December 2009.

Long-term funding

Funding structure

Aareal Bank Group's funding is solid, as proven 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, including subordinated liabilities, profit-participation certificates and silent participations. As at 31 December 2009, the long-term refinancing portfolio amounted to € 24.0 billion. Mortgage bonds accounted for € 5.9 billion and public-sector covered bonds for € 2.8 billion, whilst € 15.3 billion was made up of long-term unsecured and subordinated bonds and registered securities.

Overall, there was a renewed increase in Pfandbriefe as a proportion of total refinancing in 2009 compared with the previous year.

Capital market refinancing mix as at 31 December 2009

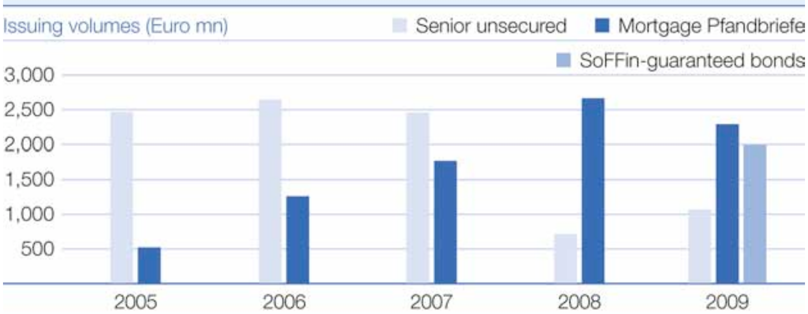
Refinancing activities

At the beginning of 2009 the capital market was dominated by the emergence of state-guaranteed bonds, with which issuers were able to respond to investors' heightened demands for security. Aareal Bank also made use of this new product, thereby extending its refinancing options.

Aareal Bank availed itself in February 2009 of the German government's programme to strengthen the banking sector as a means of securing the long-term future of its sustainable business model. This package of measures included a guarantee facility from SoFFin with a total volume of up to € 4 billion for new, unsecured issues. In March 2009 Aareal Bank made use of half of this guarantee facility, successfully placing a state-backed 3-year benchmark bond with a volume of € 2 billion among German and international investors.

During the reporting period a comparatively high volume of long-term refinancing was taken up on the capital market, at around € 5.4 billion in total. The issue volume of long-term unsecured funding, including the state-backed bond, was € 3.1 billion. The remaining € 2.3 billion related to Pfandbriefe, which represented around 43% of the new issues. This highlights the growing importance of the Pfandbrief as an integral part of Aareal Bank's refinancing mix.

Issuance – 2005 to 2009



Of the many both publicly and privately placed issues, the two € 500 million benchmark mortgage bonds with terms of three and five years respectively merit particular mention. Once again, in a year dominated by turbulence on the financial markets, the Pfandbrief proved its worth as a guarantor of security. Given their quality, the strict statutory rules that govern them, and their successful history on the capital market, Pfandbriefe represent a reliable source of funding and enable the banks issuing them to acquire long-term refinancing, even during periods when investors are clamouring for security. This gives Aareal Bank a clear advantage in terms of our refinancing. Pfandbriefe will continue to play a central role in Aareal Bank’s funding mix. Alongside Pfandbriefe, the bank was also able to issue unsecured loans to a greater extent during the final quarter of the year, reflecting investors' growing confidence in Aareal Bank.

Impact of the financial markets and economic crisis

The real economy was hit by a severe economic downturn and clear fall in global activity in early 2009. Whilst there were signs of a recovery later in the year, this was from a very low starting position. These trends were of varying intensity in the different regions of the world. The economy clearly picked up speed in East Asia – with the exception of Japan – and most particularly in China and Singapore. Meanwhile, the recovery progressed at a more gentle pace in Europe and North America, although again there were regional differences. Germany, for example, experienced signs of a slight recovery somewhat earlier, whilst Spain and the Baltic states were left waiting.

During the first half of the year the financial markets were entirely dominated by the crisis. Subsequently, however, there was a tangible improvement. On the property markets, in contrast, the situation remained tense throughout the entire year. It became very obvious that developments in the economy can take some time to filter through onto the property markets. Rents and prices came under pressure in 2009, despite the fact that the returns being sought by investors stabilised on many markets over the course of the year. On some markets they actually fell again during the second six months. These included the markets for first-rate commercial properties in the UK, which had previously featured a clear rise in returns, and the markets for top office and retail space in Paris. Movements in rent levels also differed by region. Moscow rents, for example, fell strongly, whilst levels proved more stable in German and Dutch economic centres.

The financial and economic crisis had a major impact on our business activities over the past year.

Aareal Bank duly continued to adhere to its risk-aware approach to lending, whilst also continuing to intensively monitor and actively manage its credit risks. In terms of new business, the bank focused on its existing client base, and on loan renewals. Latterly, it was also able to work together with its clients to take advantage of opportunities as they have arisen. The fact that new business has fallen from € 5.5 billion in 2008 to € 3.8 billion in 2009 is a reflection of Aareal Bank's willingness to support its existing clients and, at the same time, of the major collapse in transaction volumes on the commercial property markets. We regard our new business figures as a reasonable performance in the face of difficult overall conditions.

Developments on the capital markets, particularly at the beginning of the first half of the year, led to price falls in our securities portfolio despite the issuers' high credit ratings, though most of these falls had been made up again by the end of the year.

Our strategy of reducing risk in relation to the investment of equity, a strategy which we introduced in 2008, was consistently maintained in 2009. Equity investments held through funds have now been completely eliminated, and investments in fund units have also been further reduced.

Looking at the money market, Aareal Bank's deposit-taking business returned to normal as the year progressed. Deposits from institutional investors rose from just under € 3.6 billion at the start of the year to as high as € 6.3 billion in July 2009. As at 31 December 2009, deposits from institutional investors totalled € 4.5 billion and were thus considerably up on the previous year. Whilst short-term deposits benefited from clients returning at the beginning of the year, a lengthening in the average terms has also been in evidence since the start of the second quarter.

The volume of deposits from the institutional housing industry remained virtually stable throughout the year, and averaged at around € 4.0 billion in the 2009 financial year.

As a result of 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. Limited by developments on the financial markets, which have to a certain degree made it more difficult to access the relevant markets, we have also had to put up with additional costs. Despite a certain easing of the situation in the final quarter, premiums are still required on some currencies (e.g. USD, GBP) on the foreign-currency derivative market.

The stable Consulting/Services segment was also unable to completely escape the effects of the financial and economic crisis. The low interest rate environment, which is very unfavourable in terms of income earned from deposits in the housing sector, had a negative impact. However, the portfolio of deposits from the Institutional Housing segment remained stable. Additionally, there was a certain level of reticence towards large-scale new investments among some of Aareon's client segments.

To ensure the long-term success of its sustainable business over the long term and, at the same time, to overcome the very difficult market situation, Aareal Bank Group and the German Financial Markets Stabilisation Fund (SoFFin) entered into an agreement on 15 February 2009 whereby SoFFin provided Aareal Bank with a perpetual silent participation of € 525 million, as well as providing a guarantee facility for new unsecured issues with a total volume of up to € 4 billion. The bank pays a commitment fee of 0.1% p.a. on the undrawn portion of the guarantee facility. A fee of 0.5% is calculated for the issue of guaranteed bonds with a term of up to 12 months. The fee for terms of more than one year is around 0.95% p.a. In March 2009 we made use of the SoFFin guarantee framework and successfully placed a state-backed bond with a volume of € 2 billion on the capital market. The term of the as yet unused portion of the guarantee in the amount of € 2 billion has been extended to the end of 2010.

Regulatory indicators

Aareal Bank has exercised the option pursuant to section 2a (6) of the German Banking Act (Kreditwesengesetz – "KWG") to determine regulatory indicators at Group level only since 2007. Aareal Bank Group’s Tier 1 ratio as at 31 December 2009 was 11.0% in accordance with the KWG (Credit Risk Standard Approach).

Risk Report

Risk management at Aareal Bank AG

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 crucial for a bank's sustainable commercial success. Besides this purely economic motivation for a state-of-the-art risk management system, there are extensive regulatory requirements. It was against this background that we continued to develop our risk management system, allocating significant resources, during the financial year under review.

Risk management – scope of application and areas of responsibility

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

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

Type of risk		Risk management	Risk monitoring
Market price risks		Treasury, Dispo Committee	Risk Controlling
Liquidity risks		Treasury	Risk Controlling
Credit risks	Property Finance Single exposures	Credit Business Market, Credit Management	Risk Contolling, Credit Management
Credit risks	Property Finance Portfolio risks	Credit Management, Credit Portfolio Management	Risk Controlling
Credit risks	Treasury business	Treasury, Counterparty and Country Limit Committee	Risk Controlling
Credit risks	Country risks	Treasury, Credit Management, Counter-party and Country Limit Committee	Risk Controlling
Operational risks		Process owners	Risk Controlling
Process-independent monitoring: Audit			

Strategies available

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

Risk-bearing capacity and risk limits

The bank's ability to carry and sustain risk – which is defined by the amount of aggregate risk cover – is a core determining factor governing the structure of its risk management system. Aggregate risk cover is defined as the Tier 1 capital less any negative mark-to-market effects in the securities portfolio, plus the budgeted net income before taxes. The calculation does not include additional funds such as supplementary and subordinated capital. The aggregate risk cover is updated at least once a year, and additionally in the event of significant changes occurring (such as a capital increase, or a change in earnings projections). We have thus implemented a system based upon limits defined in a conservative manner, and differentiated according to the type of risk. The aggregation of individual limits is based on the assumption that no risk-mitigating correlation effects exist amongst different types of risk. The utilisation of individual limits for key types of risk as well as the overall limit utilisation is reported to the Management Board on a monthly basis.

We also maintain a significant part of our aggregate risk cover as a risk cushion, which is not applied to risk limits, and is thus available for risk types that cannot be quantified (for example, reputational or strategic risks). Overall, aggregate risk cover and risk limits are harmonised to ensure Aareal Bank AG's ability to bear risk at any time, based on the going concern assumption – even against the background of market distortions as a result of the financial markets crisis during the financial year under review. No breach of set limits occurred during the 2009 financial year.

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

Implementation of amendments to the Minimum Requirements for Risk Management in Banks ("MaRisk")

The German Federal Financial Supervisory Authority ("BaFin") published an amended version of its Minimum Requirements for Risk Management ("MARisk") in a circular published on 14 August 2009. Our approach to managing the bank's business has focused on continuously optimising our risk management system for many years. Hence, when implementing the new MaRisk requirements, we could afford to concentrate on the targeted refinement of our existing risk management system. The key aspects of this implementation are summarised below.

Risk concentrations

The structure and design of our risk management system have focused on identifying, monitoring and managing risk concentrations from the very beginning. Hence, we have been assessing risk concentrations both on a qualitative and quantitative level for many years.

Looking at counterparty risk, this includes regular checks of the largest borrower units in our portfolio, and analysing the portfolio according to various factors such as countries, risk classes and types of collateral. The bank uses the credit risk models deployed to conduct a model-based analysis of risk concentrations, and for monitoring them. In terms of market price risks, we monitor and manage risk concentrations particularly with respect to relevant risk factors (interest rate risks, currency risks, etc.) and products. In the context of liquidity risks, the analysis focuses on liquidity providers, the instruments used to raise liquidity, and on any concentrations of liquidity needs which may arise over time. Risk concentrations in terms of operational risk are monitored and managed by way of regular risk inventories.

Against this background, when implementing the requirements of MaRisk (as amended), we concentrated particularly on further refining our existing risk management tools. For instance, in the property finance business we implemented a ”traffic light” system supplementing the existing toolbox for assessing risk concentrations in particular market segments or regarding individual product groups. In addition, we refined our credit risk reporting system, to include a presentation of risk concentrations which is used for the purposes of quarterly reporting of concentration risks to the Management Board.

Risk concentrations involving multiple types of risk are incorporated through global scenario analyses, as described below.

Stress tests

The amended MaRisk require that stress tests be carried out for all material risks, based on validated historical data as well as using hypothetical scenarios. With this in mind, we supplemented our existing, extensive stress tests by adding additional scenarios. To be able to assess cross-relationships between various types of risk as well, we further developed stress scenarios involving multiple risk types, within the scope of so-called global stress tests. The historical scenario used for this purpose analyses the impact of the financial markets crisis on various types of risk, as well as on overall risk exposure. We implemented a deterioration of the financial markets crisis as a hypothetical scenario. The stress testing methodology implemented also considers the effects of potential risk concentrations.

We determine the aggregate risk cover available in a stress situation within the framework of the risk-bearing capacity analysis. By comparing the results of stress scenarios to this aggregate risk cover, we can assess Aareal Bank AGs risk-bearing capacity in a stress scenario. The Management Board is notified of the results of these stress analyses within the scope of the regular quarterly reporting package.

Further adjustments

Over and above the refinements described above, we carried out various adjustments and additions to our risk management system. These changes (which were mostly small in scope) included the further development of procedures to ensure intraday liquidity, or additions to trade settlement business processes.

Organisational structure and workflows

Lending business

Division of functions and voting

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

Processes in the credit business are designed to consistently respect the clear functional division of Sales units and Credit Management, 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 by Credit Management. The bank's Assignment of Approval 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 Counterparty and Country Limit Committee (CCC), which consists of executives from non-Sales units is responsible for the Credit Management vote regarding the approval of counterparty, issuer, or country limits.

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

Process requirements

The credit process comprises several phases: specifically, these include credit approval, further processing, and monitoring of loan processing. Credit exposures subject to increased risks involve supplementary processes for intensified handling, the handling of problem loans, and – if necessary – for provisioning/impairment. The corresponding processing principles are laid down in the bank's standardised rules and regulations.

Important factors determining the counterparty 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 significantly shortened. Furthermore, the risk assessment results are taken into account for pricing purposes.

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) throughout the credit term, assessing quantitative and qualitative factors, using 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 risk is assessed at least once a year.

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 risk prevention, restructuring, and recovery units.

Risk classification procedures

Aareal Bank AG employs various risk classification procedures for the initial, regular, or event-driven assessment of counterparty risk. The rating scales and exposure definitions have been customised to match the respective methods. Responsibility for development, quality assurance, and monitoring implementation of risk classification procedures, is outside the sales units. Those units are also responsible for the annual validation of risk classification procedures.

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

The bank employs a two-level risk classification procedure for large-sized commercial property financing 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 rating 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), through an assessment of collateral provided for the relevant financing. The bank's maximum risk exposure (plus a cushion for potential fees and charges incurred) is determined for this purpose: expected proceeds from the realisation of collateral, and from uncollateralised residual receivables, are deducted from this exposure at default (EaD). When evaluating collateral, haircuts are applied or recovery rates are 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.

Aareal Bank AG classifies the risk exposure to banks, financial services providers, securities firms, development banks and insurance companies using its internal rating procedure for financial institutions. This classification is based on qualitative and quantitative aspects, also taking into account clients' group affiliation. Financial institutions are assigned to a specific rating grade by way of assessing relevant financial indicators and taking into account expert knowledge.

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

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

Trading activities

Division of functions

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 Treasury and Credit Treasury, whilst Credit Management tasks are carried out by the independent divisions of Operations and Risk Controlling. Beyond this Finance and Audit are responsible for tasks not directly related to processes.

We have laid down organisational guidelines providing for binding definitions of roles and responsibilities along the entire processing chain; these are adapted to prevailing circumstances without delay.

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.

Within the scope of trading activities, Credit Treasury is responsible for entering into credit derivatives on the bank's behalf, in individual cases requiring specific approval in each case.

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 documentation/master agreements.

To assess counterparty 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 bank has also established a Counterparty and Country Limit Committee that votes on all limit applications, and is responsible for conducting the annual review of limits. Where required by current developments, the Committee may reduce or revoke counterparty or issuer limits.

The tasks of the Risk Controlling unit comprise identifying, quantifying and monitoring market price, liquidity and counterparty risk exposure from trading activities, and for 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 AG'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 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 Counterparty and Country Limit Committee will coordinate an action plan in cooperation with the bank's divisions involved.

As part of the limit monitoring process, the Management Board and Treasury are notified of limits and their current usage on a daily basis. Clearly-defined 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 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 risk. Counterparty 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 risk.

Credit risk strategy

Based on the bank's overall business strategy, Aareal Bank AG's credit risk strategy sets out all material aspects of Aareal Bank AG’s credit risk management and policies. Proposals for the credit risk strategy are prepared jointly by Sales units and Credit Management, and adopted by the entire Management Board and the Supervisory Board. The credit risk strategy will be reviewed, at least once a year, as to its suitability regarding the bank’s risk-bearing capacity and its business environment; amendments will be made as necessary. This process is instigated by management, and implemented by Sales units and Credit Management, who submit a proposal (on which they have 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, containing general guidelines, plus individual sub-strategies (lending policies) defining the type of new business the bank wishes to generate, with respect to various markets and types of business. Given the hierarchical structure of the credit risk strategy, the Group credit risk strategy overrides individual sub-strategies.

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 financing exposures, and of business with financial institutions. The models permit to identify, measure, monitor and manage risks at a portfolio level. The stress tests conducted on the basis of these models were expanded during the financial year under review, by including a scenario involving increased default correlations in the property financing business.

In addition, the bank uses specific tools to monitor individual exposures on an ongoing basis where this is required: besides the tools already described, this includes rating reviews, monitoring of construction phase loans or residential property developers, the monitoring of payment arrears, and the regular, individual analysis of the largest exposures.

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

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

All trades are immediately taken into account for the purposes of borrower-related limits. Compliance with limits is monitored in real time by Risk Controlling. Any limit breaches are documented, together with actions 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 financing specialist, Aareal Bank AG focuses on property when collateralising loans and advances. 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 an independent appraiser; any discrepancies must be substantiated in writing. In any case, the mortgage lending value determined by the bank must not exceed the value assessed by independent internal or external appraisers.

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 weighting. 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 credit system, including all material details.

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

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

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

Derivatives entered into with financial institutions provide equity relief in accordance with the Solvability Ordinance ("SolvV"); repo transactions are generally not eligible.

Prior to entering into agreements, the responsible legal services unit within the Operations department assesses the legal risks, and the legal effectiveness and enforceability. The bank uses an internal rating system to assess the credit quality of counterparties. For derivatives transactions entered into with financial institutions, where the bank is looking for capital adequacy relief in accordance with the SolvV, a clause providing for a review of eligibility is added to the netting agreements. This review is carried out in accordance with sections 206 et seq. of the SolvV, particularly through obtaining regular legal opinions, using a database developed for this purpose.

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

Only cash collateral is accepted for derivatives, whereas collateral for repos can be provided in cash or in securities. Some of the collateral agreements the bank has entered into provide for a reduction in the allowance and the minimum transfer amount under the collateral agreement in the event of a downgrade of the bank's external rating; as a result, the bank might have to provide additional collateral.

Aareal Bank AG enters into credit derivatives exclusively with financial institutions having an investment-grade rating.

In principle, Aareal Bank AG pursues a 'buy, manage and hold' strategy in managing its credit portfolio: this means that loans are generally held until maturity; sales of loans to third parties during their term are only used on a selective basis, and by selling parts of exposures. Loan syndication is used as an active element of portfolio management.

Any assets acquired upon the realisation of collateral are predominantly properties. The consideration received upon disposal is applied to repay the underlying financing. An immediate sale is generally sought for such properties.

Country risk

Definition

When defining country risk, in addition to the risk of sovereign default or default of state entities, Aareal Bank AG 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. The bank always complied with the country limits defined in accordance with its risk-bearing capacity throughout the financial year under review.

Country risk measurement and monitoring

Geographical diversification and the avoidance of concentration risks are of greater importance, from the bank’s overall perspective, than the observation of transfer risks. The system for managing country risk, utilised within the overall management of the bank, was designed in such a way that it takes both criteria into consideration.

Country risk exposure is managed using a cross-divisional process. The Counterparty and Country Limit Committee carries out a risk assessment of the relevant countries, grades them in country risk groups, and conducts an annual review in terms of country rating. The limits are set by the Management Board. The Risk Controlling division is responsible for the continuous monitoring of country limits and for monthly reporting on limit utilisation. Country limits defined for the purposes of risk management were always observed during the financial year under review.

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

Market price risks

Definition

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

Derivative financial instruments are entered into almost exclusively in the trading book, and are primarily used as hedging instruments. Spread risks between the various yield curves (e.g. government / Pfandbrief / swap curve) are also taken into account. The risk exposure from bonds that is not related to market price or interest rate risks – in particular, credit and liquidity risk exposure of the bond portfolio – is managed as part of 'specific' risk.

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

A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. VaR is calculated on a daily basis, for the Group and all its operating entities, taking into consideration the correlations between the individual types of risk. Statistical parameters used in the VaR model are calculated directly from 250-day historical data maintained within the bank. The loss potential is determined applying a 99% confidence interval and a ten-day holding period.

By its 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 two 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). Aareal Bank AG's 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.

Limits were unchanged during the 2009 financial year. No limit breaches were detected. The average utilisation of the VaR limit, which we have defined for the aggregate of general market price risk and specific risk exposure, was 71,7% during the course of the year.

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 (≤5 for a 250-day period). Within the scope of this regular review, we have recalibrated the risk calculation parameters for specific risks with effect from 1 July 2009, against the background of a marked decline in volatility over the course of the year, particularly in the bond markets. The number of negative outliers at Group level was always lower than 1 during 2009, also after recalibration (and was always lower than 5 at Group level during 2008), affirming the high forecasting quality of our VaR model.

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 1997 crisis in Asia. For this reason, the VaR projection is supplemented by simulating stress scenarios on a weekly basis.

Aareal Bank AG calculates present value fluctuations both on the basis of real extreme market movements over recent years (German reunification, Asian crisis, 11 September 2001 etc.), and also using simulated market movements (parallel shifts, structural changes, steepening of the yield curve). This analysis requires that all positions are revalued fully on the basis of these market scenarios. The resulting impact on present value is compared against a special stress limit within the scope of weekly and monthly reporting.

The ”worst-case” scenario used in the financial year under review was a 100 basis point upwards parallel yield curve shift. This scenario implied a present value loss of 27% of the market risk limit as at 31 December 2009. 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 ”delta” parameter. The first step to determine this parameter requires calculating the present values of all asset and equity/liability items on the balance sheet. In a second step, the interest rates of yield curves used for this calculation are subjected to a one basis point parallel shift up (a method known as the 'key rate method'). Delta is the present value of the profit or loss resulting from this yield curve change.

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 in a position to assign transactions to the trading portfolio as defined for the purposes of the capital ratio according to the German Banking Act. Given the small number of transactions and low volumes concluded during 2009, trading book risks played a low role in the overall risk scenario.

During the 2009 financial year, the processes employed proved to be able to quantify the risks arising from market price fluctuations in a timely and accurate manner.

Liquidity risks

Definition

Liquidity risk in the narrower sense is defined as the risk that current or future payment obligations cannot be met on time. Aareal Bank AG'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 weekly 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 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 (i.e. all assets which can be liquidated at very short notice). The difference of both figures (in absolute terms) indicates excess liquidity, once all claims assumed in the run-off profile have been fulfilled through the liquidity stock. There were no liquidity shortages throughout the period under review.

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 tests

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

We generally consider the withdrawal of customers' current account balances as the most significant scenario. Even in this stress scenario, liquidity is sufficient to cover the expected liquidity needs under stress conditions.

Liquidity Ordinance

The requirements of the liquidity ratio in accordance with the Liquidity Ordinance, which is relevant to liquidity management, were always complied with during 2009, as were the limits set by reference to the liquidity run-off profile.

Operational risks

Definition

Aareal Bank AG 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. In contrast, strategic, reputational and systematic risks are not included.

Risk measurement and monitoring

It is the objective of the policy pursued by Aareal Bank AG 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.

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. There were cases reported in the loss database during the financial year under review, but there were no losses involving significant monetary damages.

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 monitor and manage outsourced activities and processes, whereby the relevant organisational units assess the performance of outsourcing providers in regular intervals. 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.

Other risks

Definition

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

Reputational risk is defined as the risk of events that negatively affect the bank's reputation with investors, analysts, or clients. Strategic risk is typically associated with the threat of incorrect assumptions regarding market developments, burdening a bank's performance as a result.

Risk measurement and monitoring

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 AG – 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 AG 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 AG'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 Corporate Development, for instance, via the continuous monitoring of trends which may be relevant to business policy.

Internal control and risk management system related to accounting and financial reporting

Tasks of the accounting-related internal control system (ICS) and risk management system (RMS)

Pursuant to section 289 (5) of the German Commercial Code ("HGB"), the tasks of the accounting-related internal control and risk management system mainly include ensuring proper conduct of business activities, guaranteeing proper internal and external accounting, as well as ensuring compliance with statutory and legal requirements applicable to the company.

Organisation of the accounting-related ICS and RMS

Aareal Bank AG has also implemented a comprehensive internal control and risk management system for business processes related to accounting and financial reporting.

The Management Board of Aareal Bank AG prepares the financial statements of Aareal Bank AG, which are approved by the Supervisory Board. Measures taken by the Supervisory Board to ensure an efficient performance of its control functions include the establishment of an Accounts and Audit Committee. The Committee analyses and assesses the financial statements submitted to it, together with internal risk reports as well as the annual report submitted by Internal Audit. In addition, it is responsible for determining the focal points of the audit as well as for evaluating the auditors' findings.

Internal Audit, as a process-independent unit, conducts a risk-based review concerning the effectiveness and appropriateness of the process-dependent internal control and risk management system. To perform its tasks, Internal Audit has full and unrestricted information rights with respect to Aareal Bank AG's activities and processes as well as the IT systems. Internal Audit is informed on a regular basis about material changes related to the internal control and risk management system.

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

Aareal Bank AG's financial statements are prepared centrally by the Finance department at the Wiesbaden head office. In order to ensure a sufficient degree of control, activities that are incompatible are separated both from an organisational and a functional perspective.

The activities required to prepare the financial statements are defined by internal accounting manuals. Aareal Bank AG's voucher documentation regulations define the relevant documentation rules for vouchers for all of the bank's posting units. Legal requirements and relevant accounting standards are implemented through accounting manuals, and through the structure of the plan of accounts; Finance regularly reviews these documents and updates them if necessary.

Current developments of statutory and legal provisions applicable for Aareal Bank AG are constantly monitored by a steering committee established by the bank. This committee also coordinates any necessary adjustments to systems and processes.

Adherence of the accounting system to generally accepted accounting principles is ensured by controls within the accounting process itself, as well as through a comprehensive analysis of processed data. The number of employees involved in the accounting process, as well as their qualifications, are in line with requirements. They possess the necessary skills and experience relevant for performing their tasks and duties.

The bank's Risk Manual summarises the material elements of Aareal Bank Group's risk management system. Above all, the Manual describes the organisational workflows as well as methods and instruments used in the context of risk management. For more information, please refer to our explanations in the Risk Report.

Components of the accounting-related ICS and RMS

The single-entity financial statements of Aareal Bank AG are prepared in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – "HGB"). The preparation of the consolidated financial statements is characterised by multiple analyses and plausibility checks. Besides the analysis of individual accounting issues, these include comparisons of periods, and between target and actual data. Balances and positions are reconciled with clients and counterparties in accordance with existing rules. Control processes have been implemented for Credit Risk Control, in accordance with MaRisk. Balances are reconciled both between the main ledger and upstream position-keeping systems, as well as on an account level. Adequate control processes have been implemented for both manual and automated accounting transactions. Furthermore, control processes have been implemented to safeguard the complete recording of all transactions in the bank's accounts.

Measurement within Aareal Bank AG is based on amortised cost or fair value, using current market prices and generally accepted valuation techniques. The valuation techniques used – as well as the underlying parameters – are controlled regularly, and adjusted if necessary. Compliance with defined criteria is verified regularly where valuation takes place on the basis of valuation units. For further information on measurement, please refer to the relevant notes to the financial statements.

Where no integrated approval system/dual control feature has been implemented in the IT systems for significant transactions in the accounting system, this has been integrated and documented in the material manual process workflows.

A differentiated access authorisation concept is in place for the systems used for finance and accounting, preventing unauthorised access. Authorisation levels are approved, reviewed regularly and adjusted, if necessary, in accordance with internal criteria.

Aareal Bank AG uses both standard and customised software. The accounting-related IT systems of Aareal Bank AG and the Group 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 performed independently. Process-integrated controls comprise, for example, the review of error and exception reports, or the regular analysis of internal service quality. In addition, Internal Audit conducts IT reviews independently from specific processes.

Future opportunities and outlook

Macroeconomic and industry-specific environment

Global business environment

Following the severe downturn of the global economy at the beginning of last year, there were signs of recovery based on a low level in the second half of the year, as well as a gradual easing on financial markets.

Economy

It is difficult to assess at present whether these development are sustainable and will continue in the form of a considerable recovery or if setbacks can be expected, in light of the considerable opportunities and risks to hand.

The recent largely positive development of early indicators such as orders received, production and sentiment indices, support a continuation of the recovery. Alternating reinforcing effects from higher inventories and revived demand also represent an opportunity for positive economic development. On the other hand, the process of boosting inventories could subside and no further momentum would emerge. A cautious revival is also supported by the fact that the economy's capacity utilisation is low and comparatively little corporate investment would be required to stretch production. At the same time, rising unemployment adversely affects consumer demand from the private households. The end of many state economic recovery programmes, especially in the second half of 2010, could result in further negative effects on the economy.

In the medium-term, the issue of state budget consolidation will become increasingly important, which could have a dampening effect. The financial markets that have eased – but have not yet returned to normal – carry additional risk potential. The severe turbulence on the financial markets, especially in the course of the insolvency of the investment bank Lehman Brothers in autumn 2008, showed how fragile the situation can be on financial markets and how quickly sentiment can collapse. Higher capital requirements of the banks and further write-downs on their assets as a consequence of the economic crisis could limit the scope for lending and therefore weaken economic recovery.

Bearing these issues in mind, we are cautious in relation to economic development in 2010 and assume that most industrial nations will only experience a slow, cautious recovery this year. The anticipated growth in Europe in particular is low and is even slightly negative in a few individual European countries. A slow recovery is expected for the USA – albeit at a stronger pace than for most European economies. The first – and at the same time most pronounced – signs of recovery were seen in the East Asian emerging markets, especially China, in the year under review. The positive development in East Asia is expected to remain intact. Given that unemployment and corporate bankruptcies lag behind economic development as a late indicator, we should expect these figures to continue rising during 2010.

Inflation, monetary policy and interest rates

In view of the rise in commodity prices since their low at the start of 2009, the low inflation rates of most of the countries are likely to rise. We anticipate a moderate increase only this year, since economic recovery is expected to be slow. Besides the uncertainties in relation to economic development, doubts about commodity price development is another issue, since these important influencing variables are also affected by speculation and political factors. Uncertainty also prevails as to whether the expansive financial and fiscal policy pursued to date will drive up inflation again in the medium term.

At the end of 2009, the ECB first signalled a gradual withdrawal from the extraordinary liquidity support measures, by conducting the last refinancing tender with a 12-month term. Owing to the anticipated hesitant economic revival, we expect largely moderate increases in short-term as well as in long-term interest rates this year, in all the currencies in which we operate.

Global commercial property markets

The uncertainties surrounding future general economic development make if difficult to forecast the progress of commercial property markets. Individual sub-markets or properties could deviate substantially from the general market assessments outlined below.

We are cautious about future rental and price development and assume that these variables will remain under pressure for most markets in 2010. This is due to the fact that property market performance tends to follow the economy with a time lag. Late indicators such as the expected increase in unemployment and company insolvencies put pressure on rents and return on property. Lower demand for office space, a reluctant stance in relation to consumption and travel, limits on the movement of goods and tenant defaults impact negatively on rents and returns on various types of commercial property.

The gross entry yields for investments in commercial property have stabilised recently. Some markets even experienced a decline, which had a positive effect on prices. Yields may continue to stabilise further as the high level already reached could be used by investors as a buying opportunity. We are cautious regarding a widespread sharp decline in yields in 2010, given the risks associated with the general economic development. Nonetheless, yields could well fall in various markets. Renewed tensions on financial markets could entail some risk, together with the fact that numerous financings for property transactions that were also refinanced through CMBS securitisations (commercial mortgage backed securities) will mature in 2010.

Given the high gross entry yields, we expect transaction volumes in 2010 to recover over 2009, albeit from a very low level.

All told, we are guarded about the current year, due to the hesitant economic recovery anticipated as well as the late indicators (unemployment and company insolvencies) that impact on the commercial property markets. We expect rents to remain under pressure, which will also burden price development.

Economic and commercial property market development in the individual regions

Europe

We expect most European economies to grow at a slow and reticent pace in 2010. On the other hand, negative growth could persist in Spain, as a result of very high unemployment. Negative growth is also likely again for the Baltic States, which were badly affected by the economic crisis, while positive growth is expected in the other Central and Eastern European states. This also applies to Russia, which should benefit from rising commodity prices.

We see the European commercial property markets performing largely in line with the general trend, i.e. pressure on rents and prices with stabilising yields are expected for 2010. Some markets may deviate from the general trend. For instance, markets that did not exhibit excessive rental increases in the past – such as some German market segments – will be less affected by downside potential in relation to rents, and could therefore show more stable price development.

North America (NAFTA states)

We are forecasting moderate growth for the US economy in 2010. Growth in the current year could be slightly higher that in many Western European countries. Canada and Mexico are expected to follow the general economic trend of the USA. Following the sharp downturn of the Mexican economy last year, comparatively higher growth rates than Canada and the USA are likely in the current year.

We are also cautious about rental and price development in North America in the current year and assume that these variables will come under further pressure. Given the high volume of borrowing that was funded through CMBS securitisations, especially in the USA, the threat of distressed sales is high when the exposures mature. US unemployment, which reacts quicker to economic development than in many European countries and economic recovery in 2010 that would stabilise the development of unemployment can be seen as positive for the future performance of commercial property markets in the US.

Asia/Pacific

The strongest economic development at present is recorded in the East Asian emerging markets and China in particular. Internal demand is becoming increasingly important against the background of falling export surpluses. Strong growth rates are anticipated for China in 2010. There is a danger of overheating, which could lead to subdued economic policy. High growth is expected for Singapore this year, whereas a slow recovery is expected for Japan, similar to many Western countries.

Despite the faster economic recovery in East Asia, we remain cautious about developments in its commercial property markets in the current year. Buoyant construction activity, particularly in Singapore and China, could dampen rents and prices in the future. We see performance falling in Singapore this year, whilst China' s development is expected to remain relatively constant. The anticipated slow economic recovery on the Japanese market could adversely affect the commercial property markets and exercise pressure on rents and prices.

Corporate development

Aareal Bank Group prepares its consolidated planning in accordance with IFRS. No separate planning is prepared in accordance with German commercial law; accordingly, corporate planning is conducted exclusively on the basis of IFRS projections.

Aareal Bank AG's individual investments are managed centrally by the department responsible for the management of participations at the Wiesbaden head office. The results posted by these entities are reflected, directly or indirectly, in the bank's results in accordance with the HGB, especially through distributions and profit/loss transfers.

Against the background of a slight to moderate increase in interest rates, we expect net interest income of Aareal Bank Group (whose material Structured Property Financing activities are centred in Aareal Bank AG) for the current financial year to grow to a range of € 460-480 million. This projection is based on higher lending margins, together with a lower burden from liquidity reserves.

In our view, the business environment in commercial property financing will remain just as challenging this year as it was in 2009. Accordingly, we expect consolidated allowance for credit losses to remain at clearly manageable levels during the 2010 financial year. Allowance for credit losses recognised in consolidated income (in accordance with IFRS) is expected to range between € 117 million and € 165 million: the actual level will depend in particular on the extent to which the additional allowance for credit losses (which was increased from € 34 million to € 48 million in the 2009 financial year) will, in fact, be utilised. As in the previous year, the bank cannot rule out additional allowances for credit losses that may be incurred during 2010.

We expect a moderate year-on-year rise in consolidated net commission income in 2010.

Consolidated net trading income/expenses in accordance with IFRS essentially comprises the results of hedge transactions related to refinancing our core business, predominantly currency and interest rate hedges. In our opinion, the valuation of these transactions remains subject to the same high volatility as in the last two years, especially in the current environment. As a result, it is impossible to forecast net trading income/expenses for 2010.

Because of the consistent conservative risk policy we have pursued in recent years, we anticipate no material burden on consolidated results from non-trading assets in 2010.

Consolidated administrative expenses continue to be defined by the unchanged cost discipline, and are thus expected to remain unchanged from 2009 levels.

From today's perspective, Aareal Bank sees good potential for increasing operating profit for the full 2010 financial year, even though the market environment continues to be fraught with uncertainty.

New business generated in the Structured Property Financing segment at Group level is currently expected to range between € 4 billion and € 5 billion in 2010. We will continue to concentrate on the funding requirements of our existing client base. The increase in the volume of new business will reduce the share of loan term extensions relative to new business.

In the Consulting/Services segment, we anticipate the interest rate environment to remain difficult for segment results in 2010. We thus expect profit before taxes to be slightly higher than adjusted operating profit for the financial year under review.

Corporate Governance Statement pursuant to Sec. 289 a of the German Commercial Code (HGB)

Please refer to the Code website (http://www.aareal-bank.com/en/investor-relations/corporate-governance) for the Corporate Governance Statement, which includes the Declaration of Compliance pursuant to section 161 of the German Public Limited Companies Act (Aktiengesetz – "AktG"), disclosures regarding corporate governance standards, the description of the activities of the Management Board and the Supervisory Board, and Aareal Bank AG's Corporate Governance Report.

Main features of the remuneration system

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

Aareal Bank AG has entered into fixed-term service contracts with the members of its Management Board. In addition to fixed salary components, which are paid in twelve identical monthly instalments, the members of the Management Board receive a bonus in form of a variable remuneration and are granted phantom shares as a long-term remuneration. The basis for this variable remuneration component is a target system, largely based on net income (of the Group) as reported under International Financial Reporting Standards (IFRS), as well as qualitative and quantitative targets, which are redefined annually. The phantom shares granted as a long-term component may be exercised in whole or in part during an exercise period of four years after the reference date, up to one fourth per year. They may be exercised for the first time in the year of allocation, in each case within five working days after the publication of the quarterly report. Phantom shares not exercised in a particular year may be exercised in the subsequent year. Upon exercise, the relevant proportion of virtual shares is converted at the weighted average price as reported by Bloomberg on the exercise date.

If dividends are paid on the Company's shares during the exercise period, a corresponding distribution is made and classified as other remuneration.

In view of the conclusion of the agreement entered into with the Financial Markets Stabilisation Fund (SoFFin), the members of the Management Board waived the portion of the contractually fixed remuneration exceeding € 500,000 as well as the variable remuneration component for the financial years 2009 and 2010, respectively.

The remuneration of the Supervisory Board is specified in Section 9 of the Memorandum and Articles of Association of Aareal Bank AG. The resolution adopted by the Annual General Meeting on 23 May 2006, which resulted in a change of the remuneration system of the Supervisory Board, currently applies.

The total remuneration of the Supervisory Board comprises a fixed and a variable remuneration component comparable to the remuneration package of the Management Board. The variable remuneration is performance-related and comprises a short-term and a long-term component.

Please refer to the Notes to the Financial Statements 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.

The remuneration systems for the employees of Aareal Bank AG are based on the business strategy and the long-term and sustainably positive business and earnings development of the Group. Incentives for excessive risk-taking are avoided by capping variable remuneration. The remuneration systems were agreed with the representative bodies for employees elected for

Aareal Bank AG, and then published. In order to ensure an appropriate individual remuneration, salaries are compared on a regular basis. The objective is to pay remuneration to employees that is both adequate and attractive.

Disclosure pursuant to section 289 (4) of the HGB and explanatory report pursuant to section 120 of the AktG

Composition of subscribed capital

Please refer to the Notes to the Financial Statements for details regarding the composition of Aareal Bank AG's subscribed capital. 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

In March 2009, the German Financial Markets Stabilisation Fund (SoFFin) provided a silent participation to Aareal Bank AG. Within the scope of this stabilisation measure, SoFFin and Aareal Holding Verwaltungsgesellschaft mbH, the bank's main shareholder, entered into an agreement under which Aareal Holding undertook to (i) retain its current stake of 37.23% of the bank's issued share capital during the term of the capital support; and to (ii) act in SoFFin's interests for the purpose of certain resolutions to be taken by the General Meeting (or to coordinate voting with SoFFin prior to the General Meeting). Furthermore, Aareal Holding agreed to exercise its voting rights, in the event of a General Meeting resolution on capital measures, in a manner so as to retain its blocking minority.

Otherwise, the exercise of voting rights and the transferability of shares by shareholders are governed exclusively by applicable law. There are no limitations to voting rights to a given number of shares or votes. All shareholders who have registered for attending the General Meeting in good time, providing evidence of their entitlement to attending the General Meeting and casting votes, are entitled to exercise the voting rights from all the shares they hold and have 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

Please refer to the Notes to the Financial Statements for details regarding shareholdings exceeding 10% of voting rights.

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 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, amendments to the Memorandum and Articles of Association become effective upon their entry in the company's 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 (8) 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 15 June 2005 resolved to authorise the Management Board to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 58,300,000.00 (Authorised Capital) by issuance of new shares for contribution in cash or in kind. This authorisation will expire on 14 June 2010. The shareholders must be granted subscription rights in the event of a capital increase against cash contributions. The Management Board is authorised to exclude shareholders' pre-emptive subscription rights in the event of a capital increase not exceeding 10% of the issued share capital at the time of exercising the authorisation, subject to approval by the Supervisory Board and provided that the issue price is not significantly lower than the prevailing market price. Article 5 (4) lit. b) to d) of the Memorandum and Articles of Association sets out further conditions for excluding shareholders' pre-emptive subscription rights. The Management Board may exclude shareholders' pre-emptive subscription rights in the event of a capital increase against contributions in kind. Following the capital increase resolved on 06 Nov 2005 and implemented on 21 Nov 2005, the residual amount of this authorised capital currently amounts to € 46,639,504.00.

In addition, the Annual General Meeting held on 21/05/2008 resolved to authorise the Management Board to increase, on one or more occasions, the company's share capital by up to a maximum nominal amount of € 12,826,545.00 by issuance of new shares for contribution in cash or in kind. This authorisation will expire on 20 May 2013. In the event of a capital increase against cash contributions, shareholders must be granted a subscription right unless this is exceeded by virtue of one of the reasons set out in Article 5 (6) lit. a)-d) of the Memorandum and Articles of Association. The Management Board may exclude shareholders' pre-emptive subscription rights in the event of a capital increase against contributions in kind.

Conditional capital

Pursuant to Article 5 (5) of the Memorandum and Articles of Association, the share capital is subject to a conditional capital increase of up to € 30 million by means of issuing up to 10 million new notional no-par value bearer shares. The purpose of the conditional capital increase is the granting of shares to holders or creditors of convertible bonds and/or bonds cum warrants issued in accordance with the authorisation by the General Meeting held on 21 May 2008, which authorises the issue of convertible bonds and/or bonds cum warrants in an aggregate nominal amount of € 600 million until 20 May 2013. Under the authorisation, subsidiaries of Aareal Bank AG may also issue convertible bonds and/or bonds cum warrants, and subject to approval by the Supervisory Board allows the company to guarantee such issues as well as to issue shares to fulfil the resulting conversion or option rights. Subject to the approval of the Supervisory Board, the Management Board may exclude shareholders' pre-emptive rights in the certain cases. Notwithstanding the provisions of section 9 (1) of the AktG, in certain circumstances holders of conversion or option rights are entitled to be protected against dilution. The new shares will be issued at the conversion or option price to be set as defined in the resolution passed by the General Meeting on 21 May 2008. The conditional capital increase will be executed only to the extent that holders of conversion or option rights exercise such rights or any conversion obligation from such convertible bonds and/or bonds with warrants is performed, and to the extent that treasury shares are not utilised to service such convertible bonds and/or bonds cum warrants. The new shares will be entitled to a share in the profits from the beginning of the financial year in which they come into existence, by way of exercise or conversion. The Management Board is authorised to determine any further details of the conditional capital increase, subject to approval by the Supervisory Board. The purpose of this authorisation to issue convertible bonds and/or bonds cum warrants (where the issue of shares to honour the obligations under such convertible bonds and/or bonds cum warrants is covered by the conditional capital) is to provide the Management Board with the flexibility to act swiftly when raising finance, in the interests of the company. The Company has not yet exercised this authorisation.

Authorisation to purchase treasury shares

The General Meeting held on 7 May 2009 authorised the Management Board, pursuant to Section 71 (1) No. 8 of the AktG, up to 6 November 2010, to acquire and sell treasury shares for purposes other than securities trading, up to a maximum volume of ten per cent (10%) of the issued share capital at the time of passing the resolution or – if this value is lower – of the share capital existing at the time of exercising this authorisation for purposes other than securities trading. Shares may be acquired via the stock exchange or by means of a public offer to buy, directed at all shareholders. The Management Board is authorised to effect the sale of any treasury shares acquired in accordance with this authorisation, subject to approval by the Supervisory Board, via channels other than the stock exchange or an offer to all shareholders, provided that the sale is carried out at a price that is not significantly lower than the stock exchange price of the company's shares at the time of sale. This authorisation is subject to the proviso that the aggregate value of shares sold under this authorisation and of shares issued to the exclusion of shareholders' subscription rights, in accordance with section 186 (3) sentence 4 of the AktG, shall not exceed ten per cent (10%) of the issued share capital at the time of exercising said authorisation. Subject to approval by the Supervisory Board, pre-emptive subscription rights on the sold shares may also be excluded in the event of a sale against contributions in kind, or if the sold shares are given to the holders of conversion or option rights in lieu of new shares from a contingent capital increase. The Management Board is also authorised to exclude the pre-emptive subscription rights to the extent required to grant subscription rights to new shares to owners of convertible bonds or bonds cum warrants which were issued in the meantime in such an amount as would be due to them once they exercised their option rights. The Management Board is authorised to call in any of the shares acquired under this authorisation, without any further resolutions by the General Meeting being necessary. The company did not exercise this authorisation to purchase or dispose of treasury shares during the year under review.

Renewing the authorisation to purchase treasury shares on an annual basis is in line with widely accepted practice of German listed companies. In line with authorised capital and conditional capital, this serves the company's interest of having access to flexible financing options.

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 in the event of a takeover offer

Please refer to the Remuneration Report regarding company compensation agreements entered into with members of the Management Board or employees in the event of a takeover bid.

Annual Financial Statements

Income Statement of Aareal Bank AG
for the period from 1 January to 31 December 2009

Euro mn			2009	2008
Expenses				
Interest expenses			**1,291.3**	1,639.8
Commission expenses			**33.0**	37.4
Net expense on financial operations				47.6
General administrative expenses				
a) Staff costs				
aa) Wages and salaries	91.8			
ab) Social security contributions, pensions and other employee benefits	21.8	113.6		
including: pensions 11.1				
b) Other administrative expenses		107	220.6	226.2
Amortisation and write-downs on intangible assets and tangible fixed assets			**3.9**	3.5
Other operating expenses			**25.4**	12.8
Amortisation and write-downs on loans and advances and certain securities, as well as additions to loan loss provisions			**124.6**	201.5
Amortisation and write-downs on participating interests, interests in affiliated companies and securities held as fixed assets			**0.0**	6.5
Expenses for assumption of losses			**1.6**	4.6
Addition to the fund for general banking risks			**22.0**	72.0
Net income taxes			**29.5**	-22.3
Other taxes not reported under other operating expenses			**0.8**	0.0
Net income			**2.0**	4.0
Total expenses			**1,754.7**	**2,233.6**
Net income/loss			**2.0**	4.0
Profit carried forward			**0.0**	0.0
Withdrawals from retained earnings				
from the reserve for treasury shares			0.0	0.0
from other retained earnings			0.0	0.0
Transfer to retained earnings				
Amounts transferred to the reserve for treasury shares			0.0	0.0
Amounts transferred to other retained earnings			0.0	0.0
Net retained profit			**2.0**	**4.0**

Euro mn		2009	2008
Income			
Interest income from			
a) Lending and money market transactions	1,146.9		
b) Fixed-income securities and debt register claims	523.3	**1,670.2**	2,077.5
Current income from			
a) Equities and other non-fixed?income securities	0.2		
b) Participating interests	0.5		
c) Interests in affiliated companies	4.2	**4.9**	20.4
Income from profit pools, profit transfer agreements or partial profit transfer agreements		**2.9**	22.8
Commission income		**47.2**	80.1
Net income from financial operations		**2.2**	-
Income from write-ups to participating interests, shares in affiliated companies and securities held as fixed assets		**0.8**	0.0
Other operating income		**26.5**	32.8
Total income		**1,754.7**	**2,233.6**

Balance Sheet of Aareal Bank AG as at 31 December 2009

Euro mn			2009	2008
Assets				
Cash funds				
a) Cash on hand		0.0		
b) Balances with central banks		989.2	989.2	692.7
including:				
with Deutsche Bundesbank 935.6				
Loans and advances to banks				
a) Payable on demand		423.4		
b) Other loans and advances		1,065.5	1,488.9	2,736.5
Loans and advances to customers			**22,915.4**	24,122.3
Including: secured by charges on real property 9,620.7				
Loans to local authorities 1,636.6				
Debt and other fixed-income securities				
a) Money market instruments		-		
b) Bonds and notes				
ba) Public-sector issuers	6,772.5			
Including: securities eligible as collateral with Deutsche Bundesbank 6,453.1				
bb) Other issuers	4,723.1	11,495.6		
Including: securities eligible as collateral with Deutsche Bundesbank 4,325.2				
c) Own bonds		2,640.6	14,136.3	12,628.4
Nominal amount 2,634.0				
Equities and other non-fixed-income securities			**492.8**	619.9
Participating interests			**4.1**	4.8
Including: Interests in banks 0.8				
interests in financial services providers -				
Interests in affiliated companies			**498.7**	492.3
Including: Interests in banks 30.4				
interests in financial services providers -				

Euro mn			2009	2008
Equity and liabilities				
Liabilities to banks				
a) Payable on demand		657.2		
b) With an agreed maturity or notice period		4,678.9	5,336.1	9,285.5
Liabilities to customers				
a) Savings deposits				
aa) With a notice period of three months	0.0			
ab) With an agreed notice period of more than three months	0.0	0.0		
b) Other liabilities				
ba) Payable on demand	3,605.6			
bb) With an agreed maturity or notice period	17,797.2	21,402.8	21,402.8	20,726.7
Certificated liabilities				
a) Bonds issued		10,443.7		
b) Other certificated liabilities		-	10,443.7	8,526.3
Trust liabilities			**626.0**	694.0
Including: trustee loans 624.5				
Other liabilities			**77.3**	95.0
Deferred items			**114.5**	78.2
Provisions				
a) Provisions for pensions and similar obligations		70.4		
b) Tax provisions		32.0		
Including: provisions for deferred taxes 24.1				
c) Other provisions		100.2	202.6	220.9
Subordinated liabilities			**783.3**	802.1
Profit-participation certificates			**450.4**	450.4
Including: maturing within two years 225.0				

Euro mn	2009	2008
Assets		
Trust assets	**626.0**	694.0
including: trustee loans 624.5		
Intangible assets	**4.4**	4.7
Tangible fixed assets	**7.4**	7.1
Other assets	**327.9**	414.2
Deferred items	**123.9**	72.0
Deferred taxes	**36.5**	56.0
Total assets	**41,651.5**	**42,544.9**

Euro mn			2009	2008
Equity and liabilities				
Fund for general banking risks			**152.0**	130.0
Equity				
a) Subscribed capital		128.3		
Contributions by silent partners		745.2		
b) Capital reserve		509.5		
c) Retained earnings				
ca) Legal reserve	4.5			
cb) Reserve for treasury shares	-			
cc) Statutory reserves	-			
cd) Other retained earnings	673.3	689.8		
d) Net retained profit		2.0	2,062.8	1,535.8
Total equity and liabilities			**41,651.5**	**42,544.9**
Contingent liabilities				
a) Contingent liabilities from discounted forwarded bills		-		
b) Liabilities from guarantees and indemnity agreements		956.9		
c) Liability from the pledging of collateral for third-party liabilities		-	956.9	1,292.7
Other commitments				
a) Repurchase obligations from securities repurchase agreements		-		
b) Placement and underwriting obligations		-		
c) Irrevocable loan commitments		1,690.9	1,690.9	2,989.2

Notes

Accounting and Valuation Principles

The financial statements of Aareal Bank AG for the financial year 2009 were prepared in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – ”HGB”) and the supplementary regulations of the German Public Limited Companies Act (Aktiengesetz – ”AktG”) and the German Accounting Directive for Banks and Financial Services Providers (Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute – ”RechKredV”).

Loans and advances

Loans and advances to banks and customers are carried at amortised cost, including deferred interest. Premiums and discounts are shown under deferred items, in accordance with section 340e (2) of the HGB. Credit risks are accounted for by setting aside provisions in the amount of the expected loss, using prudent estimates. At Aareal Bank AG, the calculation of general loan loss provisions is based on a procedure using standard risk costs. These costs are determined on the basis of actual risk provisioning expenses. Taking into account the further deterioration in the economic outlook, the bank has recognised an additional increase in general loan loss provisions.

Securities

Bonds and other fixed-income securities, as well as equities and other non-fixed income securities, are measured strictly at the lower of cost or market value, as prescribed for current assets, taking into account hedging instruments. Where the reasons for the write-down no longer apply, such securities must be written up in accordance with section 280 of the HGB. Investment securities are valued at the lower of cost or market. Differences between cost and amounts repayable are amortised in income on a pro-rata basis.

Participating interests, interests in affiliated companies and fixed assets

Participating interests, interests in affiliated companies and fixed assets, as well as purchased intangible assets, are stated at purchase or production costs, less depreciation/amortisation. Write-downs are required in the event of value impairments deemed to be other than temporary.

Where the reasons for the write-down no longer apply, such participating interests or interests in affiliated companies must be written up in accordance with section 280 of the HGB. Where land and buildings were acquired to salvage loans, and have been in the possession of the bank for more than five years, these are reported under fixed assets. Additions of low-value commercial goods ("geringwertige Wirtschaftsgüter") of not more than € 150 are fully written off in the year of acquisition and accounted for as disposals. In addition, Aareal Bank AG made use of the simplification rule pursuant to section 6 (2a) of the German Income Tax Act (Einkommensteuergesetz – "EStG").

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

Treasury shares

Treasury shares are capitalised at cost, and the equivalent amount is transferred to the reserve for treasury shares. Treasury shares are measured strictly at the lower of cost or market ("strenges Niederstwertprinzip").

Liabilities

Liabilities are stated at their repayment amount. The difference between the nominal value and the initial carrying amount of liabilities is recognised under deferred items, and amortised over the term of the liability.

Provisions

Provisions for pensions and similar obligations are formed using an interest rate of 6%, applying the cost method ("Teilwertverfahren") according to section 6 a of the EStG. Provisions for taxes and other provisions have been set aside for existing legal or constructive obligations in the amount of the expected liability, as required by prudent commercial judgement.

Currency translation

Aareal Bank has translated balance sheet items and pending transactions in foreign currency, in accordance with section 340h of the HGB and statement 3/1995 issued by the Banking Committee of the German Institute of Auditors (BFA). The bank has classified all foreign exchange transactions as ”specific cover” in accordance with section 340h (2) sentence 2 of the HGB. Hence, income and expenses from currency translation were recognised in the income statement, in accordance with section 340h (2) sentences 1 and 2 of the HGB. As all pending foreign currency exposures at the end of 2009 were related to concurrent business operations, no amounts needed to be disclosed separately under section 340h (2) sentence 4 of the HGB.

The bank decomposes foreign exchange forward transactions into an agreed spot base and the swap rate, recognising a deferred asset (reported under other assets) equivalent to the net aggregate difference between the spot base and the exchange rates prevailing on the reporting date. Forward premiums or discounts are amortised in net interest income over the term of the transaction.

Currency translation income and expenses are reported in net profit on financial operations.

Trading portfolio

Aareal Bank AG is authorised to operate a trading book. Transactions in the trading book are subject to institutionalised risk management, with a strict limitation of risk exposure and daily risk reporting. Financial transactions accounted for in the trading book are measured strictly at the lower of cost or market in accordance with section 253 of the HGB. This measurement is carried out on a portfolio basis, whereby positive and negative measurement results within the same portfolio are set off; any net unrealised loss on a portfolio basis is reported, while a net unrealised profit is not. The results of the trading portfolio are reported in net profit on financial operations. Interest from securities and money-market instruments held in the trading portfolio is included in net interest income.

Derivatives

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

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

Structured products subject to different types of risks or rewards are accounted for separately as individual receivables or liabilities.

Notes to the Income Statement

Income by geographical segment

The aggregate of (i) interest income, (ii) current income on equities and other non-fixed income securities, and on participating interests and interests in affiliated companies, (iii) commission income and (iv) other operating income, is broken down by the following regions, in accordance with section 34 of the German Ordinance regulating the Financial Reporting of Banks and Credit Institutions (Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungs-institute – "RechKredV").

	2009	2008
Euro		
Germany	1,562.1	1,927.2
Europe/America/Asia	186.7	283.7
Total	1,748.8	**2,210.9**

Administration and intermediation services rendered to third parties:

The following administration and intermediation services were rendered to third parties Administration and intermediation of loans and trust assets.

Other operating income and expenses

Net other operating income of € 26.5 million (2008: € 32.8 million) primarily includes income from the reversal of provisions in the amount of € 13.1 million.

Other operating expenses total € 25.4 million (2008: € 12.8 million) and include, among other items, one-off expenses in connection with capital measures taken under the silent participation from SoFFin in the amount of € 5.7 million.

Net income taxes

The net income tax position amounted to € 29.5 million in expenses. This amount results from current tax expenses of € 6.4 million as well as from expenses from deferred taxes amounting to € 23.1 million. Current taxes in the amount € 6.4 million consists of tax expenses for the current year of € 13.3 million (of which € 10.1 million was payable abroad and € 3.2 million was payable in Germany) and of tax refunds for previous years of -€ 6.9 million. These are mainly the result of the completed tax audit in Germany.

Notes to the balance sheet

Securities negotiable at a stock exchange

Analysis of securities negotiable at a stock exchange in the balance sheet line items shown below:

Euro mn	Listed 31 Dec 2009	Unlisted 31 Dec 2009
Debt securities and other fixed-income securities (excluding pro-rata interest)	13,837.6	50.0
Equities and other non-fixed-income securities	11.1	481.7
Participating interests	-	-
Interests in affiliated companies	-	-

Hedging relationships have been created with respect to negotiable securities in an aggregate amount of € 7,593.6 million.

Bonds and notes of € 14,136.3 million (including accrued interest) reported under debt and other fixed-income securities include € 717.3 million in securities which are not eligible as collateral with Deutsche Bundesbank. Of that amount, € 298.6 million relate to sovereign foreign-currency bonds, which are eligible for securities lending.

Equities and other non-fixed income securities include € 12.4 million of investment fund units, and debt and other fixed-income securities include € 1.2 million in bonds, all of which are exclusively reserved to meet Aareal Bank AG's pension obligations vis-à-vis its active and retired employees in Germany.

Subordinated assets

The following items comprise subordinated assets in the amount shown (excluding pro-rata interest):

Euro mn	31 Dec 2009	31 Dec 2008
Loans and advances to banks	38.0	38.0
Loans and advances to customers	22.2	24.5
Bonds and other fixed-income securities	-	14.9
Equities and other non-fixed-income securities	0.7	0.7
Other assets	-	-

Movements in fixed assets

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

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

As at the reclassification date (2 January 2009), the markets were characterised by a severe confidence crisis between banks. This applies particularly to transactions with securities issued by public-sector entities from Eastern and Southern European countries as well as North American financial institutions. As a result of this confidence crisis, these securities – even if issued by entities with good credit quality – have been exposed to significant market-based price declines. Aareal Bank is convinced that these market anomalies will disappear in the long term, at the latest upon maturity of the securities (2010-2035). Due to the quality of the securities and the resulting long-term profit potential until the end of their term, the bank decided to reclassify these securities (with a nominal amount of € 3,803.4 million) to fixed assets on the basis of the book values as at 1 January 2009 (historical cost), with changes in book value recognised directly in equity.

As at 31 December 2009, the securities held as fixed assets include an ABS portfolio of high credit quality, bonds of North American financial institutions as well as securities issued by public-sector entities from Eastern and Southern European countries. Securities with a nominal amount of € 7,519.4 million were not measured at the lower of cost or market. An examination of cost vs. market value as at 31 December 2009 did not indicate any permanent impairment. The difference between market value and book value (incl. effects from hedging relationships) amounted to -€ 298.4 million.

	Debt and other fixed-income securities (Assets – item #5)	Participating interests (Assets – item #7)	Interests in affiliated companies (Assets – item #8)	Intangible assets (Assets – item #11)	Tangible fixed assets (Assets – item #12)	
					Office furniture and equipment	Land and buildings
Euro mn						
Purchase or production costs (1 Jan 2009)	3,563.2	5.0	547.5	38.2	32.1	0.6
Additions	4,144.0	0.0	30.0	1.5	2.4	-
Disposals	271.7	0.7	19.0	0.0	1.6	0.0
Changes in inventory / transfers	0.0	0.0	0.0	0.0	0.0	0.0
Depreciation/amortisation (accumulated, as at 31 Dec 2008)	0.0	0.2	55.2	33.6	25.5	0.1
Depreciation, amortisation and write-downs in the current year	0.0	0.0	4.6	1.7	2.1	0.0
Disposals	0.0	0.0	0.0	0.0	1.6	0.0
Transfers	0.0	0.0	0.0	0.0	0.0	0.0
Write-ups	0.0	0.0	0.0	0.0	0.0	0.0
Book value as at 31 Dec 2009	**7,435.5**	**4.1**	**498.7**	**4.4**	**6.9**	**0.5**
Book value as at 31 Dec 2008	3,563.2	4.8	492.3	4.7	6.6	0.5

	Book value 31 Dec 2009	Book value 31 Dec 2008
Euro mn		
Participating interests	4.1	4.8
Interests in affiliated companies	498.7	492.3
Bonds and other fixed-income securities	7,435.5	3,563.2
Equities and other non-fixed-income securities	-	-

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

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

As part of the transfer of some of the business activities from DEPFA Deutsche Pfandbriefbank AG to Aareal Bank AG, goodwill has been capitalised and reported under intangible assets.

Given the reverse materiality, this will be amortised over the expected useful life of five or ten years, respectively.

Other assets

Other assets include, in particular, € 258.7 million in assets recognised from currency translation and € 39.7 million in tax receivables.

Deferred taxes

In the financial year 2009, deferred tax liabilities of € 3.6 million were recognised and deferred tax assets of € 19.5 million were reversed. Accordingly, as at 31 December 2009, € 36.5 million in deferred tax assets and € 24.1 million in deferred tax liabilities were reported. Deferrals are made in the amount of the assumed tax burden or relief in coming financial years, based on the respective future local tax rates for 2010.

Other liabilities

Other liabilities include € 43.5 million in interest liabilities on silent participations.

Subordinated liabilities

Subordinated funds raised in accordance with section 10 (5a) of the KWG do not provide for any early repayment obligation for Aareal Bank AG. In the event of liquidation or insolvency, claims on interest and principal from these liabilities are subordinated to the claims of all other creditors of Aareal Bank AG, which are not themselves subordinated. This also applies to those subordinated funds raised that are not specified in detail.

Total interest expenses for subordinated liabilities of € 43.7 million (2008: € 48.1 million) include € 11.7 million (2008: € 11.5 million) in deferred interest not yet due.

Aareal Bank AG has € 250.0 million in subordinated equity from Aareal Capital Funding LLC, Delaware, USA, at its disposal, of which it, in turn, made a partial amount available to Aareal Bank France S.A. (€ 23 million). Aareal Bank AG's attributable share of € 227.0 million exceeds 10% of the aggregate nominal value of all subordinated liabilities; these subordinated funds bear interest at a rate of 7.135%, and are repayable on 31 December 2026. The bank has had a right to terminate, on a quarterly basis, since 31 December 2006; the creditors do not have any early termination rights.

Profit-participation certificates

The terms and conditions of the profit-participation certificates issued comply with the requirements of section 10 (5) of the KWG. It comprises the following profit-participation certificates issued by Aareal Bank AG:

Euro mn	Nominal amount	Issue currency	Interest rate (% p.a.)	Maturity
Bearer profit-participation certificates:	125.0	EUR	6.750	2002 - 2011
	100.0	EUR	6.375	2002 - 2011
	60.0	EUR	6.125	2003 - 2013
	285.0			
Registered profit participation certificates:	5.0	EUR	7.010	2002 - 2012
	10.0	EUR	7.010	2002 - 2012
	5.0	EUR	7.010	2002 - 2012
	10.0	EUR	7.010	2002 - 2012
	5.0	EUR	7.100	2002 - 2012
	10.0	EUR	7.150	2002 - 2012
	5.0	EUR	7.030	2002 - 2012
	5.0	EUR	7.220	2002 - 2016
	5.0	EUR	7.220	2002 - 2016
	5.0	EUR	6.080	2003 - 2013
	20.0	EUR	6.120	2003 - 2013
	5.0	EUR	6.310	2003 - 2017
	10.0	EUR	5.750	2004 - 2014
	2.0	EUR	5.470	2004 - 2014
	5.0	EUR	5.480	2004 - 2014
	5.0	EUR	5.380	2004 - 2016
	20.0	EUR	5.950	2004 - 2016
	6.0	EUR	5.830	2005 - 2017
	138.0			

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

Repayment takes place at the nominal amount (subject to any loss sharing), after the Annual General Meeting passing resolutions regarding the relevant financial year.

€ 28.0 million (2008: € 28.4 million) in interest expenses were incurred in 2009 with respect to profit-participation certificates issued.

The profit-participation certificates evidence creditors' rights; they do not grant any share in the liquidation proceeds.

Profit-participation certificates meet the requirements for liable equity capital pursuant to section 10 (5) of the KWG.

Purchase of treasury shares

The Company has been authorised by the Annual General Meeting held on 7 May 2009 to purchase and sell treasury shares, pursuant to section 71 (1) no. 7 of the AktG, until 6 November 2010. The volume of shares acquired for this purpose must not exceed 5% of the bank's share capital at the end of any day. The lowest price at which a share may be acquired is determined by the closing price of the shares in Xetra (or a comparable successor system) on the trading day prior to such purchase less 10%. The highest price shall not exceed such average closing price plus 10%.

The Company was authorised at the same Annual General Meeting in accordance with Section 71 (1) No. 8 of the AktG to purchase own shares not exceeding 10% of the bank's share capital for other purposes than securities trading until 6 November 2010. Shares may be acquired via the stock exchange or by means of a public offer to buy, directed at all shareholders. Neither the purchase price, excluding ancillary costs, (if the acquisition takes place via the stock market) nor the offering price, excluding ancillary costs, (in case of a public offer to buy) may exceed or fall below the average closing price of the bank's shares in Xetra (or a comparable successor system) during the three trading days prior to the purchase, or the public announcement of the purchase offer, by more than ten per cent (10%).

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

Development of shareholders' equity reported on the balance sheet

Euro mn		
Subscribed capital		
Balance as at 1 Jan 2009	348.5	
(of which: € 220.2 million contributions by silent partners)		
Balance as at 31 Jan 2009		873.5
(of which: € 745.2 million contributions by silent partners)		
Capital reserve		
Balance as at 1 Jan 2009	509.5	
Balance as at 31 Dec 2009		509.5
Retained earnings		
Legal reserve		
Balance as at 1 Jan 2009	4.5	
Balance as at 31 Dec 2009		4.5
Other retained earnings		
Balance as at 1 Jan 2009	669.3	
Transfer from net retained profit 2008	4.0	
Transfer from net income 2009	0.0	
Balance as at 31 Dec 2009		673.3
Net retained profit		2.0
Equity as at 31 Dec 2009		**2,062.8**

Subscribed capital amounts to € 128.3 million and is divided into 42,755,159 bearer shares at a nominal amount of € 3.00 per share.

Aareal Bank has opted to determine regulatory indicators at Group level only from 2007 onwards; as a result of this waiver, regulatory details no longer need to be disclosed at a single-entity level.

Authorised capital

Aareal Bank has authorised capital pursuant to the resolution by the Annual General Meeting held on 15 June 2005. Accordingly, the Management Board is authorised to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 58,300,000 (Authorised Capital) by issuance of new bearer shares for contribution in cash or in kind (where such contribution may represent the full contribution, or part thereof), subject to the approval of the Supervisory Board; this authority will expire on 14 June 2010. 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 is not significantly below the prevailing stock exchange price. However, this authorisation shall be subject to the proviso that the aggregate value of shares issued to the exclusion of shareholders' subscription rights, in accordance with section 186 (3) sentence 4 of the AktG, shall not exceed ten per cent (10%) of the issued share capital at the time of exercising said authorisation. Any shares that were issued or sold during the term and prior to the exercising of said authorisation, in direct or analogous application of section 186 (3) sentence 4 of the AktG, shall count towards the above threshold of ten per cent (10%) of the issued capital. Said ten-per-cent threshold shall also include shares which were issued (or the issuance of which is required) under the terms of debt securities with embedded conversion or option rights on shares, where such debt securities are issued pursuant to section 186 (3) sentence 4 of the AktG at the time of exercising said 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) up to an amount of € 4,000,000 in order to offer employees (of the Company or its affiliated companies) shares for subscription.

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

Exercising said authorisations, and with the approval of the Supervisory Board, the Management Board resolved on 6 November 2005 to increase the Company's issued share capital by € 11,660,496 (equivalent to 10% of the issued share capital prior to the increase) to € 128,265,477, by issuing 3,886,832 bearer shares against cash contributions, at an issue price of € 25.75. Excluding shareholders' pre-emptive subscription rights, Aareal Holding Verwaltungsgesellschaft mbH, Bayerische Beamtenversicherung and Neue Bayerische Beamten Lebensversicherung AG were admitted to subscribe and acquire the new shares. The capital increase was carried out, and entered in the Commercial Register on 21 November 2005.

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

The Annual General Meeting held on 21 May 2008 resolved to approve additional authorised capital. The Management Board is authorised to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 12,826,545.00 (Authorised Capital 2008) by issuing new bearer shares for contribution in cash or in kind (where such contribution may represent the full contribution, or part thereof) through the issue of up to 4,275,515 bearer shares with a share in the Company's share capital of € 3.00 each, subject to the approval of the Supervisory Board; this authority will expire on 20 May 2013. In the event of a capital increase against cash contributions, the shareholders shall be granted a subscription right. However, the Management Board is authorised to 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 does not fall significantly below the prevailing stock exchange price of the exchange-listed shares of the same description and features, and the total pro-rata share of the new shares (for which the subscription right has been excluded) in the share capital does not exceed ten per cent (10%) at the time of this authorisation entering into effect or – if this amount is lower – does not exceed the share capital existing at the time this authorisation is exercised. Any shares that were issued or sold during the term and prior to the exercising of said authorisation, in direct or analogous application of section 186 (3) sentence 4 of the AktG, shall count towards the above threshold of ten per cent (10%) of the issued capital. Said ten-per-cent threshold shall also include shares which are required to be issued under the terms of debt securities with embedded conversion or option rights on shares, where such debt securities are issued pursuant to section 186 (3) sentence 4 of the AktG during the term of this authorisation;

b) for fractional amounts arising from 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) up to an amount of € 4,000,000 in order to offer employees (of the Company or its affiliated companies) shares for subscription.

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

The latter authority was not exercised in the year under review.

Conditional capital

The share capital is subject to a conditional capital increase of up to € 30 million by means of issuing up to 10 million new no-par value bearer shares, with a share in the Company's share capital of € 3.00 each. Such conditional capital increase serves to enable the company to service convertible bonds and/or bonds with warrants on the basis of the authorisation resolution of the Annual General Meeting held on 21 May 2008. Said resolution authorised the Management Board, subject to the consent of the Supervisory Board, to issue, on one or more occasions until 20 May 2013, convertible bonds and/or bonds cum warrants with a limited or an unlimited term in an aggregate nominal amount of € 600 million and to grant option and/or conversion rights to bearers or holders of bonds with regard to no-par value bearer shares of the Company, equivalent to a share in the share capital of up to € 30 million.

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

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

No convertible bonds or warrants were in issue as at the balance sheet date. Neither said authorisation nor conditional capital were exercised or utilised in the year under review.

Contingent liabilities and other commitments

Contingent liabilities as at 31 December 2009 include € 71.4 million in maximum default guarantees extended to DEPFA Deutsche Pfandbriefbank AG (within the scope of splitting the former DEPFA Group), for the purpose of providing cover against risks of default with respect to the property loan portfolio held by DEPFA Deutsche Pfandbriefbank AG.

Irrevocable loan commitments are made up of credit and loan commitments. Of the total amount, € 117.8 million relates to domestic borrowers and € 1,573.1 million to foreign borrowers.

Unrecognised transactions (section 285 no. 3 of the HGB, as amended)

Leasing: Aareal Bank AG is the lessee mainly of operating leases. Disclosures on repurchase agreements and derivatives are presented in the following section of the Notes.

Remaining terms

Euro mn	31 Dec 2009
Loans and advances to banks	**1,488.9**
Payable on demand	423.4
Up to 3 months	225.3
Between 3 months and 1 year	43.3
Between 1 year and 5 years	136.8
More than 5 years	140.3
Pro rata interest	519.8
Loans and advances to customers	**22,915.4**
Up to 3 months	1,505.4
Between 3 months and 1 year	2,219.8
Between 1 year and 5 years	12,997.4
More than 5 years	6,061.0
Indefinite maturity	-
Pro rata interest	131.8
Debt and other fixed-income securities maturing in the following year (nominal amount)	**621.1**
Deposits from other banks	**5,336.1**
Payable on demand	657.2
Up to 3 months	2,925.7
Between 3 months and 1 year	724.2
Between 1 year and 5 years	388.5
More than 5 years	298.3
Pro rata interest	342.2
Savings deposits with agreed notice period	**0.0**
Up to 3 months	0.0
Between 3 months and 1 year	0.0
Between 1 year and 5 years	0.0
Pro rata interest	0.0
Other liabilities to customers	**21,402.8**
Payable on demand	3,605.6
Up to 3 months	3,259.9
Between 3 months and 1 year	1,500.5
Between 1 year and 5 years	3,651.1
More than 5 years	9,075.2
Pro rata interest	310.5
Bonds issued maturing in the following year (nominal amount)	**2,427.0**
Other certificated liabilities	**0.0**

Deferred items

Deferred items primarily include upfront payments as well as any premiums and discounts on registered bonds, claims under promissory note loans and other loans that have been amortised over the relevant terms.

Deferred assets in the amount of € 123.9 million (2008: € 72.0 million) include € 7.0 million (2008: € 9.7 million) in premiums on originated loans, in accordance with section 340e (2) sentence 3 of the HGB, as well as € 29.6 million (2008: € 24.5 million) in discounts on bonds issued and borrowings pursuant to section 250 (3) of the HGB.

€ 9.2 million (2008: € 13.0 million) of deferred liabilities (total 2009: € 114.5 million; total 2008: € 78.2 million) refers to discounts on originated loans, in accordance with section 340e (2) sentence 2 of the HGB.

Trust business

Euro mn	Trust assets 31 Dec 2009
Loans and advances to banks	-
Loans and advances to customers	624.5
Equities and other non-fixed-income securities	1.5
Total	**626.0**

Euro mn	Trust assets 31 Dec 2008
Liabilities to banks	418.8
Liabilities to customers	207.2
Total	**626.0**

Notes on affiliated companies and enterprises with a participatory interest

	Affiliated companies 2009		Enterprises with a participatory interest 2009		Affiliated companies 2008		Enterprises with a participatory interest 2008	
Euro mn	Certificated	Not certificated	Certificated	Not certificated	Certificated	Not certificated	Certificated	Not certificated
Loans and advances to banks	-	312.0	-	-	-	344.0	-	-
Loans and advances to customers	-	1,765.1	-	-	-	1,933.6	-	0.0
Debt and other-fixed-income securities	-	-	-	-	0.0	0.0	-	-
Liabilities to banks	-	19.0	-	-	0.0	0.0	-	-
Liabilities to customers	-	255.7	-	0.8	-	278.1	-	1.2
Certificated liabilities	-	-	-	-	-	-	-	-
Subordinated liabilities	-	250.0	-	-	-	250.0	-	-

Interests held in large limited companies

Aareal Bank AG does not hold any participating interest in a large limited company.

Shareholdings

The list of shareholdings of Aareal Bank AG pursuant to section 313 (2) of the HGB has been published in the electronic Federal Gazette, and is available on the internet (http://www.aareal-bank.com).

Assets pledged as collateral

Total assets pledged as collateral:

Euro mn	31 Dec 2009	31 Dec 2008
Loans and advances to banks	386.8	437.3
Loans and advances to customers	-	0.0
Debt and other fixed-income securities	3,856.4	6,239.7
Total	**4,243.2**	**6,677.0**

Repurchase agreements

The book value of bonds pledged under repo agreements totalled € 3,228.4 million as at 31 December 2009.

Assets and liabilities in foreign currencies

The aggregate equivalent amount of assets denominated in foreign currencies, calculated pursuant to the German Solvency Regulation (Solvabilitätsverordnung – "SolvV"), was € 10,270.0 million at the balance sheet date, whilst liabilities totalled € 10,169.9 million.

Forward transactions

The following forward transactions had been entered into as at 31 December 2009:

- Transactions based on interest rates
  Caps, floors, swaptions, interest rate swaps
- Transactions based on exchange rates
  Spot and forward foreign exchange transactions, cross-currency interest rate swaps
- Other transactions
  Credit default swaps, credit-linked notes, other forward transactions

Interest-rate based transactions and cross-currency interest rate swaps are primarily used to hedge against interest rate and exchange rate fluctuations. Spot and forward foreign exchange transactions are almost exclusively used for refinancing purposes. Credit derivatives are primarily used to assume credit risks for the purpose of portfolio diversification.

Derivatives used to hedge interest or exchange rate risks are valued together with the underlying transaction; no individual valuation of underlying transaction and derivative is carried out.

Remaining terms and nominal amounts of derivatives are broken down in the following table:

	Nominal amount by remaining lifetime (31 Dec 2009)				Nominal amount	
	Up to 3 months	3 months to 1 year	1 to 5 years	More than 5 years	31 Dec 2009	31 Dec 2008
Euro mn						
Interest rate instruments						
OTC products						
Interest-rate swaps	1,860.3	3,725.0	21,572.5	17,061.7	44,219.5	43,106.6
Forward rate agreements	-	-	-	-	-	-
Swaptions	41.0	0.0	103.0	0.0	144.0	200.0
Caps, Floors	44.5	476.8	3,050.6	133.8	3,705.7	4,126.8
Other interest rate instruments	-	-	-	-	-	-
Exchange-listed contracts						
Interest rate futures	-	-	-	-	-	-
Options on interest rate futures	-	-	-	-	-	-
Total interest rate instruments	**1,945.8**	**4,201.8**	**24,726.1**	**17,195.5**	**48,069.2**	**47,433.4**
Currency-related instruments						
OTC products						
Spot and forward foreign exchange transactions	1,924.1	46.6	17.3	0.0	1,988.0	4,347.4
Cross-currency swaps	620.6	2,501.3	3,536.4	620.6	7,278.9	5,356.0
Currency options	-	-	-	-	-	-
Other currency-related instruments	-	-	-	-	-	-
Exchange-listed contracts						
Currency futures	-	-	-	-	-	-
Currency options	-	-	-	-	-	-
Total currency-related instruments	**2,544.7**	**2,547.9**	**3,553.7**	**620.6**	**9,266.9**	**9,703.4**
Other forward transactions						
OTC products						
Credit default swaps	0.0	0.0	135.0	535.3	670.3	798.9
Credit-linked notes	0.0	0.0	0.0	11.0	11.0	21.4
Other forward transactions	-	-	28.0	-	28.0	53.0
Exchange-listed contracts						
Equity index futures	-	-	-	-	-	-
Total other forward transactions	**0.0**	**0.0**	**163.0**	**546.3**	**709.3**	**873.3**
Total	**4,490.5**	**6,749.7**	**28,442.8**	**18,362.4**	**58,045.4**	**58,010.1**

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

Unless a quoted market price is available, derivatives are measured using generally accepted methods on the basis of current market parameters (yield curves, volatility factors etc.). Methods used include standard methods and models such as discounted cash flow analyses and option pricing models. Structured products are measured after they have been split into their individual components.

Euro mn	Market value (31 Dec 2009) positive	Market value (31 Dec 2009) negative	Market value (31 Dec 2008) positive	Market value (31 Dec 2008) negative
Interest rate instruments				
OTC products				
Interest rate swaps	1,122.6	991.1	987.0	1,115.9
Forward rate agreements	-	-	-	-
Swaptions	0.0	0.4	0.0	1.2
Caps, Floors	17.8	18.8	16.5	16.4
Other interest rate instruments	-	-	-	-
Exchange-listed contracts				
Interest rate futures	-	-	-	-
Options on interest rate futures	-	-	-	-
Total interest rate instruments	**1,140.4**	**1,010.3**	**1,003.5**	**1,133.5**
Currency-related instruments				
OTC products				
Spot and forward foreign exchange transactions	6.1	40.6	217.8	45.7
Cross-currency interest rate swaps	344.6	134.2	453.1	144.1
Currency options	-	-	-	-
Other currency-related instruments	-	-	-	-
Exchange-listed contracts				
Currency futures	-	-	-	-
Currency options	-	-	-	-
Total currency-related instruments	**350.7**	**174.8**	**670.9**	**189.8**
Other forward transactions				
OTC products				
Credit default swaps	0.0	24.4	-	60.0
Credit-linked notes	0.0	0.0	-	-
Other forward transactions	1.8	1.8	2.0	5.9
Exchange-listed contracts				
Equity index futures	-	-	-	-
Total other forward transactions	**1.8**	**26.2**	**2.0**	**65.9**
Total	**1,492.9**	**1,211.3**	**1,676.4**	**1,389.2**

Derivatives have been entered into with the following counterparties:

Euro mn	Market value (31 Dec 2009) positive	Market value (31 Dec 2009) negative	Market value (31 Dec 2008) positive	Market value (31 Dec 2008) negative
OECD public-sector authorities				
OECD banks	1,228.9	1,201.3	1,375.6	1,378.2
Non-OECD banks				
Companies and private individuals	264.0	10.0	300.8	11.0
Total	**1,492.9**	**1,211.3**	**1,676.4**	**1,389.2**

Other Disclosures

Disclosures in accordance with section 28 of the German Pfandbrief Act (Pfandbriefgesetz, PfandBG)

Total amount and related cover assets pool of outstanding mortgage bonds and public-sector covered securities

Euro mn	Cover assets pool	Covered bonds outstanding	Excess cover
31 Dec 2009			
Mortgage bonds			
Nominal value	9,181.0	7,367.6	1,813.4
Present value	9,862.2	7,651.2	2,211.0
Public-sector covered bonds			
Nominal value	3,179.0	2,810.8	368.2
Present value	3,457.8	3,101.3	356.5

Euro mn	Cover assets pool	Covered bonds outstanding	Excess cover
31 Dec 2008			
Mortgage bonds			
Nominal value	7,731.3	7,016.1	715.2
Present value	8,288.1	7,219.1	1,069.0
Public-sector covered bonds			
Nominal value	3,263.8	2,984.5	279.3
Present value	3,488.5	3,228.6	259.9

Euro mn	Share of derivatives in the cover assets pool 2009	Share of derivatives in the cover assets pool 2008
Mortgage bonds	189.3	195.7
Public-sector covered bonds	73.7	51.9

Euro mn	Cover assets pool	Covered bonds outstanding	Excess cover
31 Dec 2009			
Risk-adjusted net present value			
Mortgage bonds	9,840.9	7,893.0	1,947.9
Public-sector covered bonds	3,853.5	3,634.5	219.0

Euro mn	Cover assets pool	Covered bonds outstanding	Excess cover
31 Dec 2008			
Risk-adjusted net present value			
Mortgage bonds	8,206.7	7,406.7	800.0
Public-sector covered bonds	3,730.7	3,527.0	203.7

Maturity structure as well as fixed-interest periods of the corresponding cover assets pool:

Euro mn	Cover assets pool	Covered bonds outstanding
31 Dec 2009		
Mortgage bonds		
Up to 1 year	1,329.2	1,196.5
Between 1 year and 2 years	1,620.3	1,713.6
Between 2 years and 3 years	1,253.5	1,059.6
Between 3 years and 4 years	1,343.5	955.8
Between 4 years and 5 years	1,336.7	682.8
Between 5 years and 10 years	1,983.4	1,596.7
More than10 years	314.4	162.6
Total	**9,181.0**	**7,367.6**
Public-sector covered bonds		
Up to 1 year	132.5	133.0
Between 1 year and 2 years	115.3	71.2
Between 2 years and 3 years	159.7	146.3
Between 3 years and 4 years	362.4	535.9
Between 4 years and 5 years	105.5	197.2
Between 5 years and 10 years	650.7	765.0
More than10 years	1,652.9	962.2
Total	**3,179.0**	**2,810.8**

Euro mn	Cover assets pool	Covered bonds outstanding
31 Dec 2008		
Mortgage bonds		
Up to 1 year	1,101.7	1,052.2
Between 1 year and 2 years	846.3	1,136.7
Between 2 years and 3 years	1,352.5	1,773.2
Between 3 years and 4 years	1,189.1	700.2
Between 4 years and 5 years	893.5	597.6
Between 5 years and 10 years	2,178.5	1,539.3
More than10 years	169.7	216.9
Total	**7,731.3**	**7,016.1**
Public-sector covered bonds		
Up to 1 year	220.9	223.2
Between 1 year and 2 years	107.3	119.7
Between 2 years and 3 years	115.7	70.4
Between 3 years and 4 years	192.9	146.3
Between 4 years and 5 years	271.7	547.0
Between 5 years and 10 years	721.4	828.6
More than10 years	1,633.9	1,049.3
Total	**3,263.8**	**2,984.5**

Loans and advances used to cover mortgage bonds:

Euro mn	Cover assets pool 2009	Cover assets pool 2008
Distribution of the amounts measured at nominal value by volume		
Up to € 300,000	14.2	10.5
More than € 300,000 up to € 5 million	795.5	755.4
More than € 5 million	8,371.3	6,965.4
Total	**9,181.0**	**7,731.3**

As at the balance sheet date, the loans and advances used for lending against mortgage bonds included payment arrears of 90 days or more in the amount of € 0.1 million, of which € 0.02 million refer to Germany and € 0.08 million to Italy. There were no such payment arrears of 90 days or more in the comparable period of the previous year.

Distribution of the amounts measured at nominal value by countries in which the real property collateral is located:

Euro mn	Pure building sites	Buildings not yet yielding returns	Commercial property: Office buildings	Commercial property: Wholesale/Retail	Commercial property: Industrial	Commercial property: Others	Commercial property: Total	Residential property: Single family homes	Residential property: Multi family homes	Residential property: Apartments	Residential property: Total	Total cover assets pool
31 Dec 2009												
Belgium		3.6	131.8	26.9	9.0	36.3	204.0					207.6
Denmark	10.8	65.7	94.0	27.6	14.6	24.4	160.6			2.7	2.7	239.8
Germany	1.4	10.8	170.4	79.7	252.2	197.8	700.1	0.8	3.1	795.9	799.8	1,512.1
Finland			35.7	225.8	5.4	20.5	287.4					287.4
France	1.9	2.9	418.0	46.5	194.8	61.3	720.6					725.4
UK			126.5	147.9	67.4	84.3	426.1					426.1
Italy	71.0	6.3	668.7	337.5	58.5	99.9	1,164.6			95.5	95.5	1,337.4
Canada			66.7			137.9	204.6					204.6
Luxembourg			4.5				4.5					4.5
Netherlands		13.8	150.7		173.2	104.4	428.3			16.4	16.4	458.5
Norway				14.3	6.4		20.7					20.7
Poland		89.3	182.6	153.5	44.5		380.6					469.9
Sweden			327.3	64.9	220.3	19.1	631.6			90.8	90.8	722.4
Switzerland		11.5	125.9	34.1	3.1	59.0	222.1					233.6
Spain		117.9		233.1	2.4	52.7	288.2					406.1
Republic of Slovakia					7.7		7.7					7.7
Czech Republic	3.8		128.0	9.7	16.2	70.0	223.9					227.7
USA		143.4	83.6	226.4	29.3	117.5	456.8			57.8	57.8	658.0
Total	**88.9**	**465.2**	**2,714.4**	**1,627.9**	**1,105.0**	**1,085.1**	**6,532.4**	**0.8**	**3.1**	**1,059.1**	**1,063.0**	**8,149.5**

Euro mn	Pure building sites	Buildings not yet yielding returns	Commercial property: Office buildings	Commercial property: Wholesale/Retail	Commercial property: Industrial	Commercial property: Others	Commercial property: Total	Residential property: Single family homes	Residential property: Multi family homes	Residential property: Apartments	Residential property: Total	Total cover assets pool
31 Dec 2008												
Belgium		3.4	70.8		9.0	36.3	116.1					119.5
Denmark		19.4	85.5	32.6	7.0	25.1	150.1					169.5
Germany	1.5	26.5	210.8	79.0	223.1	198.0	710.9	3.3	3.8	659.5	666.6	1,405.5
Finland			38.6	216.4	5.4	20.5	280.9					280.9
France		150.1	262.0	53.8	182.9	83.0	581.7					731.8
UK	40.9		135.1	147.0	65.2	77.8	425.1					466.0
Italy			613.9	321.0	12.8	93.7	1,041.3			85.6	85.6	1,126.9
Canada			59.6			118.5	178.1					178.1
Luxembourg			4.5				4.5					4.5
Netherlands			159.0		168.2	91.7	418.9			16.4	16.4	435.3
Norway					4.0		4.0					4.0
Poland		29.0	178.6	218.1	45.4		442.1					471.1
Sweden		10.9	218.1	62.2	219.7	35.1	535.1			81.5	81.5	627.5
Switzerland		20.5	156.7	56.6	3.1	65.5	281.9					302.4
Spain		131.8		229.7		46.4	276.1					407.9
Republic of Slovakia					7.7		7.7					7.7
Czech Republic			157.9	9.6	16.2	99.0	282.6					282.6
USA			179.3	192.1		48.4	419.8			59.8	59.8	479.7
Total	**42.4**	**391.6**	**2,530.4**	**1,618.1**	**969.7**	**1,039.0**	**6,157.0**	**3.3**	**3.8**	**902.8**	**909.9**	**7,500.9**

In the financial year 2009, the bank did not acquire any properties for the purpose of loss prevention (2008: none).

As at 31 December 2009, interest payments were overdue in the amount of € 1.6 million (2008: € 7.2 million) for commercial property, and in the amount of € 0.1 million (2008: € 0.3 million) for residential property.

As at 31 December 2009, there were no foreclosures or forced administration procedures pending.

Redemptions in cover assets pool

Euro mn	Commercial property 2009	Commercial property 2008	Residential property 2009	Residential property 2008
Scheduled repayments	204.1	159.6	42.3	50.1
Extraordinary repayments	708.7	482.8	27.4	130.3
Total	**912.8**	**642.4**	**69.7**	**180.4**

Distribution of the loans and advances measured at nominal value and used to cover public-sector covered bonds by country in which the debtor or the guaranteeing body is located:

	Sovereigns	Public-sector entities		Others	Total
Euro mn		regional	municipal		
31 Dec 2009					
Germany	142.7	2,149.4	40.3	32.0	2,364.4
Italy	89.0				89.0
France	65.0				65.0
Great Britain				7.5	7.5
Ireland	25.0				25.0
Austria	195.2	25.0			220.2
Spain		148.5	35.0		183.5
Netherlands	25.0				25.0
Hungary	25.0				25.0
Japan	50.0		20.0		70.0
Luxembourg				49.4	49.4
Portugal	25.0	30.0			55.0
Total	**641.9**	**2,352.9**	**95.3**	**88.9**	**3,179.0**

	Sovereigns	Public-sector entities		Others	Total
Euro mn		regional	municipal		
31 Dec 2008					
Germany	164.6	2,224.9	36.8	33.3	2,459.6
Italy	89.0				89.0
France	25.0			49.4	74.4
United Kingdom				7.5	7.5
Ireland	25.0				25.0
Austria	195.2	25.0			220.2
Switzerland		50.0			50.0
Spain		148.5	35.0	4.6	188.1
Hungary	25.0				25.0
Japan	50.0		20.0		70.0
Portugal	25.0	30.0			55.0
Total	**598.8**	**2,478.4**	**91.8**	**94.8**	**3,263.8**

The loans and advances used for lending against public-sector covered bonds did not include any items with payment arrears of 90 days or more.

Contingencies

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

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.

Due to its participating interest in Liquiditäts-Konsortialbank GmbH, Frankfurt/Main, in the nominal amount of € 1.0 million, Aareal Bank AG has call commitments of up to € 6.0 million. In addition, Aareal Bank AG has a pro-rata principal liability in the event of non-fulfilment of call commitments by other co-shareholders, who hold aggregate interests of € 63.0 million.

Consolidated financial statements

As the parent company of the Aareal Bank Group, Aareal Bank AG, Wiesbaden, prepares consolidated financial statements incorporating the bank. The consolidated financial statements will be deposited with the Register of Companies at the Wiesbaden District Court (Amtsgericht, company reg. no. HRB 13 184) and will also be available from Aareal Bank AG in Wiesbaden, Germany.

Loans to executive bodies of Aareal Bank

Loans granted to members of the Supervisory Board amounted to € 1.2 million as at 31 December 2009 (31 December 2008: € 1.5 million). Loans and advances to members of the Management Board of Aareal Bank AG totalled € 0.0 million (2008: € 0.0 million). Total loans and advances to other related parties amounted to € 2.0 million (2008: € 2.1 million) as at the balance sheet date. Loans extended generally have a term between ten and 18 years, and bear interest at rates between 3.06% and 5.66%. Collateral was provided in line with usual market practice. In the year under review, repayments on loans extended amounted to € 0.6 million.

Remuneration report

Principles of the remuneration of the Management Board

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

In view of the conclusion of the agreement entered into with the Financial Markets Stabilisation Fund (SoFFin), the members of the Management Board waived the portion of the contractually fixed remuneration exceeding € 500,000 as well as the variable remuneration component for the financial years 2009 and 2010, respectively.

Aareal Bank AG has entered into fixed-term service contracts with the members of its Management Board. In addition to fixed salary components, which are paid in twelve identical monthly instalments, the members of the Management Board receive a bonus in form of a variable remuneration and are granted phantom shares as a long-term remuneration. The basis for this variable remuneration component is a target system, largely based on net income (of the Group) as reported under International Financial Reporting Standards (IFRS), as well as qualitative and quantitative targets, which are redefined annually. The phantom shares granted as a long-term component may be exercised in whole or in part during an exercise period of four years after the reference date, up to one fourth per year. They may be exercised for the first time in the year of allocation, in each case within five working days following the publication of the quarterly report. Phantom shares not exercised in a particular year may be exercised in the subsequent year. Upon exercise, the relevant proportion of virtual shares is converted at the weighted average price as reported by Bloomberg on the exercise date. If dividends are paid on the Company's shares during the exercise period, a corresponding distribution is made and classified as other remuneration.

Remuneration

Remuneration of the members of the Management Board can be broken down as follows:

Euro	Year	Fixed remuneration	Cash bonus	Other remuneration [1)]	Total
Dr Wolf Schumacher	2009	500,000.00	-	25,269.47	525,269.47
	2008	725,000.04	712,500.00	22,864.84	1,460,364.88
Norbert Kickum	2009	500,000.00	-	29,161.42	529,161.42
	2008	562,500.03	243,750.00	25,018.20	831,268.23
Hermann J. Merkens	2009	500,000.00	-	48,901.86	548,901.86
	2008	592,500.03	243,750.00	33,288.31	869,538.34
Thomas Ortmanns	2009	500,000.00	-	23,323.02	523,323.02
	2008	562,500.03	243,750.00	20,595.74	826,845.77
Total	**2009**	2,000,000.00	-	126,655.77	2,126,655.77
	2008	2,442,500.13	1,443,750.00	101,767.09	3,988,017.22

1) Other remuneration includes payments (in particular for company cars) in the amount of € 73,146.71 for 2009 (2008: € 58,233.74) as well as benefits related to social security contributions totalling € 43,922.16 for 2009 (2008: € 42,794.40).

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

Long-term component

In 2009, the members of the Management Board did not receive payments from long-term components pursuant to the terms and conditions of the share-based payment transactions, based on the agreement entered into with SoFFin.

		Long-term component	
Euro	Year	Value at award date	Quantity
Dr Wolf Schumacher	2009	0.00	0.00
	2008	375,000.00	59,618.44 [1)]
Norbert Kickum	2009	0.00	0.00
	2008	375,000.00	59,618.44 [1)]
Hermann J. Merkens	2009	0.00	0.00
	2008	375,000.00	59,618.44 [1)]
Thomas Ortmanns	2009	0.00	0.00
	2008	375,000.00	59,618.44 [1)]

1) In the remuneration report for 2008, the conversion of granted € amounts into a certain number of phantom shares was based on the share price as at 31 December 2008 (€ 5.75). The share price upon granting the phantom shares was € 6.29. The holding period for these phantom shares is three years; the subsequent exercise period is also three years.

Pensions, retirement benefits and severance pay

The benefit regulations as agreed in the employment contract apply to the members of the Management Board of Aareal Bank. Accordingly, the members of the Management Board are entitled to receive pension payments after completing their 60th year of age, or earlier in case of a permanent disability of service. The pension claims listed below are vested.

The following overview shows the pension claims of the members of the Management Board as at the balance sheet date:

	Pension claims p.a.	
	31 Dec 2009	31 Dec 2008
Euro 000's		
Dr. Wolf Schumacher	350	350
Norbert Kickum	200	200
Hermann J. Merkens	200	200
Thomas Ortmanns	200	200
Total	**950**	**950**

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. The pension paid to widows amounts to 60% of the pension of the member of the Management Board, while pensions to orphans and half-orphans amount to 20% and 10%, respectively.

Aareal Bank intends to contribute parts of the assets held to cover existing pension obligations into a Contractual Trust Arrangement (CTA) in 2010. This is to ensure an improved insolvency protection of the pension claims as a result of the limited protection provided by the German Pension Guarantee Association (Pensionssicherungsverein; PSVaG).

Members of the Management Board who joined the Company before 1 January 2005 are entitled to receive contractual pension payments before they reach the age of 60 when they have served for a period of five years, in case the bank rejects an extension of their service contract.

The pension provisions for active and former members of the Management Board and their surviving dependants were increased by € 1,093 thousand (2008: € 1,689 thousand) in the year under review. The total amount of pension provisions was € 10,633 thousand (2008: € 10,640 thousand). Of that amount, € 8,354 thousand related to former members of the Management Board and their surviving dependants (2008: € 8,190 thousand). Payments to former Management Board members of Aareal Bank AG and their surviving dependants totalled € 523 thousand (2008: € 510 thousand).

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

In the case of a change of control and a resulting loss of membership in the Management Board, the members affected receive, in settlement of their total remuneration, their fixed remuneration, as agreed in their employment contracts, as well as a contractually agreed compensation for the variable remuneration, paid in monthly instalments during the remaining term of the agreements. In addition, the members of the Management Board receive a lump-sum payment of up to approx. 45% (2008: 45%) of their fixed remuneration for 2009, while the Chairman receives 70% (2008: 70%) of his fixed remuneration for 2009.

If, in case of a change of control, members of the Management Board resign from office or are not willing to extend their office in spite of an offer on the part of the Company, the respective member of the Management Board receives, in settlement of the total remuneration, the contractually agreed fixed remuneration. In addition, the relevant member of the Management Board receives a lump-sum payment of up to approx. 32.5% (2008: 32.5%) of his fixed remuneration for 2009, while the Chairman receives 45% (2008: 45%) of his fixed remuneration for 2009.

Remuneration for members of the Supervisory Board

Principles of the remuneration of the Supervisory Board

The remuneration of the Supervisory Board is specified in Section 9 of the Memorandum and Articles of Association of Aareal Bank AG. The resolution adopted by the Annual General Meeting on 23 May 2006, which resulted in a change of the remuneration system of the Supervisory Board, currently applies.

The total remuneration of the Supervisory Board comprises a fixed and a variable remuneration component, comparable to the remuneration package of the Management Board. The variable remuneration is performance-related and comprises a short-term and a long-term component.

The fixed remuneration is € 20,000 p.a. for each Supervisory Board member. The Chairman of the Supervisory Board shall receive twice the amount, while the deputy shall receive one and a half times as much as a normal member. The fixed remuneration shall be increased by € 10,000 p.a. for each membership in a Supervisory Board committee (with the exception of the Committee for Urgent Decisions, which is a part of the Credit and Market Risk Committee, as well as the Nomination Committee, which exclusively acts as an advisory committee). The fixed remuneration shall be increased instead by € 20,000 p.a. for Chairmanship of a Supervisory Board committee (also with the exception of the Committee for Urgent Decisions, which is a part of the Credit and Market Risk Committee, as well as the Nomination Committee, which exclusively acts as an advisory committee). The fixed remuneration component of a Supervisory Board member, including the remuneration for the Chairmanship of a Supervisory Board committee, forms a basis for assessing the performance-related remuneration.

The performance-related remuneration only comes into effect if a dividend of not less than € 0.20 per share is paid for the financial year in question.

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

The long-term performance-related remuneration of a Supervisory Board member amounts to 12.5% of the individual assessment basis for each 10% increase in the consolidated net income attributable to shareholders of Aareal Bank AG (as reported in the consolidated income statement) over the unweighted average of the consolidated net income attributable to shareholders of Aareal Bank AG for the three previous full financial years. The long-term performance-related remuneration is not paid if the average value is negative. On this basis, the members of the Supervisory Board are not entitled to a long-term performance-related remuneration for the 2009 financial year.

The maximum long-term performance-related remuneration is capped at 50% of the individual assessment basis, so that the aggregate variable remuneration may amount to a maximum of 100% of the fixed remuneration component.

The fixed remuneration is due at the end of each financial year. The variable remuneration component is due after the Annual General Meeting in which a resolution is passed on the appropriation of net income for the relevant financial year. The bank reimburses the VAT amounts to be paid on the remuneration.

In accordance with the methodology presented, the members of the Supervisory Board received a collective fixed remuneration for the 2009 financial year in the amount of € 559,300.00, which is the same amount paid in 2008. As a result of the agreement entered into with SoFFin, the management proposes not to pay dividends for the financial year 2009. Therefore, as in the previous year, no variable remuneration will be paid to the members of the Supervisory Board.

The individual amount of the remuneration for the Supervisory Board is shown in the following table. The figures in the table include the reimbursement for VAT (19%).

Euro	Year	Fixed remuneration	Variable remuneration	Total
Hans W. Reich,	2009	107,100.00	-	107,100.00
Chairman	2008	107,100.00	-	107,100.00
Erwin Flieger,	2009	59,500.00	-	59,500.00
Deputy Chairman	2008	59,500.00	-	59,500.00
York-Detlef Bülow,	2009	59,500.00	-	59,500.00
Deputy Chairman	2008	59,500.00	-	59,500.00
Tamara Birke	2009	35,700.00	-	35,700.00
	2008	35,700.00	-	35,700.00
Thomas Hawel	2009	23,800.00	-	23,800.00
	2008	23,800.00	-	23,800.00
Helmut Wagner	2009	23,800.00	-	23,800.00
	2008	23,800.00	-	23,800.00
Christian Graf von Bassewitz	2009	47,600.00	-	47,600.00
	2008	47,600.00	-	47,600.00
Manfred Behrens	2009	23,800.00	-	23,800.00
	2008	23,800.00	-	23,800.00
Joachim Neupel	2009	59,500.00	-	59,500.00
	2008	59,500.00	-	59,500.00
Dr. Herbert Lohneiß	2009	35,700.00	-	35,700.00
	2008	35,700.00	-	35,700.00
Prof. Dr. Stephan Schüller	2009	47,600.00	-	47,600.00
	2008	47,600.00	-	47,600.00
Wolf R. Thiel	2009	35,700.00	-	35,700.00
	2008	35,700.00	-	35,700.00
Total	**2009**	**559,300.00**	**-**	**559,300.00**
	2008	**559,300.00**	**-**	**559,300.00**

The members of the Supervisory Board did not provide any consulting or agency services, or other personal services in 2009. Therefore, no additional remuneration was paid.

Employees

The average staffing level is shown below:

	2009	2008
Employees		
of which:		
Full-time employees	838	902
Part-time employees	157	159
Vocational and other trainees	10	13
Total	**1,005**	**1,074**

Auditors' fees

The total fee charged by the auditor is as follows:

Euro 000's	
Category	
Audit services	3,007.1
Testation	214.1
Tax advisory services	159.1
Other services	1,124.5
Total	**4,504.8**

Notice pursuant to sections 21 et seq. of the WpHG

Pursuant to the German Securities Trading Act (Wertpapierhandelsgesetz – "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 Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungen – "BaFin"). The lowest threshold for this notification requirement is 3%. 62.77% of Aareal Bank AG shares are held in free float. The largest shareholder of the Company is Aareal Holding Verwaltungsgesellschaft mbH with an interest of 37.23%.

Correction of the notification of voting rights of 5 January 2010:

On 30 December 2009, Wellington Management Company LLP, Boston, Massachusetts, USA, notified us according to section 21 (1) WpHG that its share of voting rights in Aareal Bank AG, Wiesbaden, Germany, ISIN: DE0005408116, German Securities ID: 540811, fell below the threshold of 3% of total voting rights on 18 December 2009 and amounted to 2.14% (corresponding to 915,180 voting rights) on that day.

2.14% of the voting rights (corresponding to 915,180 voting rights) are attributable to the company pursuant to section 22 (1) sentence 1 No. 6 of the WpHG.

30 December 2009

On 30 December 2009, Wellington Management Company LLP, Boston, Massachusetts, USA, notified us according to section 21 (1) WpHG that its share of voting rights in Aareal Bank AG, Wiesbaden, Germany, ISIN: DE0005408116, German Securities ID: 540811, fell below the threshold of 3% of total voting rights on 18 December 2009 and amounted to 2.14% (corresponding to 915,180 voting rights) on that day.

1 April 2009

On 1 April 2009, Wellington Management Company LLP, Boston, Massachusetts, USA, notified us according to section 21 (1) WpHG that, on the basis of shares held, its share of voting rights in Aareal Bank AG, Wiesbaden, Germany, ISIN: DE0005408116, German Securities ID: 540811, fell below the threshold of 3% of total voting rights on 31 March 2009 and amounted to 3.02% (corresponding to 1,290,590 voting rights) on that day. 3.02% of the voting rights (corresponding to 1,290,590 voting rights) are attributable to the company pursuant to section 22 (1) sentence 1 No. 6 of the WpHG.

17 March 2009

”Persons subject to a notification obligation: Federal Republic of Germany, acting through the German Financial Markets Stabilisation Fund, 60329 Frankfurt/Main, Germany, represented by the Financial Market Stabilisation Authority, c/o Deutsche Bundesbank, 60329 Frankfurt/Main, Germany.

Issuer:
Aareal Bank AG
Paulinenstrasse 15
65189 Wiesbaden
Germany

We herewith notify you that the share of voting rights held by the Federal Republic of Germany exceeded the thresholds of 3%, 5%, 10%, 15%, 20%, 25% and 30% on 13 March 2009, amounting to 37.23% (equivalent to 15,916,881 voting rights) on that day. All of the voting rights are attributable to the Federal Republic of Germany pursuant to section 22 (2) of the WpHG due to an agreement on voting rights concluded with Aareal Holding Verwaltungsgesellschaft mbH, Düsseldorf. The Federal Republic of Germany does not directly hold any shares or voting rights in Aareal Bank AG.
Financial Markets Stabilisation Fund represented by the Financial Market Stabilisation Authority"

Apart from that, we are not aware of any direct or indirect shareholdings of 10% or more of the voting rights.

Corporate Governance Code

The declaration regarding the German Corporate Governance Code, pursuant to section 161 of the AktG, has been submitted and published on our website: http://www.aareal-bank.com/investor-relations/corporate-governance/entsprechenserklaerung-gemaess-161-aktg/.

Proposal on the appropriation of profits

The Management Board proposes to the Annual General Meeting that the net retained profit of € 2,000,000 for the financial year 2009 be transferred to retained earnings.

Executive Bodies of Aareal Bank AG
Offices held in accordance with section 285 no. 10 of the German Commercial Code (HGB) in conjunction with section 125 (1) sentence 3 of the German Stock Corporation Act (AktG)

Supervisory Board

Hans W. Reich, Chairman of the Supervisory Board **Chairman Public Sector Group, Citigroup**		
Aareal Bank AG	Chairman of the Supervisory Board	
Citigroup Global Markets Deutschland AG & Co.KGaA	Chairman of the Supervisory Board	
HUK-COBURG Haftpflicht Unterstützungskasse kraftfahrender Beamter Deutschlands a. G. in Coburg	Member of the Supervisory Board	
HUK-COBURG-Holding AG	Member of the Supervisory Board	
ThyssenKrupp Steel AG	Member of the Supervisory Board	until 30 September 2009

Erwin Flieger, Deputy Chairman of the Supervisory Board **Chairman of the Supervisory Boards of Bayerische Beamten Versicherungsgruppe**	
Aareal Bank AG	Deputy Chairman of the Supervisory Board
Bayerische Beamten Lebensversicherung a.G.	Chairman of the Supervisory Board
Bayerische Beamten Versicherung AG	Chairman of the Supervisory Board
BBV Holding AG	Chairman of the Supervisory Board
DePfa Holding Verwaltungsgesellschaft mbH	Chairman of the Supervisory Board
MEAG MUNICH ERGO Kapitalanlagegesellschaft mbH	Member of the Supervisory Board
Neue Bayerische Beamten Lebensversicherung AG	Chairman of the Supervisory Board

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

Christian Graf von Bassewitz, **Banker (ret'd.); former Spokesman of the General Partners of Bankhaus Lampe KG**		
Aareal Bank AG	Member of the Supervisory Board	
Balance Vermittlungs- und Beteiligungs-AG	Deputy Chairman of the Supervisory Board	
Bank für Sozialwirtschaft Aktiengesellschaft	Member of the Supervisory Board	
Deutscher Ring Krankenversicherungsverein a.G.	Deputy Chairman of the Supervisory Board	
OVB Holding AG	Member of the Supervisory Board	
SIGNAL IDUNA Allgemeine Versicherung AG	Member of the Supervisory Board	since 26 March 2009
SIGNAL IDUNA Holding AG	Member of the Supervisory Board	since 26 March 2009
Societaet CHORVS AG	Member of the Supervisory Board	

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

Manfred Behrens		
Chairman of the Management Board of AWD Holding AG		
Aareal Bank AG	Member of the Supervisory Board	
Tamara Birke*		
Aareal Bank AG		
Aareal Bank AG	Member of the Supervisory Board	
SIRWIN AG	Member of the Supervisory Board	until 7 May 2009
Thomas Hawel*		
Aareon Deutschland GmbH		
Aareal Bank AG	Member of the Supervisory Board	
Aareon Deutschland GmbH	Deputy Chairman of the Supervisory Board	
Dr Herbert Lohneiß		
Former Chief Executive Officer of Siemens Financial Services GmbH (ret'd.)		
Aareal Bank AG	Member of the Supervisory Board	
UBS Global Asset Management (Deutschland) GmbH	Member of the Supervisory Board	
Joachim Neupel, Chairman of the Accounts and Audit Committee		
German Chartered Accountant, tax consultant		
Aareal Bank AG	Member of the Supervisory Board	
Prof Dr Stephan Schüller		
Spokesman of the General Partners of Bankhaus Lampe KG		
Aareal Bank AG	Member of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	
hanse chemie AG	Chairman of the Supervisory Board	
NANORESINS AG	Chairman of the Supervisory Board	
Universal-Investment-Gesellschaft mbH	Member of the Supervisory Board	
Wolf R. Thiel		
President and Chairman of the Management Board of Versorgungsanstalt des Bundes und der Länder		
Aareal Bank AG	Member of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	
Helmut Wagner*		
Aareon Deutschland GmbH		
Aareal Bank AG	Member of the Supervisory Board	
Aareon Deutschland GmbH	Member of the Supervisory Board	

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

Management Board

Dr Wolf Schumacher, Chairman of the Management Board		
Aareal Estate AG	Deputy Chairman of the Supervisory Board	
Aareal Valuation GmbH	Chairman of the Supervisory Board	
Aareon AG	Member of the Supervisory Board	
Leica AG	Chairman of the Supervisory Board	until 31 August 2009
Norbert Kickum, Member of the Management Board		
Aareal Bank France S.A.	Member of the Board of Directors	
Aareal Financial Service Polska Sp.z o.o.	Member of the Supervisory Board	
Aareal Bank Asia Limited	Member of the Board of Directors	
Aareal Bank Asia Limited	CEO (Chairman)	
Aareal Capital Corporation	Chairman of the Board of Directors	
Aareal Financial Service spol. s r.o.	Member of the Supervisory Board	
Aareon AG	Member of the Supervisory Board	
Deutsche Structured Finance GmbH	Member of the Advisory Board	
Hermann Josef Merkens, Member of the Management Board		
Aareal Estate AG	Chairman of the Supervisory Board	
Aareal Bank Asia Limited	Member of the Board of Directors	
Aareal Capital Corporation	Member of the Board of Directors	
Aareal First Financial Solutions AG	Member of the Supervisory Board	
Aareal Property Services B.V.	Chairman of the Supervisory Board	
Aareal Valuation GmbH	Member of the Supervisory Board	
Aareon AG	Member of the Supervisory Board	
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Chairman of the Supervisory Board	
Deutsche Interhotel Holding GmbH & Co. KG	Member of the Council of Shareholders	
Deutsche Structured Finance GmbH	Member of the Advisory Board	
RMS Risk Management Solutions GmbH	Member of the Supervisory Board	
Thomas Ortmanns, Member of the Management Board		
Aareal Bank France S.A.	Member of the Board of Directors	
Aareal First Financial Solutions AG	Chairman of the Supervisory Board	
Aareon AG	Chairman of the Supervisory Board	
Innovative Banking Solutions AG	Member of the Supervisory Board	

Offices held by Employees of Aareal Bank AG pursuant to 340a (4) No. 1 of the HGB

Dr Michael Beckers, Bank Director		
Aareal Financial Service Polska Sp. z o.o.	Member of the Supervisory Board	
Aareal Financial Service spol. s r.o.	Member of the Supervisory Board	
Sven Eisenblätter		
Aareal Valuation GmbH	Member of the Supervisory Board	
Dr Christian Fahrner, Bank Director		
Innovative Banking Solutions AG	Deputy Chairman of the Supervisory Board	
Ralf Gandenberger, Bank Director		
Terrain-Aktiengesellschaft Herzogpark	Deputy Chairman of the Supervisory Board	
Deutsche Interhotel Holding GmbH & Co. KG	Member of the Council of Shareholders	
Uli Gilbert		
Terrain-Aktiengesellschaft Herzogpark	Member of the Supervisory Board	
Dr Stefan Lange, Bank Director		
Aareal Estate AG	Member of the Supervisory Board	
Aareal First Financial Solutions AG	Member of the Supervisory Board	
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Member of the Supervisory Board	since 23 February 2009
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Deputy Chairman of the Supervisory Board	since 18 June 2009
Terrain-Aktiengesellschaft Herzogpark	Chairman of the Supervisory Board	
Peter Mehta, Bank Director		
Innovative Banking Solutions AG	Member of the Supervisory Board	
Markus Schmidt		
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Deputy Chairman of the Supervisory Board	until 23 February 2009
Christine Schulze Forsthövel, Bank Director		
Aareal Bank France S.A.	President of the Board of Directors	
Aareal Financial Service Polska Sp. z o.o.	Member of the Supervisory Board	
Aareal-Financial Service spol. s r.o.	Member of the Supervisory Board	
Martin Vest, Bank Director		
Aareal Bank France S.A.	Member of the Board of Directors	

Composition of Supervisory Board committees

Executive Committee	
Mr Reich	Chairman
Mr Flieger	Deputy Chairman
Mr Bülow	Deputy Chairman
Prof Dr Stephan Schüller	
Mr Thiel	

Committee for Urgent Decisions	
Mr Reich	Chairman
Dr Lohneiß	
Graf von Bassewitz	
Mr Flieger	
Mr Neupel	

Accounts and Audit Committee	
Mr Neupel	Chairman
Prof Dr Stephan Schüller	Deputy Chairman
Graf von Bassewitz	
Mr Bülow	
Mr Reich	

Nomination Committee
Mr Reich
Mr Flieger

Credit and Market Risk Committee	
Mr Reich	Chairman
Dr Lohneiß	Deputy Chairman
Graf von Bassewitz	
Mrs Birke	
Mr Flieger	
Mr Neupel	

Wiesbaden, 2 March 2010

The Management Board

Dr Wolf Schumacher   Norbert Kickum   Hermann J. Merkens   Thomas Ortmanns

Responsibility Statement

Statement pursuant to section 37y of the German Securities Trading Act (WpHG) in conjunction with section 37v (2) No. 3 of the WpHG

To the best of our knowledge, and in accordance with the applicable reporting principles for financial reporting, the financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the company, and the management report includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal opportunities and risks associated with the expected development of the company.

Wiesbaden, 2 March 2010

The Management Board

Dr Wolf Schumacher	Norbert Kickum	Hermann J. Merkens	Thomas Ortmanns

Auditors' Report

Following the completion of our audit we have certified the financial statements on 10 March 2010 without qualification:

Auditors' Report

We have audited the Financial Statements of Aareal Bank AG, Wiesbaden, comprising the Balance Sheet, Income Statement, and Notes to the Financial Statements for the financial year from 1 January to 31 December 2009. The company's Management Board is responsible for the accounting and the preparation of the Financial Statements and the Management Report in accordance with the German Commercial Code and supplementary provisions of the company's Memorandum and Articles of Association. Our responsibility is to express an opinion, having conducted an audit which included the accounting records, on the Financial Statements and the Management Report.

We conducted our audit in accordance with section 317 of the German Commercial Code, observing the generally accepted German auditing principles laid down by the Institute of Public Auditors in Germany (IDW). These standards require that we plan and perform the audit to obtain reasonable assurance as to whether the Financial Statements (based on generally accepted accounting principles) and the Management Report are free of material misrepresentations and present a true and fair view of the net worth, financial position and results of the company. In determining specific actions within the scope of our audit, we considered the Company's business activities as well as its economic environment and legal structure. Expectations regarding potential sources of error were also taken into account. The conduct of an audit includes examining the efficiency of the company's internal controlling mechanisms for its accounting system, as well as (on a sample basis) evidence supporting the disclosures in the accounting records, the Financial Statements and the Management Report. The scope of an audit also includes assessing the accounting principles used and significant estimates of the Management Board, as well as evaluating the overall presentation of the Financial Statements and the Management Report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any objections.

In our opinion, the financial statements present, in compliance with legal requirements, generally accepted accounting principles and the supplementary provisions of the Company's Memorandum and Articles of Association, a true and fair view of the Company's net worth, financial position and results. The management report is in accordance with the annual financial statements. On the whole, the management report provides a suitable understanding of the Company's position, and suitably presents the opportunities and risks of future developments.

Frankfurt/Main, 10 March 2010

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft (auditing firm)

Christian F. Rabeling Wirtschaftsprüfer (German Public Auditor)	(per power of attorney) Kerstin Klein Wirtschaftsprüferin (German Public Auditor)

Report of the Supervisory Board of Aareal Bank AG, Wiesbaden

Ladies and gentlemen, dear shareholders,

During the significant market turbulence in the course of the crisis affecting financial markets, Aareal Bank AG always reacted in a forward-looking manner, making use of the opportunities that arose to further safeguard the bank against negative market developments. Aareal Bank had sufficient cash and cash equivalents, and a solid refinancing base at all times throughout the 2009 financial year. Aareal Bank's utilisation of the opportunities presented by the Financial Markets Stabilisation Act reflects its forward-looking approach. This Act was originally designed to strengthen fundamentally sound banks against further turbulence on financial markets, thus preventing them from being affected by the general developments. On this basis, Aareal Bank AG sought SoFFin support.

The Supervisory Board continuously advised, controlled and monitored Aareal Bank AG's senior management throughout the challenging financial year under review. The Management Board informed the Supervisory Board regularly, and in a timely and detailed manner, both orally and in writing, of all issues important to the Group with regard to its situation, business development, and key financial indicators and market developments. Additionally, the Supervisory Board was informed in detail about the current liquidity status and measures for liquidity management, as well as about the risk situation, the risk controlling measures and the risk management system of the Group. The Supervisory Board also received comprehensive reports on the development of business segments, and on operative and strategic planning. It was involved in, and informed about, all key resolutions. All important events were subject to in-depth discussions and reviews. If a resolution by the Supervisory Board was necessary, the proposals for resolution were presented to the Supervisory Board and a decision was taken.

Furthermore, the Chairman of the Management Board provided the Chairman of the Supervisory Board with a continuous and regular update between the individual meetings, both in written form and orally, about all material developments within the company. The Chairman of the Management Board maintains regular close contact with the Chairman of the Supervisory Board, in order to discuss important issues and decisions within the scope of personal discussions.

Aareal Bank Group generated a profit in all quarters since the outbreak of the crisis affecting financial markets. The Supervisory Board sees this as an impressive confirmation of the sustainability of the Group's business model.

Activities of the plenary meeting of the Supervisory Board

Four ordinary meetings and one extraordinary meeting of the Supervisory Board were convened during the financial year under review. Within the scope of the meetings, the members of the Supervisory Board received the reports and explanations from the members of the Management Board, which they discussed intensively. The activities and reporting focused in all meetings on the manner in which the challenges posed by the financial markets crisis and the changes to the bank's business environment, as a consequence of the ensuing global economic crisis were dealt with. The process for making use of the opportunities presented by the Financial Markets Stabilisation Act is also associated with this. The entire process of applying for and negotiating the support from SoFFin was fully supported by the Supervisory Board.

The extensive changes to the regulatory environment this year were also discussed within the scope of the Supervisory Board's discussions; these include the amendments to the Minimum Requirements for Risk Management (MaRisk), the implementation of the German Accounting Law Reform Act (Bilanzrechtsmodernisierungsgesetz – "BilMoG"), the far-reaching changes to the corporate governance regulations and the adjustments to the generally accepted accounting principles under German commercial law.

The Management Board informed the Supervisory Board about the potential effects of economic developments, in a timely, detailed and transparent manner throughout the financial year as a whole, within the scope of all meetings and otherwise. It outlined in full the measures that were taken, in order to react appropriately to the challenges and the effects of the economic development on Aareal Bank AG.

In all ordinary plenary meetings of the Supervisory Board, the Management Board regularly provided the Supervisory Board with extensive reports about, including other things, the performance of the Structured Property Financing and Consulting/Services segments, especially taking into account current economic developments. The Supervisory Board was regularly informed about the liquidity situation and the corresponding measures taken by the bank's Treasury. Current figures and projections were also used to explain to the Supervisory Board the business development of Aareal Bank Group as a whole. Furthermore, the quality of the property financing portfolio was regularly reported against the background of the crisis affecting financial markets and the associated situation on the various property markets. The following key issues outlined below were also dealt with in individual meetings.

The planned utilisation of the SoFFin support measures, in the form of a silent participation in the amount of € 525 million and guarantees for issuing unsecured bonds up to a maximum of € 4 billion, was presented to the Supervisory Board and discussed conclusively at an extraordinary meeting held on 15 February 2009. The Supervisory Board approved the proposed procedure and the related agreements at this meeting.

In its meeting in March of last year, the Supervisory Board concerned itself intensively with the financial statements and consolidated financial statements presented for the 2008 financial year, as well as the external auditor's report. The relevant facts were reported in the Supervisory Board report of the previous year. Additionally, the proposal for selecting the external auditor for the Annual General Meeting was discussed and the subsequent appointment to be conducted. This also included the scope and focal points of the audit for the 2009 financial year, as defined by the Supervisory Board.

Other issues covered in the March meeting included the preparations for the Annual General Meeting in May 2009, the annual reports of the Internal Audit and the Compliance Officer.

The purpose of the Supervisory Board meeting in May was especially to debrief on the previous Annual General Meeting of Aareal Bank AG.

The fundamental aspects of the business plan for the years ahead was discussed in the meeting held in September. Corporate governance issues were also dealt with. These included the update of the German Corporate Governance Code, as well as the measures and procedures for implementing the BilMoG and other regulatory changes.

In the December meeting, the Management Board reported on projections for the Group from 2010 to 2012. The Management Board submitted and explained the projections in detail to the Supervisory Board. Corporate governance issues were discussed as well: within this context, the Supervisory Board adopted the Declaration of Compliance, pursuant to section 161 of the German Public Limited Companies Act (Aktiengesetz – "AktG"), for the year 2009, which was subsequently published on the bank's website. Another important issue in relation to the changes to the Corporate Governance regulation was the adjustment of Aareal Bank AG's existing rules and regulations in line with the updated status.

The Supervisory Board regularly examines the efficiency of its own working processes in order to identify any areas requiring improvement. The efficiency review conducted in the 2009 financial year confirmed the previous year's good results. The results were acknowledged by the members of the Supervisory Board, and were discussed in detail. No organisational changes to enhance efficiency were required this year either.

The Management Board regularly informed the Supervisory Board about the implementation of the regulatory regime, for example the amendments to the Minimum Requirements for Risk

Management (MaRisk) and the current status of the capital adequacy requirements in accordance with Basel II. The Management Board outlined the impact of such regulations on the bank, and discussed any changes to the regulatory framework with the Supervisory Board. The business strategy in accordance with the Minimum Requirements for Risk Management in Banks (MaRisk) was submitted and discussed, as scheduled.

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

Supervisory Board decisions that were met by way of circulation, were reported in the subsequent meeting. Thus the implementation of decisions taken was confirmed.

No conflicts of interest of members of the Supervisory Board, as defined in No. 5.5.3 of the German Corporate Governance Code, arose during the financial year 2009.

Activities of Supervisory Board committees

The Supervisory Board has established five committees in order to perform its supervisory duties in an efficient manner: the Executive Committee, the Credit and Market Risk Committee, the Committee for Urgent Decisions, the Accounts and Audit Committee, and the Nomination Committee.

The Executive Committee of the Supervisory Board convened four times. The Executive Committee prepared the plenary meetings of the Supervisory Board, together with proposed resolutions. In its meeting in March, it discussed issues concerning the remuneration of the Management Board that arose as a consequence of the utilisation of the SoFFin funds and the associated regulations on the remuneration of members of the Management Board.

The Credit and Market Risk Committee convened three times. The Management Board submitted detailed reports to the Committee, covering all markets in which the bank operates in the property finance business, as well as supplementary reports on property markets that are particularly affected by the financial markets crisis. The reports and market assessments were discussed in detail by the members of the Committee. The Committee also dealt with the granting of loans requiring approval and transactions subject to reporting requirements. The Management Board presented individual significant exposures to the Committee, and discussed these with it.

Decisions were also reached on all other issues requiring the Supervisory Board’s approval pursuant to the company’s Memorandum and Articles of Association, or the Management Board's internal rules of procedure. The Committee received regular reports on the bank's risk situation, which were submitted and explained by the Management Board. Having discussed the contents with the Management Board in detail, these were duly noted and approved by the members of the Committee. The Committee dealt with market risk, liquidity risk and operational risk, in addition to credit and country risks.

The Committee for Urgent Decisions is a sub-committee of the Credit and Market Risk Committee. Since the Committee for Urgent Decisions approves loans subject to approval requirements by way of circulation, it did not convene any meetings. Decisions taken between the meetings convened by the Credit and Market Risk Committee were dealt with in each of the subsequent meetings of the Credit and Market Risk Committee.

The Accounts and Audit Committee convened for six meetings. In its meeting in March 2009, the Committee received the external auditors' report on the 2008 financial year and discussed the results in detail with the auditors. The members examined the audit reports intensively and formed an opinion on the results of the audit on this basis, as well as within the scope of in-depth discussions held with the external auditors. Similarly, in accordance with the duties incumbent upon it pursuant to the Memorandum and Articles of Association, the Accounts and Audit Committee discussed the appointment of the external auditor in its meeting, and the focal points of the audit for 2009. The meetings held in August and November served to submit initial information on the progress of the audit activities for the 2009 financial year and to discuss issues that arose in the course of preparing the financial statements. In its December meeting, the Committee was presented with another report on the progress of the audit, as well as with the updated Group planning, which was also explained. The committee also received reports submitted by Internal Audit, and the Compliance Report, requesting and receiving detailed explanations.

Within the scope of the meetings convened in February, May, August and November, the Management Board presented and outlined to the Committee the quarterly results for the financial year and the preliminary results for the year 2008 as a whole, in accordance with the provisions of the German Corporate Governance Code.

In its meeting on 30 March 2010, the Accounts and Audit Committee received a comprehensive report from the external auditors on the audit and audit results for the 2009 financial year; the results were extensively discussed with the auditors and the Management Board.

The Nomination Committee, which was established in 2008, did not convene in 2009. The Committee is charged with coordinating and conducting the search for new shareholder representatives in the Supervisory Board, when a shareholder representative retires from office. In view of potential changes to the composition of the Supervisory Board in the 2010 financial year, preparatory consultations were entered into in the financial year under review.

Where members of the Supervisory Board were unable to attend a meeting, their absence was announced in advance, and the reasons for such absence were stated in advance. In relation to material decisions, these members of the Supervisory Board were represented by proxy or submitted their decision retrospectively in writing to the minutes. Two members of the Supervisory Board were unable to participate at fewer than half of the Supervisory Board meetings, due to external circumstances beyond their control.

Transactions of particular importance during 2009

On 15 February 2009, the Supervisory Board agreed to draw down funds made available within the scope of the Financial Markets Stabilisation Act. The Supervisory Board supported the preceding process and agreed to utilise a silent participation in the amount of € 525 million and a framework guarantee totalling up to € 4 billion for new unsecured issues with a maximum term of 36 months. The Supervisory Board is convinced that Aareal Bank has a viable business model and a sound funding structure: for this reason, the bank should be prepared for unpredictable developments on the financial markets, which are outside the bank's control. In deciding to make use of the opportunities presented by the Financial Markets Stabilisation Act, the Supervisory Board of Aareal Bank AG believes that the bank is well-positioned to deal with challenges that may arise within the course of the economic crisis.

Financial statements and consolidated financial statements

The Supervisory Board instructed PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt/Main, who were elected as external auditors by the Annual General Meeting 2009, to conduct the audit of the financial statements. The external auditors appointed submitted a statement regarding their independence to the Supervisory Board, which was duly noted. The Supervisory Board has no reason to doubt the accuracy of this statement of independence. Fulfilling their duties, PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft audited the financial statements and the Management Report prepared in accordance with the German Commercial Code (Handelsgesetzbuch – "HGB"), the consolidated financial statements and the Group Management Report prepared in accordance with IFRS, and certified the financial statements without qualification.

All members of the Supervisory Board received the audit reports regarding the financial statements and the consolidated financial statements, including all annexes thereto, in good time prior to the meeting during which the audit results were discussed. They informed themselves about the audit results on the basis of the documents received. The representatives of the external auditor participated in the meeting and presented the results of their audit in detail. The representatives of PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft were available to the Supervisory Board to answer further questions afterwards, 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, the consolidated financial statements prepared in accordance with IFRS and the Group Management Report, the proposal of the Management Board regarding the appropriation of profit and the audit report were all examined in detail. No objections were raised to the audit results. At its meeting on 30 March 2010, the Supervisory Board approved the results of the audit. The Supervisory Board therefore approved the financial statements and the Management Report of Aareal Bank AG, prepared in accordance with the HGB, together with the consolidated financial statements prepared in accordance with IFRS and the Group Management Report, thus confirming 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.

In conclusion, the Supervisory Board would like to thank the Management Board and all of the Group’s employees for their commitment and successful work during the challenging 2009 financial year. The employees' commitment and motivation during the recent months characterised by the general economic crisis, have undoubtedly contributed to the success enjoyed by Aareal Bank in this challenging situation.

Kronberg, March 2010

For the Supervisory Board

Hans W. Reich (Chairman)

Offices

Wiesbaden Head Office

Aareal Bank AG
Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3480
Fax: +49 611 3482549

Structured Property Financing

Amsterdam
Byzantium Building
Stadhouderskade 14e
1054 ES Amsterdam, The Netherlands
Phone: +31 20 5898660
Fax: +31 20 5898666

Berlin
Wallstrasse 9-13
10179 Berlin, Germany
Phone: +49 30 880990
Fax: +49 30 88099470

Brussels
7, rue Guimard
1040 Brussels, Belgium
Phone: +32 2 5144090
Fax: +32 2 5144092

Copenhagen
Frederiksgade 7, 1
1265 Copenhagen K, Denmark
Phone: +45 70 109090
Fax: +45 70 109091

Hamburg
Pelzerstrasse 7
20095 Hamburg, Germany
Phone: +49 40 33316546
Fax: +49 40 33316599

Helsinki
Aleksanterinkatu 44, 4. OG
00100 Helsinki, Finland
Phone: +358 9 6961010
Fax: +358 9 69610111

Istanbul
Ebulula Mardin Caddesi
Maya Meridyen Is Merkezi
D:2 Blok · Kat. 11
34335 Akatlar-Istanbul, Turkey
Phone: +90 212 3490200
Fax: +90 212 3490299

London
38 Lombard Street
London EC3V 9BS, United Kingdom
Phone: +44 20 74569200
Fax: +44 20 79295055

Madrid
Paseo de la Castellana, 60 - 4D
28046 Madrid, Spain
Phone: +34 915 902420
Fax: +34 915 902436

Milan
Via Paolo Andreani, 6
20122 Milan, Italy
Phone: +39 02 76419001
Fax: +39 02 764190211

Moscow
Business Centre „Mokhovaya“
4/7 Vozdvizhenka Street · Building 2
125009 Moscow, Russia
Phone: +7 499 2729002
Fax: +7 499 2729016

München
Prinzregentenstrasse 22
80538 Munich, Germany
Phone: +49 89 51270
Fax: +49 89 5127275

New York
Aareal Capital Corporation
250 Park Avenue · Suite 820
New York NY 10177, USA
Phone: +1 212 5084080
Fax: +1 917 3220285

Paris
Aareal Bank France S.A.
5, rue Scribe
75009 Paris, France
Phone: +33 1 44516630
Fax: +33 1 42669794

Prague
Aareal Financial Service spol. s r.o.
FORUM Building
Václavské námestí 19
11000 Prague 1, Czech Republic
Phone n: +420 234656006
Fax: +420 234656011

Rome
Via Mercadante, 12/14
00198 Rome, Italy
Phone: +39 06 83004200
Fax: +39 06 83004250

Shanghai
Suite 2902 · Tower 2 Plaza 66
No. 1266 Nanjing West Road
Jing An District
Shanghai 200040, P.R. of China
Phone: +86 21 62889908
Fax: +86 21 62889903

Singapore
Aareal Bank Asia Limited
3 Church Street
#17-03 Samsung Hub
Singapore 049483, Singapore
Phone: +65 6372 9750
Fax: +65 6536 8162

Stockholm
Hamngatan 11
11147 Stockholm, Sweden
Phone: +46 8 54642000
Fax: +46 8 54642001

Warsaw
RONDO 1
Rondo ONZ 1
00-124 Warsaw, Poland
Phone: +48 22 5449060
Fax: +48 22 5449069

Wiesbaden
Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3482950
Fax: +49 611 3482020

Zurich
Rennweg 52
8001 Zurich, Switzerland
Phone: +41 43 8887575
Fax: +41 43 8887576

Aareal Estate AG
Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3482446
Fax: +49 611 3483587

Aareal Valuation GmbH
Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3482059
Fax: +49 611 3482640

Deutsche Structured Finance GmbH
Westendstrasse 24
60325 Frankfurt/Main, Germany
Phone: +49 69 9714970
Fax: +49 69 971497510

Consulting/Services

Aareal Bank AG
Institutional Housing Unit
Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3482967
Fax: +49 611 3482499

Institutional Housing Unit
Berlin Branch
Wallstrasse 9-13
10179 Berlin, Germany
Phone: +49 30 88099444
Fax: +49 30 88099470

Institutional Housing Unit
Essen Branch
Huyssenallee 48
45128 Essen, Germany
Phone: +49 201 81008100
Fax: +49 201 81008200

Institutional Housing Unit
Hamburg Branch
Pelzerstrasse 7
20095 Hamburg, Germany
Phone: +49 40 33316850
Fax: +49 40 33316399

Institutional Housing Unit
Leipzig Branch
Neumarkt 2-4
04109 Leipzig, Germany
Phone: +49 341 2272150
Fax: +49 341 2272101

Institutional Housing Unit
Munich Branch
Prinzregentenstrasse 22
80538 Munich, Germany
Phone: +49 89 5127265
Fax: +49 89 51271264

Institutional Housing Unit
Rhine-Main Branch
Paulinenstrasse 15
65189 Wiesbaden, Germany
Hotline: +49 611 3482000
Fax: +49 611 3483002

Institutional Housing Unit
Stuttgart Branch
Kriegerstrasse 3
70191 Stuttgart, Germany
Phone: +49 711 2236116
Fax: +49 711 2236160

Aareon AG
Isaac-Fulda-Allee 6
55124 Mainz, Germany
Phone: +49 6131 3010
Fax: +49 6131 301419

Aareal First Financial Solutions AG
Peter-Sander-Strasse 30
55252 Mainz-Kastel, Germany
Phone: +49 6134 560119
Fax: +49 6134 560319

Deutsche Bau- und Grundstücks-Aktiengesellschaft
Chlodwigplatz 1
53119 Bonn, Germany
Phone: +49 228 5180
Fax: +49 228 518298

Deposit-taking

Dublin
4 Custom House Plaza · IFSC
Dublin 1, Ireland
Phone: +353 1 6369220
Fax: +353 1 6702785

Financial Calendar

11 May 2010	Presentation of interim report as at 31 March 2010
19 May 2010	Annual General Meeting – Rhein-Main-Hallen, Wiesbaden
August 2010	Presentation of interim report as at 30 June 2010
November 2010	Presentation of interim report as at 30 September 2010

North America

Europe

Asia / Pacific

Structured Property Financing
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Aareal Bank AG
Investor Relations
Paulinenstrasse 15
65189 Wiesbaden, Germany

Phone: +49 611 348 3009
Fax: +49 611 348 2637
E-mail: aareal@aareal-bank.com
www.aareal-bank.com

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