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2012

Aareal Bank AG – Annual Report 2012

Aareal Bank

Management Report

Business and operating environment

Group structure and business activities

Aareal Bank AG, headquartered in Wiesbaden, Germany, is the parent company of the Group. Its shares are admitted to listing and trading on the regulated market (Geregelter Markt) of the Frankfurt Stock Exchange, and are included in the mid-cap MDAX® index. Aareal Bank Group provides financing as well as advisory and other services to the commercial property sector and the institutional housing industry. It supports German and international clients, as a financing partner and service provider.

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

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

Structured Property Financing

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

In this segment, Aareal Bank facilitates property projects for its domestic and international clients, and is active in this respect in Europe, North America and Asia. The bank's particular strength lies in its ability to successfully combine 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 national and international clients. What makes Aareal Bank special are its direct client relationships, which – in very many cases – it has maintained for many years.

Aareal Bank has a broad and solid refinancing base. It has established itself as an active issuer of Pfandbriefe, which account for a major share of the bank's long-term funding. The quality of the cover assets pool is also confirmed by the AAA-rating of Aareal Bank's Pfandbrief issues. To cater to a broad investor base, Aareal Bank covers a wide range of other refinancing tools, including promissory notes and debt securities. Private placements are the focal point of our capital market activities. These are complemented by larger, public placements that are issued depending on market conditions. The bank also generates deposits from its long-term business relationships with companies from the institutional housing industry, and with institutional money market investors.

The success of our capital and money market activities, and the business with institutional housing industry clients, are the results of a combination of a sustainable business model with a sound understanding of the capital markets, and the quality of the cover assets pool.

Consulting/Services

The Consulting/Services segment offers the institutional housing sector services and products for managing residential property portfolios and processing payment flows. Within this segment, our subsidiary Aareon AG and the Institutional Housing Unit work closely together.

We operate the IT systems consultancy and related advisory services for the institutional housing industry through our Aareon AG subsidiary, which looks back at more than 50 years experience. Aareon pursues a multi-product strategy that covers the requirements of all client groups. It is active in several European countries with Germany being its core market. The ERP product portfolio for efficient process planning comprises SAP-based solutions such as Blue Eagle and the proprietary software Wodis with the Wodis Sigma product generation, as well as the GES and WohnData solutions that have long been established on the market. This product range is combined with extensive advisory services and integrated services that support networking between property companies and their business partners.

With its Institutional Housing Unit, Aareal Bank operates mass payment systems that are automated for the property management sector and integrated into clients' processes. The settlement of payment transactions via Aareal Bank generates client deposits that contribute to the refinancing base of the entire Group.

Company management

Since Aareal Bank AG's business is managed at Group level, the following description of company managementhas been prepared from the Group's perspective.

Aareal Bank Group's management concept is focused on sustained group development. The standard is to create added value for our shareholders, clients and employees. Particularly against the background of the financial markets and economic crisis, as well as the European sovereign debt crisis, the balanced approach which we pursue in our Group management has proved its mettle.

Aareal Bank Group is managed with the aid of indicator-based management tools that are designed and differentiated specifically by segment.

In addition to return and productivity management tools and the risk management system described in the risk report, we use the equity base and profitability – in particular at Group level – as central performance parameters, to manage and monitor our business. Our extensive risk management system is of great importance to us.

Aareal Bank Group manages its Group entities and their individual risk positions centrally. All management-relevant information is systematically collected and analysed to develop suitable strategies for risk management and monitoring. We also employ forecasting models for balance sheet structure, liquidity and portfolio development for strategic business and revenue planning.

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

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

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

In the Consulting/Services segment, management of the Group entities allocated to the segment is oriented on specific indicators, primarily EBIT (earnings before interest and taxes) and the EBIT margin, depending on each entity's business focus. We also use specific performance indicators that are typical for consulting and services in the IT business, the focus of this segment. These include indicators relating to regular client satisfaction surveys, as well as capacity utilisation indicators in the consultancy business. The primary performance indicators in the Institutional Housing Unit are volume of deposits, and the margin on deposits.

Macro-economic environment

The macro-economic environment in 2012 was defined largely by the European sovereign debt crisis. This had negative implications for sentiment in the real economy and led to a weak or even declining economy in many places in Europe. Via the transmission mechanism of international trading, it also burdened the economies in North America and Asia, although economic development there was more positive overall. Overall, the development of the global economy was only slightly positive.

The European sovereign debt crisis also impacted upon developments on the international financial and capital markets. The high level of uncertainty generated sharp price fluctuations on the international stock exchanges. The risk premiums for government bonds from euro zone periphery countries were also extremely volatile. The willingness of the European Central Bank (ECB) in the third quarter of 2012 to buy government bonds on the secondary market under certain conditions drove down the risk premiums for government bonds from the euro zone periphery countries.

The budget dispute in the US and related unresolved issues were highly significant, and also impaired the business climate there.

Economy

Global economic expansion continued to lose momentum in the year under review. Having still posted a growth rate of 2.9% in 2011, real global economic output in 2012 was 2.3%.

The weak economic expansion was largely due to the European sovereign debt crisis, which prompted uncertainty amongst companies and private households and therefore dampened overall economic demand. Demand was also tempered in many countries by restrictive fiscal policy, efforts by private households and companies to reduce debt levels and by high unemployment. This also burdened the economy in other regions by virtue of the links in international trade. Another factor that burdened the global economy was the temporarily high price of oil. On the other hand, support was forthcoming for the economy from the expansive monetary policy pursued by many central banks.

The euro zone slid into a slight recession in the year under review, which was due to a slump in demand within the euro zone. However, net exports of the euro member states increased. There were considerable differences between the individual member states. The southern member states, including Italy and Spain, which were particularly affected by the sovereign debt crisis and measures taken to consolidate the budgets, were in a marked recession. The problems in the banking sector also had a negative impact, particularly in Spain. Real gross domestic product was also down sharply in the Netherlands, albeit to a lesser extent than in the southern European countries. On the other hand, real gross domestic product fell only slightly in Belgium. In Finland and France, real gross domestic product in 2012 was almost unchanged from 2011. Germany, Luxembourg and Austria posted slight economic growth. Economic growth rates in 2012 in the euro member states as well as European countries outside the euro zone were either lower than in the previous year, or economic output even declined.

Real gross domestic product in the Czech Republic fell significantly. It declined slightly in Denmark, remained unchanged from the previous year in the UK, and grew slightly in Sweden and Switzerland. As in previous years, Poland saw economic growth which was considerable by European standards. The growth economies of Russia and Turkey showed a similar development, albeit with growth rates considerably lower than the year before.

Annual rate of change in real gross domestic product in %

	2012	2011		2012	2011		2012	2011
Europe						***North America***		
			further european countries					
Euro zone	-0.5	1.5	Czech Republic	-1.1	1.9	Canada	2.0	2.6
Austria	0.6	2.7	Denmark	-0.5	1.1	Mexico	3.9	3.9
Belgium	-0.2	1.8	Poland	2.2	4.3	USA	2.2	1.8
Finland	-0.1	2.7	Russia	3.4	4.4			
France	0.0	1.7	Sweden	1.2	3.8	***Asia***		
Germany	0.9	3.1	Switzerland	0.9	1.9			
Italy	-2.1	0.6	Turkey	2.6	8.5	China	7.8	9.3
Luxembourg	0.5	1.7	United Kingdom	0.0	0.9	Japan	2.0	-0.5
The Netherlands	-0.9	1.1				Singapore	1.4	4.9
Portugal	-3.1	-1.6						
Spain	-1.3	0.4						

Economic growth in the US was moderate in 2012. Growth was supported by a sharp rise in corporate investment and a moderate increase in private consumption, while the decline in government-driven demand had a dampening effect. Economic growth in Canada and Mexico was also positive.

China's economy continued to grow strongly by international standards. However, the pace of expansion eased markedly compared with the previous year. This was due to the slow pace of export growth on the back of the muted global economy. The driving force behind the expansion was domestic demand, although growth rates were slightly lower than in the previous year. Japan's economy recovered slowly from the consequences of the previous year's earthquake disaster, and real gross domestic product rose during the period under review. Economic growth was also positive in Singapore.

The economic slowdown in Europe was also reflected on the labour markets of numerous countries. Due to the recession in Southern Europe, unemployment there rose particularly strongly. The unemployment rate in Spain was above 26% at year-end. It also increased markedly in Italy, albeit at a considerably lower level of 11%. The unemployment rate rose in most other European countries too. Levels increased significantly in

France, the Netherlands, Poland and the Czech Republic, although they were less pronounced than in Southern Europe. The increases were moderate, for example, in Finland, Sweden and Austria. Unemployment in Germany, however, fell slightly. Together with Luxembourg and Austria, Germany saw the lowest unemployment rate within the EU. Unemployment rates also fell in the US, where the number of persons employed increased by 2.4 million during 2012. Unemployment was lower in Japan too.

Sovereign debt crisis

The European sovereign debt crisis defined the overall economic environment in the year under review. It not only impacted on the economy but also on the financial and capital markets, and was at the forefront of economic policy discussions.

The euro member states, together with the European Central Bank (ECB), agreed on various measures to counter the sovereign debt crisis. At the start of the year, the finance ministers of the euro zone nations agreed on a second bailout package for Greece. This was accompanied by a haircut for the private bondholders. Since Aareal Bank has no exposure to Greek government bonds, it was not affected by this haircut. A third package of measures was agreed at year-end. At the same time, Greece bought back government bonds.

The focus was also on the Spanish banking sector, which was seriously affected by the considerable drop in value of Spanish residential property, the recession in the country, and write-downs on securities portfolios. Consequently, several Spanish banks had to resort to support. The government in Madrid was no longer able to raise the additional funds required at acceptable terms on the financial and capital markets without help from third parties – also given the high risk premiums on Spanish government bonds. The Eurogroup – the meeting of euro zone finance ministers – therefore offered loans up to € 100 billion to Spain in mid-2012. In response to an application by the Spanish government, the European Stability Mechanism (ESM) in December 2012 provided loans in the amount of € 39.5 billion, which were granted to the Spanish bank restructuring fund (FROB). These loans are designated mainly to recapitalise specific Spanish banks, and, to a small extent, the Spanish 'bad' bank, Sareb. This settlement bank became operational during the last quarter. It acquires problem property-related assets and loans from various Spanish banks, thus contributing to the restructuring of the Spanish banking sector.

The ESM came into force at the start of October. As a permanent instrument, the ESM is expected to provide loans to euro states with funding problems. It was explained at the Eurogroup summit held at the end of June that the ESM would also be able to support banks directly with loans in the future, provided a standardised regulatory mechanism, incorporating the ECB, is established for the euro zone banks. The EU finance ministers agreed on guidelines in this respect at the end of the year.

The government bond market remained markedly segmented. The risk premiums (spreads) on bonds from the European periphery states were significantly higher than for countries classified by investors as safe, such as Germany. Following the sharp narrowing of spreads on Italian and Spanish government bonds at the start of the year, these widened again sharply. In view of the high rates of interest, the ECB launched a government bond buying programme (called Outright Monetary Transactions) and accepted to buy government bonds on the secondary market, provided these countries took up an ESM or EFSF programme. No limit was set for the ECB's buying programme. The yields on Italian and Spanish government bonds dropped sharply when the programme was announced in August, but were still well above the levels of bonds from countries that investors consider to be safe. Spreads for Portuguese government bonds tightened significantly throughout the entire year, but remained above those for Italy and Spain.

Numerous countries implemented various measures for consolidating their budgets, and most succeeded in lowering the budget deficits relative to gross domestic product compared with the previous year. However, nominal debt levels continued to rise. The budget deficit in the euro zone relative to gross domestic product fell from 4.1% in 2011 to 3.3% in 2012. Italy and Spain also achieved a slight reduction in their deficits, to 2.8% and 8.2% respectively of gross domestic product. Germany's deficit ratio was lower, at 0.2% of gross domestic product, due to a sharp increase in revenues. At the start of the year, the EU heads of state – with the exception of the United Kingdom and the Czech Republic – agreed on measures to strengthen budgetary discipline, including the binding incorporation of a debt ceiling in national law. Budget deficits were high in Japan at 9.8% of gross domestic product, as well as in the UK at 6.5% and the US at 8.4%.

Financial and capital markets, monetary policy and inflation

The financial and capital markets eased significantly compared with the heavily strained situation at year-end 2011. Various countries, companies and banks were able to place securities on the market. The spreads for riskier bonds tightened again towards mid-year. Banks' funding situation improved continuously in the core European countries during the year. Aareal Bank successfully placed two Mortgage Pfandbriefe, each with a volume of € 500 million, a bearer bond also sized at € 500 million and numerous private placements.

Pfandbriefe and other European covered bonds were the first asset class to benefit from the ongoing recovery. At the beginning of the year, demand was already strong and spreads tightened sharply until the end of the year. Moreover, the placement of unsecured benchmark bonds became possible in the early part of the year. Spreads tightened continuously and the maturities of the issues placed were increasingly longer. Even large amounts of subordinated bank bonds could be placed in the second half of the year. In the year under review, banks in various southern European countries had no direct access to the capital markets for quite a long period of time, and secured their liquidity through the ECB. Some Southern European banks succeeded again in the second half of the year to raise funds via the capital market, and therefore reduced their funding via the ECB slightly.

The issuing volume of German Pfandbriefe has fallen significantly since 2000, most pronounced for Public Sector Pfandbriefe issuance. Mortgage Pfandbriefe benefit from this trend, resulting in a slight increase in the volume of new issues. Their share of total German Pfandbrief issuance has increased continuously in recent years. The declining trend in Pfandbrief issuance was exacerbated this year by the liquidity provided by the ECB. Some Pfandbrief banks took advantage of the ECB's open-market transactions, securing alternative sources of funding through its tender.

Another reason for declining Pfandbrief new issuance, especially of public-sector Pfandbriefe, is the increasing reduction of assets and the decision taken by some competitors to suspend business activities entirely. This impacts on public-sector finance in particular, and can be explained in part by regulatory rules.

We are still a long way off normality on the financial and capital markets. The European sovereign debt crisis generated high volatility and uncertainty. The interbank markets remained subject to friction. This was evident in the high volume of deposits banks held with the ECB and the euro zone central banks, which increased further compared to the end of 2011.

Another trend evident in the year under review was the downgrade of sovereign and bank ratings. This was largely due to stricter approaches adopted by the rating agencies, and deteriorating credit quality. Some issuers returned the ratings on a selective basis. Aareal Bank's Mortgage Pfandbriefe are analysed by rating agency Fitch and carry an AAA rating. This meant that Aareal Bank was able to escape from this negative rating trend. On 11 September 2012, the AAA rating for our Mortgage Pfandbriefe was confirmed with a stable outlook.

The external value of the euro was under strong devaluation pressure at times during 2012. However, from the middle of the third quarter onwards, it picked up against some of the most important currencies in which we are active, although at year-end the euro was valued slightly lower against the pound sterling and the Swedish krona than it had been at the end of the previous year. In contrast, it was nearly unchanged against the Canadian dollar, slightly higher against the US dollar compared to year-end 2011 and considerably stronger against the Japanese yen. The euro remained almost constant against the Danish krone and the Swiss franc during the year. It must be taken into account here that Denmark is aiming at a largely stable exchange rate against the euro, and that the Swiss Central Bank does not allow the EUR/CHF exchange rate to fall below 1.20. In fact, the exchange rate remained just above this level in 2012.

The euro zone's financial and capital markets were highly segmented between the different countries. Risk premiums (spreads) were high for the euro zone's periphery countries; these tightened considerably following the announcement of the ECB's government bond buying programme. When analysing interest rate developments, one must take into consideration the segmentation of the financial and capital markets. The long-term interest rates[1] of the most important currencies in which we are active fell in the course of 2012. The only exception was the Canadian dollar, whose long-term interest rates at the end of the year were comparable with those of the end of the previous year. Short-term interest rates[2] were lower in most currencies too, with the euro and the Swedish krona showing the most pronounced declines. However, short-term Japanese yen and Swiss franc interest rates remained almost constant, albeit just above zero.

[1] Calculated on the basis of the 10-year swap rate vs. 6-month Euribor/LIBOR
[2] Calculated on the basis of the 3-month Euribor/LIBOR, or comparable rates (depending on the currency)

The financial and capital markets eased significantly on the back of the ECB's long-term refinancing operations for commercial banks in December 2011 and February 2012, in which many banks participated. Other central banks also pursued an expansive monetary policy. Various quantitative easing measures continued or were expanded. The UK and Japanese central banks, for example, extended their government bond buying programmes. The US Federal Reserve also persisted with an expansive monetary policy, undertaking in September to purchase USD 40 billion in mortgage-backed bonds every month until further notice. It had previously extended its programme to buy long-term bonds in exchange for selling short-term bonds, up to the end of 2012.

Central banks kept their key rates low. The ECB lowered its main refinancing rate by 0.25 percentage points in July, to 0.75%. Denmark's and Sweden's central banks lowered their key rates several times, to reach 0.20% and 1.00%, respectively. The Bank of England (BoE) and the Fed also kept their key interest rates at very low levels. There were only a few central banks that raised key interest rates: these included the Russian central bank and – temporarily – the Polish central bank, too. The Central Bank of China, which had previously striven to prevent the economy from overheating, switched to easing its monetary policy in 2012 as economic momentum declined. It cut its key rates for the first time in several years, and also lowered the minimum reserve rate.

Inflation was moderate in many countries in 2012. The average annual inflation rate in the euro zone fell marginally year-on-year to 2.5%, which was slightly above the ECB's target level. Average annual inflation in the US was 2.4%. Inflationary pressure eased in the emerging economies. At 2.5%, Chinese inflation was considerably lower than in the previous year due to a weaker increase in food prices. The price level was virtually stable in Japan.

Regulatory environment and competition

The focus in the banking sector remains on the various regulatory and reform measures. Many measures were adopted during the period under review, while others were still being discussed or prepared. The question as to what the cumulative impact will be for banks and the real economy has yet to be answered. The focus at year-end shifted to the issue of how these regulatory plans can be uniformly implemented internationally, in order to prevent European – and particularly German – banks from being subjected to competitive disadvantages.

The environment in which the banks were operating was defined in recent years by a rapid rise in regulatory requirements. In this context, examples of these are the comprehensive Basel II framework and its implementtation in the EU (CRD I), the implementation of the "Sydney Press Release" in the EU and of the regulation on large-volume loans (CRD II), the implementation of the short-term package of measures of the Basel Committee (CRD III), their implementation in national law as well as the various amendments to the Minimum Requirements for Risk Management (MaRisk).

The various regions clearly differed with regard to the competitive environment on the markets for commercial property financing.

As in previous years, many banks in Europe offering commercial property financing concentrated on their domestic market as well as a few core markets. Many international banks withdrew from commercial property financing in Europe during the financial markets crisis. This trend persisted in 2012. Hence, there are only a few banks still active in the market which finance international commercial property to a considerable extent – as does Aareal Bank. There was evidence in Europe of significant reticence among the banks to act as financing partners for specific products, including large-volume projects, cross-border portfolios, properties of less favourable quality or in peripheral locations, financing with high loan-to-value (LTV) ratios and financing in Southern Europe. Financing of construction projects also encountered reluctance amongst lenders. On the other hand, intensive competition surrounded the financing of first-class properties with low LTVs in top locations in the economic centres. This was the case for Germany, in particular, as well as other economic centres in Western and Northern Europe.

As in previous years, a growing number of insurance companies and pension funds stepped up their activities in commercial property financing, in Germany too. This opened up new opportunities for cooperations within the scope of syndicated finance.

The number of players on the syndication market in Europe remains small. Most transactions involving several finance providers were structured as club deals. These are defined by the fact that the different financing partners involved in concluding a loan agreement participate directly in the transactions. With secondary syndications, however, one or several financing partners are not involved until the loan agreement has been concluded.

The market for club deals and secondary syndications in the US, on the other hand, is more liquid. Liquidity was high, too, in the market for commercial property financing in the US, resulting in intensified competition. Alongside banks, this is due in paritcular to the life insurers, who have been active in the commercial property financing segment for many years. The market for securitisations (CMBS, commercial mortgage-backed securities) also recovered.

Besides some large international banks, the domestic banks are highly significant in commercial property financing in Asia. The market environment in Asia was competitive for Aareal Bank.

Segments and business development

Structured Property Financing segment

In view of the uncertainty on the financial and capital markets, and in conjunction with the European sovereign debt crisis, we concentrated initially on our issuing activities at the start of 2012. We started to increasingly exploit market opportunities presented in the lending business during the second quarter and continued to do so during the remainder of the year.

The volume of new business amounted to € 6.3 billion in 2012 (2011: € 8.0 billion), thus significantly exceeding the target corridor of € 4.5 billion to € 5.5 billion. A comparison with the previous year must take into account that last year's new business benefited from the capital increase conducted in the second quarter of 2011. The share of newly-originated loans in total new business exceeded 47.2% in 2012 (2011: 62.2%).

In terms of region, the highest share was accounted for by Europe with 75.5% (2011: 78.8%), followed by North America with 22.0% (2011: 19.7%) and Asia with 2.5% (2011: 1.5%).[3] We generate our new business through our local branches as well as through our teams of sector specialists covering financing solutions for retail, logistics and hotel properties in Wiesbaden.

Our new business in 2012 was also broadly diversified in terms of property type. Office property accounted for the largest share, with 39.8% (2011: 29.0%), followed by retail property with 22.1% (2011: 20.1%) and hotels with 20.0% (2011: 24.9%). The share of new business attributable to the financing of logistics properties was 10.1% (2011: 15.9%) and 5.2% (2011: 7.4%) for residential property. 2.8% was attributable to other financings (2011: 2.7%).

Developments on the commercial property market are very important for the Structured Property Financing segment, which is why they will be explained in more detail here.

What is characteristic of property markets is that they are not homogeneous. The individual properties differ with regard to the factors that determine their value and rents, such as location, modernity, floor space and energy efficiency, flexibility and property management. Differences may also arise between individual markets and sub-markets, which are influenced by the regional economies, the number of construction projects, or a sub-market's transport infrastructure. As a result, rents and values can vary between individual properties and sub-markets, and must be taken into consideration when market trends are described below.

In the year under review, differences were evident between Europe, North America and Asia regarding rental development and the trend in the yield requirements of investors as described below. The global volume of commercial property transactions in 2012 increased marginally and was largely stable compared with the previous year. Investors focused on first-class properties in the corresponding locations in the economic centres.

Developments in the individual regions

Europe

Rental development for first-class commercial property in many European economic centres was stable. However, as we can see below, the markets in the premium segment varied with rents rising in some and falling in others. User demand in many markets was burdened by uncertainty and the weak economy.

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[3] New business is allocated to the individual regions on the basis of the location of the properties used as collateral. For exposures not collateralised by property, the allocation is based on the borrower's country of domicile.

Rental development of first-class office premises in the European centres was largely stable, for example in Berlin, Brussels, Frankfurt, London, Moscow, Paris, Prague, Stockholm and Warsaw. On the other hand, rental development was negative in the southern European economic centres of Barcelona, Madrid as well as Milan and Rome. There were only a few examples of rents for first-class office properties tending to fall, for example in The Hague, Copenhagen and Zurich. However, some markets also posted rising rents in this segment, such as Dusseldorf, Gothenburg, Hamburg, Helsinki and Munich.

On the market for high-quality retail properties, the number of European economic centres producing rising rents was almost in line with those producing stable rents. Rents increased in the economic centres of various Western European regions, such as Amsterdam, Berlin, Dusseldorf, London, Munich and Paris. In Northern Europe, rents in the first-class retail property segment increased slightly in Helsinki and Copenhagen, in Eastern Europe, Moscow also posted small increases. Rents were stable in the Italian and Spanish economic centres of Milan and Rome, Barcelona and Madrid. Rents were constant in the economic centres of many other countries, such as Brussels, Frankfurt, Hamburg, Prague, Stockholm and Warsaw. Only a few locations saw a general market trend for falling rents among first-class retail properties, such as Birmingham and shopping centres in Istanbul.

First-class logistics properties enjoyed mostly stable development with a broad regional distribution. Examples here were Brussels, Hamburg, London, Paris, Rotterdam, Stockholm and Warsaw, as well as the southern European centres of Madrid and Rome. On the other hand, rents for high-quality logistics properties fell in Barcelona and Milan, as well as in Amsterdam and Copenhagen, while rising in Frankfurt, Helsinki and Munich, to name some examples.

Properties that are not included in the first-class segment in terms of their quality and location lagged behind the overall market with regard to rental development. Rents here tended to come under pressure. This development continues to reflect the high demands on quality placed by tenants.

Developments in the hotel sector were largely positive in Europe's economic hubs, in terms of the important indicator of average revenues per available hotel room. This variable increased across a broad regional base in different economic centres. In Western Europe, these included Berlin, Frankfurt, London, Munich and Paris. In Northern Europe, average revenues rose in Helsinki and Copenhagen, and in Moscow, Prague and Warsaw in Eastern Europe. Average revenues also increased slightly in Barcelona and Rome, compared with Madrid and Milan, where they fell. Average revenues also fell in some other economic centres, including Brussels and Rotterdam as well as Geneva and Zurich, where the hotel trade was burdened by the strong Swiss franc.

Uncertainty in the overall economic environment led to pronounced risk-aversion among investors. They focused their demand accordingly on prime properties deemed to be safe that are defined by first-class quality in the corresponding locations in the economic centres and a solid rental situation. The regional focus was very pronounced here too. Demand was high in the economic centres of the UK, particularly London, followed by Germany, France and Northern Europe. In some cases, demand for prime properties exceeded supply. The volume of transactions in Europe was – largely driven by a strong fourth quarter – roughly unchanged from the previous year.

The yield requirements of investors on the markets for high-quality office property were inconsistent. Yields were stable on several markets such as Copenhagen, London, Prague and Warsaw. At the same time, yield requirements for first-class office properties fell on many markets[4] such as Brussels, Frankfurt, Helsinki, Moscow, Paris and Stockholm. In turn, the yields in this segment increased for many markets too, affecting the economic centres of the UK (excluding London), Italy, the Netherlands and Spain.

Yield requirements for high-quality retail properties were stable or down slightly in the vast majority of European economic centres. Examples of retail property markets with stable yields in the premium segment were Amsterdam, Brussels, Istanbul, London, Prague and Warsaw. Falling yields were recorded in the leading economic centres of Germany, France and Northern Europe, as well as in the big Spanish cities of Barcelona and Madrid. Yields for first-class retail properties rose only on isolated markets, such as some UK economic centres and the Italian cities of Milan and Rome.

The logistics markets in the first-class segment painted a mixed picture. Examples of stable rental development were most of the leading German economic centres, as well as Copenhagen, London, Prague, Stockholm and the Spanish centres of Barcelona and Madrid. On the other hand, rising yields were registered in the British (excluding London) and Italian centres, and in Paris. Yields fell slightly on various markets, particularly in Amsterdam, Brussels, Rotterdam and Warsaw.

[4] Falling yield requirements lead to rising property market values, while rising yield requirements correspondingly produce falling values, all other things emaining equal.

One thing that almost all markets with rising or falling yields in the first-class segment have in common is that changes over the previous year were only marginal. It must be taken into account that demand on some markets, especially in Southern Europe, was low and yields were influenced by a small number of transactions only. With investor demand concentrated on the prime segment, the gap between yields for first- and second-class properties widened further, with the latter lagging behind and performance coming under pressure.

Aareal Bank manages its market activities in the individual regions through sales hubs (totalling six in 2012, plus the sector specialist sales hub in Wiesbaden). The national sales unit in our Wiesbaden head office managed our market activities in Germany. Market activities in Belgium, Luxembourg, France, Switzerland and Spain were managed by our Paris branch. The Stockholm branch was responsible for the management of the northern European countries, while our London branch was responsible for managing market activities in the UK and the Netherlands. The branch in Rome was responsible for market activities in Italy, and our Warsaw branch for Eastern Europe. The business in Turkey was managed by the sector specialist sales unit in Wiesbaden, since in Turkey, international investors are mainly active in shopping centres and hotels, and market activity is greatest in these segments.

The volume of new business we originated in Europe amounted to € 4.8 billion. At € 2.7 billion, Western Europe[5] accounted for the highest share thereof, and also dominated transaction volumes on the European markets. New business was considerably lower in Northern Europe (€ 0.8 billion), Southern Europe (€ 0.7 billion) and Eastern Europe (€ 0.6 billion). We are not active in property financing in Greece, Ireland or Portugal.

North America (NAFTA states)

The commercial property markets in the US were stable to slightly positive, on a national average.

The recovery on the office markets in the US continued slowly in 2012, and rents increased slightly on a national average. However, the various regions continued to differ considerably. Rents rose sharply in San Francisco, for example. Office rents increased in Boston and New York, to a lesser but still considerable extent. They increased slightly on the other hand in Dallas and Los Angeles, while remaining constant in Chicago and Washington D.C. The vacancy ratio for office property fell slightly in the US on national average. The retail sector posted a similar development. Rents in the retail segment fell marginally on national average. Rental development varied greatly by region: slightly higher rents were seen in Boston and New York, but remained virtually constant in Dallas and Los Angeles. Retail rents, on the other hand, were lower in Chicago, San Francisco and Washington D.C. The vacancy ratio for logistics properties also fell, and the average rents for these properties in the US increased slightly on national average. Chicago, Dallas, Los Angeles, San Francisco and Washington D.C. are examples for rising rents in the logistics sector, while the increase in Boston was minimal. Logistics rents fell marginally in New York.

The upside trend that had already started in the hotel sector in the USA persisted, with average revenues per available hotel room increasing over the corresponding period of the previous year. This was driven by increases in the occupancy ratio and in room rates. Average revenues per available hotel room also increased in Canada and Mexico.

In North America, the transaction volume in newly-acquired commercial property was up on the previous year. The final quarter was strong here too, helped – amongst other factors – by tax considerations. Investor interest was focused on high-quality properties in the corresponding locations, although there was also evidence of interest in properties outside the premium segment. Investor yield requirements on the office markets in the US fell slightly on national average in the central locations, but remained constant in the suburbs. Yields were lower on average for retail and logistics properties.

We have an active presence in North America through our subsidiary Aareal Capital Corporation, which has an office in New York and also manages our new business activities locally. In the year under review, we generated new business of € 1.4 billion in North America, which was accounted for mainly by the US.

Asia

Rental development in the big Asian cities varied. Rents for first-class office properties in Beijing and Shanghai increased – in some cases strongly, depending on the sub-market – although the Shanghai Puxi sub-market reported a decline. Rents for high-quality offices in Tokyo remained constant, compared with a considerable drop in Singapore. Rents in high-quality shopping centres in Beijing, Shanghai and Singapore

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[5] The breakdown of the regions in the new business reporting deviates from the distribution structure described above. The volume of new business reported also includes new business initiated by our sector specialists.

remained stable. This was also the case for premium retail property in Tokyo. The first-class logistics segment in Beijing, Shanghai, and the greater Tokyo region saw an increase in rents – and to a lesser extent, Singapore.

The hotel sector in Beijing, Shanghai, Singapore and Tokyo improved over the previous year, accompanied by an increase in the average revenues per available hotel room. The increase was particularly strong in Tokyo, as a consequence of the recovery from the earthquake catastrophe in March of 2011.

Transaction volumes in Asia were down slightly compared with 2011. Investors' yield requirements varied in the major Asian cities in 2012; they fell slightly in the segment for first-class office property in Beijing and Singapore, while remaining constant in Tokyo and increasing slightly in Shanghai. Yields for first-class retail properties were up slightly in Shanghai too. They remained stable in Beijing and Tokyo, and fell in Singapore. Higher yields for first-class logistics properties were registered in the big Chinese cities of Beijing and Shanghai, with declines in Singapore and Tokyo.

Our Singapore subsidiary Aareal Bank Asia Limited is responsible for managing our market activities in Asia. We have a presence in China with our representative office in Shanghai. Our new business in Asia amounted to € 0.1 billion in the year under review.

Consulting/Services segment

Institutional Housing Unit

The institutional housing industry in Germany proved stable also in 2012. This was evidenced in particular by predominantly constant rental income and long-term financing structures. The sector continued to focus particularly on sustainable property management and development, with a strong emphasis on increasing energy efficiency. The housing and property companies that are organised in the German Federation of German Housing and Real Estate Enterprises (*Bundesverband deutscher Wohnungs- und Immobilienunternehmen* – "GDW") and its regional federations, invested more than € 10 billion in the future of their portfolios.

The housing market was largely immune to economic fluctuations, since market developments here tend to be determined more by long-term factors such as population and income perspectives. Advertised rents were once again above the previous year's level throughout Germany, whereby the rents in major cities increased to a greater extent than in rural areas. The price increases were largely due to the sustained demand for apartments, because, on the one hand, apartments are becoming increasingly more attractive as an investment and also given the low interest rate levels on the other.

The housing market was still subject to great regional differences. The demand for housing was greater in prosperous urban areas; this was associated with supply bottlenecks, while rural regions suffered from population loss. After the forecasts from June 2012, the vacancy ratio on the housing market for the full year 2012 was unchanged from the previous year at around 3% in the former West German Federal states and approx. 8% in the former East Germany.

Considering the high volatility on the financial and capital markets and the low returns offered by alternative investments, investors focused on residential property again in 2012. Residential property portfolios totalling around € 11.4 billion were traded. Transaction volumes therefore increased by around 90% over the same period of the previous year. This sharp increase in volume is due to a series of large-volume property transactions, especially in the first half of the year.

Looking at the origin of buyer groups, domestic and international institutional investors are active on the housing market. With international investors accounting for around 27% of investment turnover on 2012, their share on the transactions market was mainly stable compared with the previous year (29%). Overall, great interest was shown by various investor groups, with listed property companies and equity/property funds dominating the market.

The bank's Institutional Housing Unit further strengthened its market position in 2012 through acquiring new clients as well as intensifying business relationships with existing clients, acquiring business partners managing between them more than 130,000 residential units for payments and deposit-taking. Existing business partners in commercial property management connected more managed units to our payment processes than in the previous year. Additional companies from the utilities and waste disposal industries opted for our payment systems and/or investment products. We meanwhile have an established customer base from this sector, which has created a solid base for further growth.

Against the background of introducing the Single European Payments Area (SEPA) at the start of 2014, we have started to convert our systems ahead of schedule by introducing the relevant SEPA credit transfers and direct debit payment methods. To prepare for the migration projects involved in conjunction with the SEPA conversion, we held workshops with our clients during the financial year under review, where we offered them the opportunity to obtain comprehensive information about the SEPA aspects that are relevant to banking.

In addition, we extended the BK01 sector solution for the utilities and waste disposal industry to include standardised applications that calculate usage and billing data.

This brings the number of business partners currently using our process-optimising products and banking services to more than 2,700. Despite continued intense competition, the volume of deposits from the institutional housing industry increased to € 5.6 billion on average in the 2012 financial year (2011: € 4.7 billion). Deposits averaged € 6.2 billion in the fourth quarter of 2012. This reflects the strong trust placed in Aareal Bank by our clients.

The marked increase was particularly evident in current account balances, which also increased by more than one third compared with the previous year, in line with call money. With an 11% increase in 2012, we once again succeeded in significantly growing the volume of rent deposits over the previous year.

Aareon AG

Cloud computing – one of the most important current IT trends – is becoming increasingly important in the market for property management software, and demand is steadily growing. Using cloud computing, companies can procure and retrieve IT solutions from service providers through a network. This facilitates efficient investments in IT and helps to keep administrative expenses low. Aareon AG has the ability to benefit sustainably from this new trend. It looks back on several decades of experience, both as an IT centre operator and as provider of GES, an ASP-based software solution. ASP, or "Application Service Providing", can be seen as the predecessor of today's cloud computing concept. Another important trend in the housing industry is the mobile use of software solutions and processes, for example, via smartphones and other mobile devices. The flow of information between housing enterprises and tenants will therefore open up optimisation potential that supports the service for tenants for both sides. Examples are maintenance management, mobile property inspection and acquisition management.

Aareon offers its customers a one-stop shop for advisory, software and other services – tailored to meet the needs of the property management sector. The country-specific ERP solutions that allow for the local market conditions can be extended to include integrated services and additional products. With its service range, Aareon supports housing enterprises in simplifying and automating their processes: quicker data access, greater transparency and efficient management of the rental units support the rental service of the housing enterprises. The ERP solutions also offer a wide range of analytical options, for example, to prepare management decisions and budget management. With its ERP multi-product strategy in Germany, Aareon meets the various requirements across the board on the property market. It offers the ERP products Wodis Sigma and SAP®-based solutions such as Blue Eagle, and the GES system. The international subsidiaries offer ERP systems that are tailored to meet the needs of the respective market. These are Prem’Habitat und PortalImmo in France, QL in Great Britain and SG|tobias and the new product generation SG|tobias^{AX} in the Netherlands. ERP solutions and integrated services, together with additional services, support the efficient cooperation of property companies and their business partners. This range is complemented by sector-specific advisory services for all products and services.

The positive development of the Wodis Sigma product generation that Aareon launched in 2009 remained intact. Wodis Sigma is based on one of the leading international development platforms, Microsoft®.NET™. 477 clients have already opted for Wodis Sigma, 102 alone in the 2012 financial year. 404 clients were working with the system in their day-to-day operations as at the end of 2012. Wodis Sigma is being developed on a permanent basis, and is constantly adjusted to meet clients' requirements. Aareon presented the new Wodis Sigma Release 4.0 – with new functions and the integration of the current legal requirements – at the annual Wodis Sigma Forum client event held in Bochum. Wodis Sigma was introduced as a service from the exclusive Aareon Cloud one year previously, and continues to be well received. 77 clients have already opted for this type of operating mode.

The market for SAP®-related projects remained subdued in 2012, as expected. Demand was concentrated on Aareon's SAP® consultancy services, where Aareon successfully agreed a large number of advisory agreements. Allbau AG, Essen for example, signed a contract for SAP®-application management services to manage Aareon's existing SAP® installation. Aareon has been managing the system at Allbau AG (18,000 units) since 1 February 2012. The production rollout of Blue Eagle Individual at LEG

Landesentwicklungsgesellschaft NRW GmbH, Düsseldorf, with more than 90,000 rental units, was on schedule at the start of 2012. The development of the new Blue Eagle Release 6.3 is proceeding as planned.

It was agreed during the period under review to continue the partnership with SAP that has already been in place for ten years. The new cooperation agreement confers the status of SAP PartnerEdge Services Partner on Aareon. In addition to the existing certifications “SAP-Certified Provider of Application Management Services” and “SAP-Certified Provider of Hosting Services”, Aareon was also given the SAP status “Partner Center of Expertise”, following an extensive audit in October.

The volume of business with the established GES system was stable in 2012. The new GES client contact management and GES contract management module that was introduced in the fourth quarter of 2011 met with a positive response. Key topics of the two GES versions on 2012 were the “E-Bilanz” electronic balance sheet service, and the development of GES contract management and GES customer contact management. The product continues to be characterised by a high level of customer satisfaction, which is supported by the large number of contract renewals.

Integrated Services continued to develop favourably. It simplifies and automates the daily workflows of the property companies, linking these with internal and external business partners through the ERP system and beyond. Demand was particularly strong for the Mareon service portal, the BauSecura insurance solutions and the Aareon invoicing service. In addition, RWE AG, Essen – one of the highest-profile electricity and gas utilities in Germany – is one of the companies to have decided in favour of the Aareon invoicing service. This product facilitates the paper-free exchange of invoices between business partners, and purely digital invoice processing.

The Mareon service portal, which networks housing enterprises, calorimetric systems providers, and tradesmen, is used by some 250 property companies and 8,500 craftsmen to simplify their processes. There are 42 product interfaces to tradesmen's software programmes. Another major client, GEWOBA Aktiengesellschaft Wohnen und Bauen, Bremen, managing more than 41,000 rental units, signed a contract to implement Mareon. Demand for the BauSecura insurance solutions was strong throughout Germany and contributed to continuous growth.

Aareon also extended its integrated services with the purchase of immoblue-Plus (now operating as Aareon immoblue+), a web-based solution for managing prospective tenants, from DataConnexx GmbH, Schönebeck, with effect from 1 April 2012. Aareon immoblue+ supports and simplifies the entire rental process from publishing the rental offer through property maintenance to the qualified preparation of the offer for the prospective tenants and conclusion of the contract. This solution is already used by around 50 companies in the institutional housing industry that are now serviced by Aareon. Aareon immoblue+ was integrated in the customer relationship management (CRM) service range and has met with great customer interest. Aareon plans to expand this line of business further in the future.

Together with Aareal Bank, Aareon offers the integrated payments solution that is integrated in the Aareon ERP systems. The BK01® payments system can be used for the Wodis Sigma and GES systems, and the BKXL® system (which includes integrated digital signature functionality) for SAP®-based Blue Eagle.

Aareon focuses its international business activities on important strategic markets. The company is represented with subsidiaries in France, the UK and the Netherlands, and has expanded its activities further by acquiring the UK company 1st Touch. International business remained positive during the period under review. It’s share of Aareon Group’s total revenue increased to 28.7% (2011: 27.4%). Within the scope of its product and business development, Aareon benefits from the constant exchange of information and experience on an international level. Synergies in the areas of business models, technologies, and cooperation partners are systematically identified and exploited. Topics in this context are the planned development of the mobile solutions in the UK subsidiary 1st Touch, and the development of a modern sector-specific customer relationship management software within the scope of one of Aareon Group's international projects.

Aareon is the leading IT partner in the "I-stay@home" project funded by the European Union. Several European partners in the institutional housing industry have merged under the overall management of the housing enterprise Joseph-Stiftung in Bamberg, and were awarded the tender. These include housing enterprises from Germany, France, Belgium and the Netherlands, as well as research and technology partners. The project aims to allow older people to remain living within their own four walls for as long as possible, and is becoming increasingly important from a social and economic perspective, in view of the demographic development. The project partners are therefore developing an IT-based platform to access domestic support services.

SG|automatisering bv, Emmen, offer the ERP solution SG|tobias with the new product generation SG|tobias^{AX} on the basis of Microsoft® Dynamics® AX. SG|tobias^{AX} continues to be well received by the market. De Key, Amsterdam, managing 35,700 rental units, is a new and important client. The releases of the SG|Treasury and SG|Vastgoed additional products were launched on schedule in the second quarter of 2012. SG|automatisering (Group) has 164 employees at three locations, and has 182 clients.

Aareon France SAS, Meudon-la-Forêt, offer the two ERP systems Prem'Habitat 2.0 and PortalImmo Habitat 2.0. systems. At the start of the year, and on schedule, Aareon France rolled out the ERP solution PortalImmo Habitat 2.0 for major client Logement Français, Paris (approx. 85,000 rental units), and for housing enterprise Le Foyer Remois from Reims (approx. 18,000 rental units) in June. Aareon France extended its service range during the past financial year with the acquisition of the SIG Habitat solution from D6GEO. SIG Habitat is a geographically-oriented information system that reproduces and visualises general information (purchasing power, local transport) as well as individual information (vacancies, arrears) geographically. Aareon France has 158 employees at four locations in France, and has around 250 clients. Aareon UK Ltd., Coventry, offers the ERP solution QL. Aareon UK leveraged its leading position on the highly competitive UK market for property management software, and bid successfully for various tenders. Aareon UK has a staff base of 62 employees at its locations in Coventry and Swansea (Wales). Currently it has 95 clients.

Another step in Aareon's international growth strategy was the full takeover of the UK company 1st Touch Ltd., Southampton, with effect from 01 July 2012. 1st Touch was founded in October 2007 and is the leading and rapidly-growing provider of mobile software solutions for the housing industry in the United Kingdom. The company's clients are based in the social housing market. It not only targets Aareon UK clients but also those of other housing enterprises. 1st Touch is active on the market under the umbrella of Aareon Group at its previous Southampton location, and as an independent operator. Aareon is also developing the 1st Touch mobile solutions with the aim of offering them in other countries. The company employs 20 staff and has 50 clients.

Aareon Group achieved profit before taxes and interest (EBIT) of € 26 million in the 2012 financial year (2011: € 25 million).

Financial performance

Aareal Bank AG closed the financial year 2012 – which was characterised by a challenging market environment, as in the previous year – with an operating profit (excluding loan loss provisions) of € 226 million (2011: € 285 million).

The aggregate of net interest income and net commission income amounted to € 433 million, down € 100 million compared to the previous year. Interest income from lending and money-market transactions fell by € 120 million year-on-year, whilst interest income from securities declined by € 48 million. Interest expenses were down by € 67 million. Current income totalled € 0 million during the year under review (2011: € 10 million). Net commission income of € 54 million was € 11 million higher than in the previous year, due to lower expenses for the utilisation of support by the German Financial Markets Stabilisation Fund (SoFFin).

Administrative expenses (including depreciation and amortisation of intangible assets and tangible fixed assets) of € 216 million were down € 24 million from the previous year, which was attributable to measures implemented to optimise structures and processes. In addition, the previous year's figure was burdened by non-recurring effects.

Net other operating income and expenses was up € 16 million year-on-year, to € -1 million. The previous year's figure included € 11 million in expenses incurred in connection with the capital increase 2011.

The balance of provisions for loan losses and the result from securities held as liquidity reserve amounted to € -216 million (2011: € -239 million). This figure includes expenditure for specific and general loan loss provisions. Securities held as liquidity reserve were revalued strictly at the lower of cost or market; the item also includes capital gains and losses realised on this portfolio.

Net other income and expenses of € -20 million (2011: € -1 million) includes the results and revaluation of subsidiaries, as well as the results from investment securities.

Taking into account a tax refund claim of € 15 million (2011: tax liability of € 25 million), the bank posted net income of € 5 million (2011: € 20 million).

Financial position

Net assets

Aareal Bank Group's total assets as at 31 December 2012 amounted to € 43.2 billion, after € 41.3 billion as at 31 December 2011. The increase was largely due to a higher level of cash and cash equivalents.

Net assets are dominated by the property financing business and securities investments. Commensurate with the still-volatile market environment, the liquidity reserves maintained are invested in a high-quality securities portfolio. Aareal Bank can quickly deploy the portion of the securities portfolio serving as a liquidity reserve, for example, through repo transactions on the money market.

As at 31 December 2012, the securities portfolio with a nominal value of € 12.1 billion (2011: € 10.5 billion) comprised the four asset classes of public-sector borrowers, covered bonds and Pfandbriefe, bank bonds and asset-backed securities (ABS). 97% of the overall portfolio is denominated in euros, and around 98% of the portfolio has an investment grade rating.[6]

Public-sector borrowers are the largest asset class held, accounting for a share of approx. 80%. These include securities and promissory note loans that qualify as ordinary cover for Public Sector Pfandbriefe. 97% of these issuers are domiciled within the EU. Approximately 77% are rated AAA or AA and a further 5% are rated single-A. Overall, 98% have an investment grade rating.

The share of Pfandbriefe and covered bonds at year-end was 12%. 95% consists of European covered bonds, with the remainder invested in Canadian covered bonds. Around 48 % have an AAA rating and a further 26% are rated single-A. The remainder are rated BBB.

The bank bond asset class is made up mainly of European issuers with high credit quality. The share of this asset class was approx. 6% at year-end. A total of around 94% were rated at least single-A.

The securities portfolio also contains ABS securities that account for a share of approx. 2%. Of this amount, European mortgage-backed securities account for 89%. The asset class comprises 64% RMBS, 25% CMBS and 11% asset-based securities on car and student loans.

Property financing portfolio

Portfolio structure

The volume of Aareal Bank Group's property financings decreased from € 22.5 billion to € 21.8 billion in 2012. On a consolidatedlevel, the volume of property financings also decreased, from € 24.0 billion to € 23.3 billion – a decline of 2.9%.

Whilst the Group portfolio in Western and Southern Europe increased slightly, the development of the property financing portfolio in the other regions was slightly negative. The marginal increase in the Southern Europe portfolio was largely on account of new business acquired in the 2011 financial year that was disbursed at the start of 2012. The slight fall in the North America portfolio was mainly due to the repayment of large-volume individual transactions.

With regard to the breakdown of the Group property finance portfolio by property type, office, retail and logistics finance was up slightly, while the volume of loans for residential property was slightly lower. At the end of the period under review, the property finance portfolio was highly diversified, with regard to region and property type.

Portfolio development

Aareal Bank Group continued its successful lending policy in the 2012 financial year, despite the challenging market environment. New business amounted to € 6.3 billion (2011: € 8.0 billion). This figure included € 3.0 billion in newly-originated loans, which was down on the previous year (€ 5.0 billion). The capital increase conducted in 2011 had a positive impact on the previous year's figure.

Repayments on the property financing portfolio include all types of scheduled and unscheduled principal payments by clients. Repayments of € 3.0 billion (2011: € 3.2 billion) in 2012 fell slightly. Based on the portfolio at year-end 2011, this represents a repayment ratio of 12.5% (2011: 14.1%).

[6] All rating details are based on the composite ratings.

A portion of the property financing portfolio has been committed in foreign currencies. Exchange rate fluctuations have an impact on the euro equivalent of the portfolio. Despite exchange rate fluctuations during 2012, the exchange rates at year-end were roughly at the same level as at the start of 2012. Currency fluctuations therefore had no material effects on property financing volumes over the year.

The volume of loans included in cover for Mortgage Pfandbriefe increased further during the year under review, to € 10.7 billion at 31 December 2012 (31 Dec 2011: € 10.2 billion). This corresponds to an increase of 3.5% over the previous year to around 46%.

In 2012, our activities on the capital market for property finance focused again on the arrangers of syndicated financing and the management of existing syndications, in particular on granting loan extensions. The volume of syndications amounted to € 224 million in the 2012 financial year (2011: € 404 million).

No securitisations were carried out during the reporting period.

Financial position

Interbank and repo business

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

Aareal Bank participated in the ECB's LTRO (long-term refinancing operations) in 2012. Repurchase (repo) transactions of € 1 billion were outstanding in this context as at 31 December 2012. No other open-market transactions were concluded with the ECB.

Customer deposits

As part of our activities on the money market, we generate deposits from institutional housing clients, and from institutional investors. The volume of deposits from the institutional housing industry increased during the reporting period. As at 31 December 2012, they amounted to € 6,3 billion (2011: € 4,8 billion) Deposits from institutional investors also increased slightly in 2012, amounting to € 5,2 billion as at 31 Dec 2012 (2011: € 4,5 billion).

Long-term funding

Funding structure

Aareal Bank Group's funding is solid, as evidenced by the high proportion of long-term refinancing. This encompasses registered and bearer Pfandbriefe, promissory note loans, medium-term notes, other bonds and subordinate issues. The latter include subordinated liabilities, profit-participation certificates, silent participations and trust preferred securities. As at 31 December 2012, the long-term refinancing portfolio amounted to € 26.7 billion. Mortgage Pfandbriefe (comprised € 9.7 billion and Public Sector Pfandbriefe € 3.5 billion, whilst € 11.9 billion was made up of unsecured bonds, and € 1.6 billion was in subordinated bonds.

In 2012, Mortgage Pfandbriefe accounted for a total share of 36% of long-term refinancing.

Refinancing activities

During the period under review, Aareal Bank succeeded in raising a total of € 4.5 billion of medium- and long-term funds on the capital market. The issue volume of our unsecured funds amounted to € 2.1 billion, of which € 0.1 billion was accounted for by subordinated debt. Mortgage Pfandbriefe made up € 2.3 billion of the total volume. This highlights how very important Pfandbrief issuance remains to Aareal Bank's funding mix.

Of the various privately- and publicly-placed issues, particular mention should be made of the two benchmark Mortgage Pfandbriefe placed in January and June 2012, with terms of four and five years respectively, and an issue volume of € 500 million each. We also successfully placed a three-year € 500 million unsecured benchmark bond on the capital market in February 2012.

Owing to the strong demand for Pfandbriefe and unsecured issues from solid issuers, we were able to implement all the refinancing activities as planned and already achieve the refinancing targets for the full year during the third quarter.

Regulatory indicators

Aareal Bank AG has opted to determine regulatory indicators at Group level only since 2007, applying the regulation of section 2a (6) of the German Banking Act (KWG). In this respect, the following disclosures relate to Aareal Bank Group.

Regulatory indicators pursuant to AIRBA

	31 Dec 2012 [1]	31 Dec 2011
€ mn		
Tier 1 capital	2,430	2,501
Total capital	2,991	2,988
Risk-weighted assets (incl. market risk)	14,513	15,313
%		
Tier 1 ratio	16.7	16.3
Total capital ratio	20.6	19.5

[1] After confirmation of the financial statements 2012 of Aareal Bank AG.
The inclusion of retained earnings transferred as part of Aareal Bank AG's liable equity as at 31 December 2012 is subject to approval by the Annual General Meeting.

Our employees

Personnel data as at 31 December 2012

	31 Dec 2012	31 Dec 2011	Change
Number of employees of Aareal Bank Group	2,289	2,353	-2.7 %
Number of employees of Aareal Bank AG	875	942	-7.1 %
of which: outside Germany	92	111	-17.1 %
of which: women	45.0 %	45.0 %	
Share of women in executive positions	26.2 %	23.2 %	
Years of service	13.5 years	13.0 years	0.5 years
Average age	44.5 years	43.9 years	0.6 years
Fluctuation rate	2.7 %	2.8 %	
Share of part-time employees	19.0 %	18.5 %	
Pensioners and their surviving dependants	577	553	4.3 %

Age structure and fluctuation

The fluctuation ratio for 2012 was 2.7%. The average number of years in service for the company is 13.5. These two figures are a reflection of the strong relationship of the employees with the company. The average age of our employees is 44.5 years.

Remuneration system

The remuneration systems are based on remuneration principles that apply throughout Aareal Bank Group. When the German Ordinance on Remuneration in Financial Institutions, (*Institutsvergütungsverordnung*) incorporating external advisors and the employee representative bodies came into force, the remuneration structures at Aareal Bank AG and bank-related subsidiaries were adjusted in line with the regulatory requirements on the basis of these principles. The modified systems came into effect as at 1 January 2011.

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

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

Qualification and training programmes

Aareal Bank invests in its employees on an ongoing basis, and in a targeted manner. The emphasis is on supporting specialist, entrepreneurial and communicative skills over the long term. The international orientation is particularly important to the bank in relation to continuing professional development (CPD). Specifically, this involves training to achieve and expand linguistic and cultural competencies.

Aareal Bank believes that promoting qualification and continued professional development (CPD) is one of the fundamental principles of professional development. This is underlined by a broad range of management, qualification and training programmes offered by our internal corporate university "Aareal Academy".

Aareal Academy's specialist seminars are established in cooperation between Human Resources and the bank's specialist divisions. During the period under review, more than 70% of the training measures were organised by internal advisors from the bank's specialist divisions. Within the scope of the Aareal "Speakers' Day", Aareal Bank experts have the opportunity to impart knowledge about technologies and methods, thus making their contribution towards further active and sustainable knowledge management in the Group. Within the scope of the strategic personnel development programme, Human Resources thus developed tailor-made training programmes that were adjusted to meet the bank's various functions and requirements.

One of the key issues in the 2012 financial year was the review and development of the employee appraisal. Workshops to this effect were held with all members of Aareal Bank's management team in summer 2012. In addition, the development of the bank's managers was also supported through seminars and coaching measures. This applies in particular to those managers that have taken on a new management role in conjunction with the procedure for assessing potential during the period under review.

Aareal Bank views its training and CPD activities as an investment in its own employees, and therefore in the future of the entire Group. The "Structured Appraisal and Target Setting Dialogue", Aareal Bank's employee review, is the starting point for the individual development plans. Once again, more than 900 development measures were agreed between management and employees at the start of 2012. As a result of these plans, 3,050 employees participated in Aareal Bank's training measures during the year under review.

The long-standing cooperation with the Real Estate Management Institute (REMI) and the European Business School (EBS) is a fixed component of the training and professional development concept: it was expanded during the year under review. Within the scope of the cooperation, the bank's employees are offered the chance to participate in the executive courses of study that are specific to the property sector, or in events arranged by this partner institute of higher education.

Group subsidiary Aareon AG implemented the training measures that were determined by the development centre for executives in the 2012 financial year. New executives also participated in a development centre in 2012. The training also focused on training offers for the Wodis Sigma product line plus the revival of the training programme to become a certified Property Manager at the HfWU Hochschule für Wirtschaft und Umwelt Nürtingen-Geislingen. An increasing number of language courses were also offered, in keeping with Aareon's policy of internationalisation.

Supporting the next generation

Promoting the next generation through training is a central element of our HR work. To this end, Aareal Bank has been offering a tailored trainee programme for university graduates since 2000. The programme concentrated on the Institutional Housing Business during the year under review.

Besides the trainee programme, new entrants starting out in Aareal Bank Group also have a choice of a range of training programmes. Our subsidiary Aareon AG offers vocational training in various careers: office administrator, IT applications developer, IT system integrator. It also offers the dual course of study: "Business Administration – Property Manager" in cooperation with the College of Advanced Vocational Studies in Leipzig and the technical institute "Duale Hochschule" in Baden-Württemberg. Aareon had 18 young trainees at the start of the new training year as at 1 August 2012. Within the scope of promoting the next generation, Aareal

Bank Group also offers students the opportunity to gain their first impressions of the professional world and Group divisions by actively participating in internships. The work placement programme was continued successfully during the year under review.

Aareal Bank also supports the Chamber of Commerce (IHK) in Wiesbaden by providing guest speakers at workshops and events held for pupils.

Work-life balance

Aareal Bank supports the compatibility of career and family amongst its staff in many ways.

Since July 2012, the bank has cooperated with the non-profit organisation "Fit For Family Care", which operates two crèches in Wiesbaden. This cooperation agreement offers childcare places for children aged between ten months and six years to employees. Furthermore, Aareal Bank cooperates with the City of Wiesbaden to offer childcare facilities to its employees during the school holidays. These offers are supplemented by flexible working hours, part-time work or the possibility to incorporate home working into their working hours – provided the respective position allows it. During the year under review, 166 employees (19%) worked part-time (2011: 174 or 18.5%), and 26 employees (2.0%) worked from home during parts of their working hours (2011: 27 or 2.0%).

Aareal Bank's work-life balance measures focused in particular on health issues during the period under review. The bank introduced an extensive range of advisory and support services for cases where close relatives are ill or in need of care, as well as a health control policy within the company. This comprises the various measures surrounding health protection and preventative healthcare. This includes an *Employee Assistant Programme*, where each employee may seek professional help – 24 hours a day, 365 days a year – from a well-known external provider on specific matters relating to their professional or private environment. Moreover, Aareal Bank's in-house medical service launched a web-based healthcare portal, which offers employees the opportunity to find out the latest news about health protection and promotion.

Aareon has been certified as a family-friendly company by berufundfamilie gemeinnützige GmbH, a non-profit organisation, since 2008. Aareon's staff policy services include promotion of workplace flexibility through part-time work and home working. At the end of 2012, Aareon had 126 (16.8%) part-time positions (2011: 127, 16.8%) and 82 (10.7%) home working places (2011: 76, 10.1%). Aareon also works together with a family service company. It has established parent/child offices at various locations and offers crèche places in Mainz, in conjunction with another company. Project activities were focused on the issue of care in 2012 too. Under the patronage of Chancellor Angela Merkel and the "Success Family Factor 2012" competition for companies organised by the Federal Ministry for Family Affairs, Aareon was distinguished as Germany's most family-friendly company in the category for "Medium-sized company" due to its comprehensive and innovative range of family-friendly services.

Diversity

Aareal Bank promotes a culture of diversity, as this supports and motivates our employees in different situations and phases in their lives to develop their individual talents, opinions, prospects and ability, and thereby impact positively on the company's success.

Report on material events after the reporting date

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

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

Risk management – scope of application and areas of responsibility

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

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

<table>
<tr><th colspan="2">Type of risk</th><th>Risk management</th><th>Risk monitoring</th></tr>
<tr><td colspan="2">Market price risks</td><td>Treasury; Dispo Committee</td><td>Risk Controlling</td></tr>
<tr><td colspan="2">Liquidity risks</td><td>Treasury</td><td>Risk Controlling</td></tr>
<tr><td rowspan="4">Credit risks</td><td>Property finance Individual Risks</td><td>Credit Business Market, Credit Management</td><td>Risk Controlling, Credit Management</td></tr>
<tr><td>Property finance Portfolio risks</td><td>Credit Management</td><td>Risk Controlling</td></tr>
<tr><td>Treasury business</td><td>Treasury; Counterparty and Country Limit Committee</td><td>Risk Controlling</td></tr>
<tr><td>Country risks</td><td>Treasury, Credit Management, Counterparty and Country Limit Committee</td><td>Risk Controlling</td></tr>
<tr><td colspan="2">Operational risks</td><td>Process ow ners</td><td>Risk Controlling</td></tr>
<tr><td colspan="4">Process-independent monitoring: Audit</td></tr>
</table>

Strategies

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

Risk-bearing capacity and risk limits

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

In accordance with this approach, potential risk cover is determined using data derived from the income statement and from the statement of financial position; this derivation also forms the basis for determining regulatory capital. This involves setting aside the maximum amount of own funds required as potential risk cover to offset risks without causing a breach of minimum requirements pursuant to the German Solvency Regulation (SolvV). Aareal Bank has decided to considerably exceed this minimum requirement, and to prudently apply a minimum core Tier 1 ratio (calculated in accordance with Basel III) of 8%. Only free own funds exceeding this level are applied as potential risk cover, of which a further portion is retained as a risk cushion. This cushion is not applied to risk limits, and is thus available for risk types that cannot be quantified (for example, reputational or strategic risks).

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

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 risks".

Stress testing

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

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 (*"Markt"*) and Credit Management (*"Marktfolge"*), up to and including senior management level. In addition, the Risk Controlling division, which is not involved in making lending decisions, is responsible for monitoring all material risks whilst ensuring an adequate and targeted risk reporting system at a portfolio level.

Lending decisions regarding credit business classified as relevant for the bank's risk exposure require two approving votes submitted by a Sales unit and a Credit Management unit. The bank's 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, 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 market and risk management process across all relevant divisions.

Process requirements

The credit process comprises the credit approval and further processing phases,each governed by a control process. Credit exposures subject to increased risks involve supplementary processes for intensified handling, the handling of problem loans, and – if necessary – for allowance for credit losses. 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 instruments such as periodic monitoring and internal ratings. The intensity of the ongoing assessments is based on the risk level and size of the exposure. The Group's risk management processes ensure that counterparty risk is assessed at least once a year.

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

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

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

Risk classification procedures

Aareal Bank 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 the implementation of risk classification procedures is outside the Sales units. These divisions are responsible for the annual validation of the risk classification procedure.

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

Property financing business

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

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

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

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

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

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

Financial institutions

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

Sovereign states and local authorities

In addition, Aareal Bank 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

Functional separation

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

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

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

The detailed assignment of responsibilities is outlined below.

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

Operations is responsible for controlling trading activities, confirming trades to counterparties, and for trade settlement. The division is also responsible for verifying that trades entered into are in line with prevailing market conditions, as well as for the legal assessment of non-standard agreements, and of new standard 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 division comprise identifying, quantifying and monitoring market price, liquidity and counterparty risk exposure from trading activities, and the timely and independent risk reporting to senior management.

Process requirements

Processes are geared towards ensuring end-to-end risk management, from conclusion of the trade right through to monitoring portfolio risk. The monitoring and reporting function comprises deploying adequate risk measurement systems, deriving limit systems, and ensuring the transparency of Aareal Bank 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 the Sales units in their business activities.

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

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

Risk exposure by type of risk

Credit risks

Definition

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

Credit risk strategy

Based on the bank's overall business strategy, Aareal Bank's credit risk strategy sets out all material aspects of the Group's credit risk management and policies. Proposals for the credit risk strategy are prepared jointly by the 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 the Sales units and Credit Management, who submit a proposal (on which they are 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 finance exposures, and of business with financial institutions. The models permit to identify, measure, monitor and manage risks at a portfolio level.

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

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

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

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

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

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

Credit risk mitigation

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

As an international property finance house, Aareal Bank 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 market and mortgage lending values determined by the bank must not exceed the values 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. For this purpose, the bank differentiates between banks, public-sector banks, and other guarantors. The value of financial collateral is determined according to the type of collateral. Haircuts are generally applied when determining the value of guarantees/indemnities and financial collateral.

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

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

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

Prior to entering into agreements, the responsible legal services unit within the Operations division assesses the legal risks, and the legal effectiveness and enforceability. The bank uses an internal rating system to assess the credit quality of counterparties. For derivatives transactions entered into with financial institutions, where the bank is looking for capital adequacy relief in accordance with the 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.

In principle, Aareal Bank 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. 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 ability to carry and sustain risk throughout the financial year under review.

Country risk measurement and monitoring

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 limit utilisation, and for monthly reporting. Country limits defined for the purposes of risk management were always observed during the financial year under review.

Market price risks

Definition

Market price risk is broadly defined as the threat of losses due to changes in market parameters. Aareal Bank's market price risk exposure predominantly comprises interest rate risks, whilst currency risks are largely eliminated through hedges. 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 primarily used as hedging instruments. Spread risks between the various yield curves (e.g. government, Pfandbrief and swap curves) are taken into account. The risk exposure from bonds that is not related to market price or interest rate risks is managed as part of 'specific risk', in particular, credit and liquidity risk exposure of the bond portfolio.

Risk measurement and monitoring

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

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

A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. Determined on a daily basis for the Group and all its operating units, the VaR figure takes into account the correlation between individual risk types. 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 95% confidence interval and a 250-day holding period.

By their very nature, VaR calculations are based on numerous assumptions regarding the future development of the business, and the related cash flows. Key assumptions used include current account balances which are factored into calculations for a period of 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'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.

These limits remained unchanged during the financial year under review. No limit breaches were detected. The overall average utilisation of the value-at-risk limit – which we have defined for the aggregate exposure to market price risk and specific risk – was 76.7% for 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 (≤17 for a 250-day period). Three negative outliers at Group level occurred during the last 250 trading days, affirming the high forecasting quality of the VaR model we use.

Stress testing

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

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

The worst-case scenario used in the financial year under review was a hypothetical scenario, where a deteriorating financial markets crisis caused bond and CDS spreads to widen due to rating downgrades, combined with an appreciation of the euro and unchanged interest rate markets. This scenario implied a present value loss of 29% of the stressed aggregate risk cover limit as at year-end 2012. No breach of set limits occurred during the year under review.

Interest rate sensitivity

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

Interest rate gap analysis

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

Trading book

Being authorised to maintain a trading book, Aareal Bank AG is the Group entity that is in a position to assign transactions to the trading portfolio as defined by the German Banking Act. Given that no such trades were concluded during 2012, trading book risks played a negligible role in the overall risk scenario.

Liquidity risks

Definition

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

Risk measurement and monitoring

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

a) Cash flow forecast

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

b) Liquidity run-off profile

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

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

c) Funding profile

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

Stress testing

Moreover, we employ stress tests and scenario analyses to assess the impact of sudden stress events on our liquidity situation. The various 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 throughout the year 2012, as were the limits set by reference to the liquidity run-off profile.

Operational risks

Definition

The bank defines operational risk as the threat of losses caused by inappropriate internal procedures, human resources and systems (or their failure), or through external events. This definition also includes legal risks. 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 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.

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

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

Other risks

Definition

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

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

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

Risk measurement and monitoring

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

Other risks are predominantly managed and monitored through qualitative measures. A Group-wide Code of Conduct sets the framework regarding integrity and professional conduct for all activities. The Code provides a standard that is binding for all employees of Aareal Bank 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'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.

Accounting-related internal control and risk management system

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

The accounting-related internal control and risk management system includes principles, procedures and measures to ensure the effectiveness and the efficiency of internal and external accounting, in accordance with applicable legal provisions. Pursuant to section 289 (2) no. 5 of the German Commercial Code (HGB), the tasks of the accounting-related internal control system mainly include ensuring proper conduct of business activities, guaranteeing proper internal and external accounting, as well as ensuring compliance with relevant statutory and legal requirements applicable to the Company.

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

Organisation of the accounting-related ICS and RMS

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

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

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

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

Internal Audit also has a process-independent monitoring function. It reports directly to the Management Board, and provides objective and risk-oriented auditing and consulting services which are designed to optimise Aareal Bank AG's business processes with regard to accuracy, safety and efficiency. The Internal Audit division supports the Management Board by evaluating the effectiveness and appropriateness of the process-dependent internal control system and of the risk management system in general. The review of the risk management's effectiveness and appropriateness covers the risk management and risk control systems, reporting, information systems, and the accounting process. Any detected weaknesses regarding the identification, evaluation and reduction of risks are reported and addressed within the context of specific action plans.

To perform its tasks, Internal Audit has full and unrestricted information rights with respect to activities, processes and IT systems of Aareal Bank AG. Internal Audit is informed on a regular basis about material changes related to the internal control and risk management system.

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

Components of the accounting-related ICS and RMS

Within Aareal Bank AG, various measures related to the bank's organisational structures and workflows help to fulfil the monitoring duties concerning the accounting and financial reporting process within the framework of its internal control system.

A prerequisite for the monitoring system to work efficiently is a written set of procedural rules governing the distribution of tasks between the individual divisions and the scope of the respective activities. The organisational structure of the Finance division is set out in the bank's organisational guidelines. Aareal Bank AG's accounting system is structured observing the principle of separation of functions. The functional separation makes for a split between operative and administrative roles, and is designed to ensure a sufficient level of control. In addition, the preparation of the single-entity and the consolidated financial statements is carried out in distinct units.

Various guidelines exist for activities and processes. These guidelines are set out in the Written Set of Procedural Rules of Aareal Bank AG and available for inspection for all employees. There are requirements as regards data entry and control – as well as data storage – which have to be observed in general by all of the bank's posting units. If necessary, results are reconciled across divisions or companies.

Activities required within the scope of preparing the financial statements are defined by internal accounting instructions. Aareal Bank AG's voucher documentation rules set out the rules governing accounting vouchers for all of the bank's posting entities. Legal requirements and the relevant accounting standards are set out in detail in the accounting instructions, and by reference to the plan of accounts. The Finance division regularly reviews these documents, and updates them if necessary. The valuation techniques used, as well as the underlying parameters, are controlled regularly, and adjusted if necessary. Where valuation units (Bewertungseinheiten) are used for measurement purposes, defined criteria are reviewed on a regular basis. For further information on measurement, please refer to the relevant notes to the consolidated financial statements.

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

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

Adherence of accounting to generally accepted accounting principles is ensured by both preventive and detective controls within the accounting process itself, as well as through a comprehensive review of processed data. The preparation of the consolidated financial statements is characterised by multiple analyses and plausibility checks. Besides the evaluation of individual accounting issues, these include comparisons of periods, and between plan and actual data. Reconciliation of balances and positions with clients and counterparties is carried out in line with existing regulations. Control processes in accordance with MaRisk have been implemented for credit risk provisioning. Reconciliations take place between the main ledger and upstream position-management systems, as well as on the level of individual accounts. Adequate control processes have been implemented for both manual and automated accounting transactions. Additional control processes are in place to ascertain the complete recording of all transactions in the bank's accounting systems.

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

In terms of organisational workflows, the accounting-related internal control and risk management system is based on a comprehensive standardisation of processes and software. Aareal Bank AG uses both standard and customised software. The bank's accounting-related IT systems were designed in such a way that both manual controls and automatic plausibility checks are performed for material technical and procedural system steps of the applications used. The controls in relation to processing within the IT systems are also integrated in the processes, as well as being independently performed. Process-integrated controls comprise, for example, the review of error and exception reports or the regular analysis of internal service quality. In contrast, IT reviews are conducted independently from processes, by Internal Audit.

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

Aareal Bank AG reviews its accounting-related internal control and risk management system on an ongoing basis. Necessary adjustments are made with respect to the accounting process based on the bank's reviews. Adjustments may have to be made, for example, in connection with changes in the bank's organisational structure, to the business model, or new legal requirements.

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

Report on expected developments

Macro-economic environment

Economy

The global economy finds itself in a difficult situation. The outlook is dampened by considerable pressure and uncertainties. The insecurities and uncertainties in conjunction with the progression of the European sovereign debt crisis are of great significance. Important burdening factors are the desire to reduce debt levels among private households and companies, resulting in cautious consumption and investment behaviour, the consolidation efforts undertaken by several governments, and the high level of unemployment in many countries. Future oil price development also entails additional risks for economic trends. On the other hand, the still-expansive monetary policy pursued by many central banks is likely to provide support.

The uncertainty generated by the European sovereign debt crisis, together with the greater regulatory requirements for banks and the resulting necessary reduction in the risk-weighted assets of many banks may lead to a cautious stance on lending. This would burden companies' investment activities. At the same time, the less positive economic outlook ist also expected to dampen demand for credit.

We therefore assume that global economic growth will be restrained in 2013. It will be roughly on par with 2012 levels, although we are likely to see marked regional differences. What is relevant from Aareal Bank's perspective is that the anticipated weak economy is also expected to have negative implications for the development of rents and asset values on the commercial property markets. We will deal with this in more detail below.

Our forecast in detail: the economy in the euro zone will be burdened to a large extent by uncertainty in the course of the European sovereign debt crisis, and consolidation efforts in the private and public sectors.

We believe real gross domestic product in the euro zone will again fall – albeit only marginally – in 2013. With regard to individual countries, we assume that the southern member states, including Italy and Spain, will remain in recession. We also anticipate a slight recession for the Netherlands. Economic development is expected to virtually stagnate in many other member states, such as Belgium, Finland and France. We forecast marginal growth in real gross domestic product for Germany, Luxembourg and Austria. Most European countries outside the euro zone are likely to see only a slight increase in real gross domestic product in 2013; this affects Denmark, UK, Poland, Sweden and Switzerland. The momentum in the growth economies of Russia and Turkey will be strong by European standards. On the other hand, we anticipate economic output to decline slightly in the Czech Republic.

The absence of a lasting solution to the US debt issue represents a significant uncertainty for the US economy. The Federal Reserve's expansive monetary policy on the other hand, is expected to lend support. Real gross domestic product in the USA is expected to grow moderately in 2013, with rates comparable to those in 2012. We also assume moderate growth rates for Canada and Mexico, which will be only marginally lower than levels in 2012.

The process of economic recovery in Japan after the earthquake catastrophe is expected to have run its course, with only marginal growth seen for real gross domestic product in 2013. The Chinese economy will continue to post high growth rates by international standards. Supported by domestic demand, growth momentum could increase again compared with 2012. We anticipate a faster pace of economic growth in Singapore year-on-year. Overall, growth in Asia should be relatively moderate.

Given the weak economic outlook in Europe, we expect unemployment rates to further increase in most European countries this year, again with a more pronounced increase in the southern euro zone member states. However, we anticipate a marginal rise in unemployment or almost stable unemployment rates in only a few European countries, for example, Germany, UK and Poland. In view of the comparatively positive economic outlook in the US, we forecast a slow decline in the unemployment rate there.

The global economy should recover slightly in 2014. However, economic momentum in Europe will pick up only gradually. Economic growth rates in numerous European countries will only be slightly positive, but they will be above the expectations for 2013. Italy and Spain might also shake off the recession then, although progress will not be dynamic and growth rates only minimal. However, we could see dynamic economic development in North America and Asia. We anticipate unemployment rates to virtually stagnate in Europe in 2014, and to become lower in the US. The improvement in economic development in 2014, however, assumes that the sovereign debt crisis will ease, and that governments, companies and private households will have found an acceptable way to reduce the level of public-sector debt.

Future economic development, and hence the forecasts, are subject to considerable risks and uncertainty – primarily with respect to further developments concerning the European sovereign debt crisis. The risk of the crisis escalating is still present. The distortions on the financial and capital markets, alongside the banking sector's more pronounced reticence to lend and a deep-rooted uncertainty amongst economic operators, all hold the threat of a deep global recession. Even though we do not consider such a deep global recession to be the most likely outcome, the risk does exist. The absence of a lasting solution to the US debt issue poses another risk. It cannot be ruled out that this will lead to uncertainty and a significant decline in growth rates in the US, which could result in a worldwide collapse in investment.

Financial and capital markets, monetary policy and inflation

The European sovereign debt crisis and its repercussions, as well as the not sustainably resolved US debt issue, will continue to command the attention of the financial and capital markets. From the market participants' perspective, developments on the financial and capital markets in recent months suggest that the worst may be over. In any event, there is nothing at present to imply another round of major market distortions. At the same time, uncertainties and risks on the financial and capital markets in conjunction with the European sovereign debt crisis will remain. The financial and capital markets are still very susceptible to shocks, should the sovereign debt crisis escalate.

The weak economic outlook is exercising low upside pressure on inflation. However, there is significant uncertainty concerning oil price development – which is an important factor for inflation, since the price of oil is influenced considerably by economic as well as political factors and speculation. As we see it, the rate of inflation in Europe for 2013 will be down slightly on the 2012 level. Inflation in North America should remain roughly unchanged from 2012. We are forecasting a similar inflation trend for China. In Japan, even a slightly negative inflation rate is possible. Inflation rates in 2014 will, in our opinion, remain comparable to levels in 2013.

In view of inflationary expectations, the muted economic outlook and the uncertainties arising in the course of the sovereign debt crisis, most central banks will probably continue to pursue an expansive monetary policy. Key interest rates are therefore expected to remain low in 2013. Consequently, under current conditions, short-term interest rates will remain low. We expect a slightly higher interest rate environment for 2014. Looking at long-term interest rates, the risk premiums (spreads) for bonds deemed as unsafe by investors are set to remain high. The risk premiums will be very important for euro zone periphery governments as well as the companies operating there. This assessment would change if there were any significant reduction in market uncertainty. Interest rates in the markets that were affected most by the sovereign debt crisis would then fall, while higher rates would be anticipated in other euro zone countries, such as Germany.

Regulatory environment and competition

The trend towards a tighter regulatory framework in the banking business is set to persist during the coming years. Accordingly, Aareal Bank will also focus on the related measures for implementation and how these will affect the bank’s business activities.

In addition to the core elements of the Basel III regime, which include enhancing the quality and quantity of regulatory capital, as well as the introduction of international liquidity standards and a leverage ratio (and which were not adopted on schedule at a European level in 2012), further new regulatory requirements will need to be implemented in parallel. These include implementation of the new financial reporting (FINREP) that was deferred to 1 January 2014, the harmonisation of reporting solvency figures (COREP), and its accelerated conversion to international accounting standards. In addition, the requirements, for example, at national level will be increased continuously through the Minimum Requirements for Restructuring Plans ("MaSan") and the revision of the Minimum Requirements for Risk Management ("MaRisk"), and at European level through the EU directive on determining a framework for the recovery and workout of banks and securities firms.

Regulators have yet to come up with final details for a large portion of these additional requirements, and adopt them. The final draft of the various technical standards that are essential for implementation is still pending. To nevertheless facilitate the timely implementation, we have already started to deal with and pursue the various issues in numerous projects – devoting considerable resources to this task.

Some of the previous year's trends will remain intact on the market for commercial property financing. We believe that insurance companies, pension funds and other non-banks will expand their activities in Europe, thus creating more opportunities for cooperation in relation to property financing. The banks in Europe are likely to continue focusing on their domestic markets and a number of core markets. Various banks are undertaking efforts to scale back their commercial property financing activities. With regard to new loans, the active banks will attempt to concentrate on first-class commercial property in the corresponding locations, with low LTVs. We will continue to see a degree of reticence with regard to lending for specific financings, such as properties not included in the premium segment or those in peripheral locations, financings with high LTVs, and for cross-border portfolios. Particularly in Southern Europe, credit supply is likely to be tight in general. The restraint exercised by the banks in Europe is attributable to the uncertain environment, the need for some banks to reduce risk-weighted assets and tighter regulatory requirements. However, lending activity is likely to pick up if the European sovereign debt crisis clearly eases. On the demand side, the high refinancing requirements of investors from expiring financing agreement must be taken into account, as well as from CMBS securitisations. A credit crunch might be possible in some areas, particularly in Southern Europe.

Although maturing financings will probably lead to higher refinancing requirements in North America, the financing markets there are considerably more liquid at present than in Europe. We assume that this scenario will remain in place. We believe the financing markets in Asia will remain liquid and therefore highly competitive in the future.

The estimates stated above are valid for the current and the next year.

Segments and business development

Structured Property Financing segment

Developments concerning rents and values on commercial property markets will be influenced to a great extent by the future economic environment.[7]

The great uncertainty in the overall economic environment, weak economic outlook and high unemployment will burden the commercial property markets in Europe. On the other hand, property values are supported by the low interest rate environment. Bearing these conditions in mind, we anticipate rents and values to remain almost stable on average in 2013 in many European countries, such as Belgium, Germany, the United Kingdom and Poland. Developments in France and Sweden, on the other hand, are expected to be slightly weaker. In view of the recession in Italy, the Netherlands and Spain, property values and rents will probably come under greater pressure there in 2013. On the other hand, market developments in the growth economies of Russia and Turkey should be slightly positive.

The more favourable economic outlook for North America offers potential for slightly higher rents and values. The economy in China continues to grow significantly, albeit with less momentum. We are therefore cautious, and forecast only a slight increase in rents and values in China. A trend towards stability was evident last year on the Japanese markets. This trend could continue, so that – on average – we anticipate virtually stable rents and values for Japan. Rents and values are expected to rise in Singapore during 2013.

Based on the projected slight economic recovery projected for 2014, we anticipate largely stable to slightly increasing property values and rents next year. Development in Italy might then also be stable – provided the economy can find its feet there again. Only for Spain do we anticipate a marked drop in rents and values, in view of the persistent high rate of unemployment. We expect the positive trend in North America to continue, and developments in Asia should be largely stable in 2014.

The trends described above should, in our view, tend to apply to office, retail and logistics property markets. Revenues in 2013 and 2014 for hotel properties in Europe are expected to fluctuate around the previous year's levels. The hotel sector in Southern Europe might deviate from this trend and come under downside pressure. We believe a slightly positive development for hotel properties is possible for North America and Asia in the two years covered by the forecast horizon.

It is fair to expect that the concept of security will no doubt continue to play a major role for investors, so that investor interest will focus on first-class properties with a solid rental situation and sustained marketability. These property types are likely to benefit from this with regard to their performance, compared with properties not included in the premium segment that may come under pressure.

The uncertainties in the overall economic environment generate tangible risks on the commercial property markets. In the event of a deeper recession, more extensive declines in rents as well as in property values are probable; these would occur with a certain time lag. An additional risk factor for the commercial property markets is the high volume of financings which mature this year and the next. Any failure to refinance maturing loans might trigger an increased level of sales to redeem residual debt – which would burden prices.

On the other hand, the low volume of new commercial property on the markets of Europe and North America could support rents and values. Should commercial property become increasingly attractive to investors as a form of investment from a risk/return perspective; this might also provide support. In this case, however, primarily property in the high-quality segment would benefit over those properties of lower quality or in peripheral locations.

Aareal Bank takes property market developments into account for its risk assessment. Aareal Bank considers diverging developments in different countries within the framework of its lending policies. The anticipated development of a country's specific regions is also taken into account in the lending policies.

The new business targets also take into consideration market conditions and expected developments. Our new business target for 2013 is between € 6.0 billion and 7.0 billion. The volume of new business in the following year is expected to remain within the same range.

We want to continue to use syndicated financings allowing us to participate in large-volume financings and to diversify risk. In our opinion, the environment for syndicated financing will remain challenging in 2013 and 2014.

[7] Assessments of individual sub-markets and properties may deviate from the general assessment of the commercial property markets outlined below.

Subject to the performance of the relevant currencies vis-a-vis the euro, we expect the volume of the property financing portfolio for 2013 to increase compared to the year-end 2012. The regional breakdown of the portfolio is driven by our three-continent strategy, whereby the regional focus will be on Western Europe and North America.

The forecasts are based on the assumption that there will be no protracted global recession and that recessionary trends should remain restricted to a few European countries. We would otherwise anticipate a much lower volume of new business.

Consulting/Services segment

Institutional Housing Unit

We expect stable development for the German institutional housing industry in the current and the next year. This is supported mainly by largely constant rental income and solid property values.

Besides the impact of the demographic shift, climate change and the federal government's energy saving targets will require the housing stock to be adapted in the future. The companies operating in the institutional housing industry will therefore continue to pursue a sustainable development of their portfolios that is largely aimed at improving energy efficiency.

The lack of properties suitable for the elderly is also increasing the necessity in the industry to adapt the housing stock to meet the changing needs of an ageing population. In addition to restoring existing housing stock, investment activities will focus on new construction projects, above all in the conurbations.

We anticipate a stable development on the housing market in 2013 and 2014. The demand for housing is expected to continue growing in the next two years, especially in cities with more than 100,000 inhabitants. This will also lead to higher housing prices. Property prices are likely to increase most in cities with more than 500,000 inhabitants.

This trend will be beneficial to property investors and potential sellers of residential property within the institutional housing industry. The level of rents already reached in conurbations might in itself curb price performance if an economic downturn has a negative effect on households' economic situation, thus reducing the number of buyers that can afford the rising cost of property.

Given the uncertainty resulting from the European sovereign debt crisis, residential property will continue to gain importance in 2013 and 2014, being seen as tangible assets by national and international investors alike. Since the strong appeal of the Germany residential property market remains unchecked, we anticipate the volume of investment to remain high next year. The large share of interested international investors places relatively high demands on our sales activities with regard to our efforts in maintaining our existing client base for the long term.

Nonetheless, we see good opportunities during the course of 2013 and 2014, to acquire new clients and to intensify the business relationships with our existing client base. This also applies to our payments services for utilities and the waste disposal industry.

Looking at the development of deposits taken, we expect the positive trend to continue. Given the ongoing low interest rate environment, we expect margins in the deposit-taking business will continue to remain under pressure in 2013 and 2014. However, the importance of this business goes way beyond the interest margin generated from deposits, which is under pressure in the current market environment. This is because the deposits from the institutional housing industry represent a strategically important additional source of funding for us.

Aareon AG

The IT trend of cloud computing will become even more established on the market for property management software. The use of mobile solutions is also becoming increasingly important.

Aareon anticipates further growth in sales revenues for the Wodis Sigma product line in the two forecast years. Wodis Sigma is well received by our clients as a service from the Aareon Cloud, and supports the growth in the product line's sales revenues. Aareon is prepared for anticipated migrations from other ERP solutions to Wodis Sigma. It had already increased the advisory and support capacity in 2012.

The high degree of client satisfaction with the ERP system GES has an influence on their readiness to migrate to other solutions; as a result, the migration ramp-up of GES clients has been slower than anticipated, and will shift to later years. For 2013, we expect GES revenues to be on a par with the previous year's level, with a moderate decline anticipated from 2014 due to clients' migrating to other software solutions.

We continue to expect a small number of tenders for new implementations on the market for SAP®solutions and Blue Eagle. Aareon therefore anticipates generally stable sales revenues with advisory solutions for the two forecast years. A decline is only expected in licence revenues.

Sales revenues in the Integrated Services segment are expected to increase in the two forecast years. The launch of new products, such as a state-of-the-art sector-specific customer relationship management system (CRM) and mobile solutions, as well as Aareon Archiv kompakt and Mareon FM (facility management) will have a positive effect on sales. The CRM system and mobile solutions are developed in international projects within Aareon Group. This can enhance synergies to increase the benefit of these solutions for the clients. Owing to the market launch of the new products as of 2013, investment costs will burden the contribution margin of the Integrated Services segment in the next two years.

The EBIT of the International Business segment will fall slightly in 2013 before exceeding 2012 levels again in 2014.

The EU-supported I-stay@home project will continue until 2015. The first pilot clients are planned to come on board in 2014.

In the Netherlands, structural changes in the social housing sector are being pursued by policy makers. Aareon is adapting to this by adjusting the product portfolio. The market penetration with the product generation SG|tobias^{AX} is progressing, while market penetration of the facility management information system (FMIS) solution of subsidiary SG|Facilitor B.V. is advancing at a much slower pace than expected. Overall, Aareon expects a somewhat lower contribution to sales revenues in 2013 compared with 2012, due to longer terms of the licence agreements of its Dutch subsidiary SG|automatisering. As we see it, sales revenues will pick up again in 2014. Assuming an unchanged cost base, we expect a lower EBIT for 2013 that will increase again in 2014.

In France, the introduction of Release 3.0 of the ERP solution PortalImmo Habitat is planned for 2013: Release 3.0 of the Prem'Habitat ERP solution will meanwhile follow in 2014. Although the SAP® business is lower than anticipated, Aareon France is expected to record a slightly steady increase in sales revenues, which will be generated mainly from consulting. The Flexiciel module will be sold on the market in future as software-as-a-service (SaaS). Seen in the context of Aareon's social responsibility, the I-stay@home project should be regarded initially during the two forecast years as an investment in the development of an innovative platform. The cost effect for the project will prevent Aareon France's EBIT from growing in 2013. Growth can be anticipated again as of 2014.

In the UK, the price war on the market for ERP solutions continues to exercise a considerable influence on new client acquisition. Nonetheless, Aareon UK is expected to increase sales revenues, with costs remaining constant. The ERP solution QL is being developed further in line with the latest technological requirements. Demand remains strong for the document management and mobile solutions offered by Aareon UK. Aareon UK will also increase its EBIT contribution in the next two years.

New client business will significantly increase the sales revenues of 1st Touch Ltd., the specialist for mobile solutions acquired in 2012, given the sharp increase in the demand for such products on the market. The growing number of new projects anticipated in both new and existing client business will lead to greater demand for advisors, which 1st Touch Ltd. will address through investment in new personnel capacity. This will raise staff-related costs significantly. 1st Touch is an important acquisition for Aareon Group and will also have a positive effect on Aareon's EBIT.

All in all, Aareon Group expects a slight increase in revenues for the following year. Increased demand, in particular for advisory services for Wodis Sigma, sales growth in integrated services through the new CRM products, Aareon Archiv kompakt and Mareon FM, together with anticipated growth in sales at 1st Touch Ltd., Aareon France SaaS and Aareon UK Ltd. will combine to offset the decline in licence sales at the Dutch subsidiary. Given that higher licence revenues are expected again in 2014, due to contract renewals, Aareon Group forecasts further sales growth as of 2014. Investments in the new integrated services products, investment costs for I-stay@home, and additional sales-related personnel expenses on account of the recruitment drive at 1st Touch will lead to higher costs in the next two years. Aareon Group expects a stable EBIT of around € 27 million for 2013, which should be increased slightly in 2014.

Group targets

Aareal Bank Group draws up its corporate planning in accordance with IFRSs. Hence, no single-entity planning is being made for Aareal Bank AG, which is why the following statements on Group targets refer to Group planning in accordance with IFRSs.

We see the start to the current year as moderately positive. Despite the challenges that still exist – especially the recessionary trend in some European countries and ongoing uncertainty surrounding future regulatory measures – we forecast a slight improvement in the business environment for Aareal Bank.

In view of the decisions reached in recent months at EU level as well as in the crisis states, the sovereign debt crisis is expected to ease further. Even though a sustainable solution to the crisis has not yet been found, and a renewed escalation cannot be ruled out, market participants believe the worst is over.

We had therefore already started to adjust our previously very cautious investment strategy in mid-2012. We will continue on this track in 2013, and may further reduce the funds deposited with the ECB and the Bundesbank. However, the low interest rate environment has a negative impact on these investments and on the deposit-taking business. The good margins achieved on the lending side are offset in part by these effects, so that net interest income in 2013 is expected to come in only slightly above the previous year's figure. In our opinion, a growing loan portfolio, a rising volume of deposits, and a slightly higher interest rate environment, are likely to drive up net interest income more significantly in 2014.

Planning in relation to allowance for credit losses reflects the developments on the property markets worldwide. Aareal Bank expects allowance for credit losses to fluctuate in a slightly adjusted range of € 110 million to € 150 million, particularly in view of the recessionary trends in Italy, Spain and the Netherlands, as well as a growing loan portfolio; from today's perspective however, we expect allowance for credit losses to be at the lower end of the range. Given the late-cyclical nature of our business, we expect allowance for credit losses in a similar range for 2014. As in the previous years, the bank cannot rule out additional allowance for unexpected credit losses that may be incurred during 2013 and 2014.

We expect a stable trend for net commission income in 2013, between € 165 million and € 175 million. Particularly, a higher contribution from our Aareon subsidiary should improve net commission income in 2014.

Thanks to the measures implemented in 2012 to optimise our structures and processes, administrative expenses are also expected to rise only slightly compared with 2012, to between € 360 million and € 370 million. We expect administrative expenses in 2014 to increase in line with the general rate of inflation.

Notwithstanding a still-challenging environment, we believe there is a good chance the bank’s consolidated operating profit will match the level of 2012. We anticipate an increase in consolidated operating profit for 2014.

Our new business target in the Structured Property Financing segment is € 6 billion to € 7 billion for the year 2013. The volume of new business in the following year is expected to remain within the same range.

In the Consulting/Services segment, we anticipate a stable result before taxes compared with the previous year, of around € 27 million for Aareon Group in 2013. We expect to increase this result slightly in 2014.

Corporate Governance Statement pursuant to section 289a of the HGB

The Corporate Governance Statement, including the Declaration of Compliance pursuant to section 161 of the AktG, disclosures regarding Corporate Governance standards, the description of work processes for the Management Board and the Supervisory Board, as well as Aareal Bank AG's Corporate Governance Report, are publicly available on the Company's website, at http://www.aareal-bank.com/investor-relations/corporate-governance/. Reference is made to the details disclosed there.

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

The Supervisory Board determines the structure and amount of remuneration for members of the Management Board. Aareal Bank AG has entered into fixed-term service contracts with the members of its Management Board.

Against the background of the German Act on the Appropriateness of Management Board Compensation dated 31 July 2009 (*Gesetz zur Angemessenheit der Vorstandsvergütung – VorstAG*), and the German Ordinance governing supervisory requirements for remuneration systems of financial institutions (*Instituts-Vergütungsverordnung – (InstitutsVergV*), the remuneration system for members of the Management Board of Aareal Bank AG was examined, also using the support of external advisors, and adjusted with effect from 1 January 2012.

Besides their fixed annual salary, Management Board members receive a performance-related bonus (variable remuneration) that is determined using an assessment basis extending over several years. The level of this performance-related bonus is determined by reference to the personal performance of each Management Board member which is measured by the degree to which targets set in advance by the Supervisory Board are achieved, based on contractually agreed initial values. The targets which are relevant for performance-related bonuses include annual targets and three-year targets. The weighting of annual to three-year targets is fixed for each financial year, in line with legal rules; with a 60%/40% weighting taken as a guideline.

In terms of substance, annual and three-year targets are derived from the overall strategy and medium-term planning of Aareal Bank Group, each of which are agreed upon with the Supervisory Board. The targets comprise quantitative components and qualitative components, which are also related to non-financial parameters. In this context, the bank's overall performance, the performance of the relevant section, and the individual performance contributions of the Management Board member concerned are all taken into consideration.

The amount of the initial value of the performance-related bonus increases – depending on the Management Board member's degree of target achievement – up to a maximum of 200%. Once the target achievement exceeds a level of 200%, the initial value of the performance-related bonus will not increase any further (cap). If target achievement is 0%, no performance-related bonus will be awarded for the financial year concerned. The initial value is fixed at 100% for target achievement levels between 90% and 110%.

To ensure that the remuneration system provides long-term incentives, performance-related bonuses are awarded at the end of the financial year, according to the following principles:

20% of the initial value of the performance-related bonus is disbursed as a cash bonus directly after the financial year has concluded. A further 20% of the performance-related bonus is awarded as a share bonus[8] in the form of phantom shares directly after the end of the financial year and are the subject of the Share Bonus Plan. 30% of the performance-related bonus is deferred as a cash deferral (Cash Deferral). The remaining 30% of the performance-related bonus is deferred as a share deferral[8] and is the subject of the Share Deferral Plan.

With regard to the portion of the performance-related bonus that is deferred initially as a cash deferral or a share deferral, the Supervisory Board makes a decision regarding the granting of one third of the amount as well as the associated interest in the three years following the determination of the performance-related bonus (retention period). If the deferred remuneration components for the Management Board members are actually

[8] Please refer to the subsection "Cash-settled share-based remuneration" in the remuneration report, which is part of the Notes to the Financial Statements, for details concerning the specifications of the Share Bonus Plan and the Share Deferral Plan.

awarded, the cash deferral is paid out in cash and the share deferral is converted into virtual shares, subject to a two-year holding period.

In making its determination about the amount to be awarded, the Supervisory Board particularly takes into account any negative aspects of the Management Board member's performance, his section as well as any weakness in the performance of Aareal Bank AG or the Group as a whole. The final amount may be awarded in full, partially, or not at all. If the full amount of the bonus is not awarded, the remaining sum is forfeited, i.e. it is not carried forward into subsequent years. No bonus may be awarded if BaFin makes an official ruling against the bank pursuant to section 45b (2) of the German Banking Act (KWG) due to shortcomings relating to capital adequacy or liquidity issues. If a case of serious individual misconduct by a member of the Management Board is identified afterwards in the financial year in which the remuneration components were awarded as a cash deferral and share deferral, the retained remuneration components are cancelled in full. Members of the Management Board may not undertake to limit or hedge the risk orientation of the performance-related bonus themselves (hedging ban).

Remuneration for the services of the Supervisory Board members is specified in Article 9 of the Memorandum and Articles of Association of Aareal Bank AG. The Annual General Meeting held on 18 May 2011 resolved to adjust the system for Supervisory Board's remuneration in order to reflect the ongoing discussions related to a remuneration system that is appropriate in view of corporate governance aspects. In doing so, Aareal Bank AG follows the current status of the discussions related to the proper structure for remuneration systems for supervisory boards according to which supervisory board members should receive a fixed remuneration only.

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

The fixed remuneration is € 30,000 p.a. for each Supervisory Board member. The Chairman of the Supervisory Board shall receive two and a half times this amount, while the deputy shall receive one and a half times as much as a normal member. The fixed remuneration is increased by € 15,000 p.a. for each membership in a committee (with the exception of the Nomination Committee, which is an exclusively advisory committee, and the Committee for Urgent Decisions, which is part of the Risk Committee). The fixed remuneration is increased by € 30,000 p.a. for the chairmanship of a committee (with the exception of the Nomination Committee and the Committee for Urgent Decisions).

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

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

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

Disclosures in accordance with section 289 (4) of the German Commercial Code (HGB)

Composition of subscribed capital

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

Restrictions affecting voting rights or the transfer of shares

The German Financial Markets Stabilisation Fund (SoFFin) agreed to provide a stabilisation measure to the bank in March 2009, in the form of a silent participation. In the context of this stabilisation measure, SoFFin and the bank's main shareholder, Aareal Holding Verwaltungsgesellschaft mbH ("Aareal Holding") entered into an agreement under which Aareal Holding has undertaken to maintain its stake in the bank's capital (currently 15,916,881 shares) throughout the term of the recapitalisation, and to act in SoFFin's interest when casting certain votes during the General Meeting (or to seek SoFFin's opinion prior to such a poll). Furthermore, Aareal Holding has undertaken to exercise its voting rights for resolutions to be adopted by a General Meeting in such a way that Aareal Holding will retain its blocking minority.

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

Shareholdings exceeding 10 % of voting rights

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

Shares with special rights granting the holder supervisory powers

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

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

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

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

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

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

Authorisation of the Management Board to issue or repurchase shares

Authorised capital

The Annual General Meeting held on 23 May 2012 resolved to authorise the Management Board to increase, the Company’s share capital by up to a maximum total amount of € 89,785,830 (Authorised Capital) by issuance of new shares for contribution in cash or in kind. This authorisation will expire on 22 May 2017. 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 the authorisation becoming effective or being exercised, subject to approval by the Supervisory Board and provided that the issue price is not significantly lower than the prevailing market price of shares already listed, at the time of final determination of the issue 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. When exercising this authorisation, the Management Board will restrict the exclusion of shareholders' pre-emptive rights to a total of 20% of the Company's registered share capital. Accordingly, the aggregate exclusion of shareholders' subscription rights upon exercise of this authorisation must not exceed 20% of the registered share capital at the time said authorisation comes into effect or is exercised. This limitation also includes shares issued by the Company on the basis of the authorisation by the General Meeting on 23 May 2012 under convertible bonds and/or bonds cum warrants issued excluding the pre-emptive rights of shareholders.

No use has been made do date of the authorised capital.

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 19 May 2010. Under this authorisation, bonds cum warrants or convertible bonds with an aggregate nominal amount of up to € 600 million may be issued until 18 May 2015. 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 19 May 2010. 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 19 May 2010 authorised the Management Board, pursuant to section 71 (1) No. 7 of the AktG, to purchase and sell treasury shares for the purposes of securities trading, at a price not falling below or exceeding the average closing price of the Company's share in Xetra trading (or a comparable successor system) during the three trading days on the Frankfurt Stock Exchange prior to the relevant transaction by more than 10%. This authorisation expires on 18 May 2015. The volume of shares acquired for this purpose must not exceed 5% of the issued share capital of Aareal Bank AG at the end of any given day.

The General Meeting held on 19 May 2010 authorised the Management Board, pursuant to Section 71 (1) No. 8 of the AktG, up to 18 May 2015, to acquire and sell treasury shares for purposes other than securities trading, up to a maximum volume of 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. Where acquisition is effected via the use of derivatives in the form of put or call options, or a combination of both, the option terms must ensure that said options are only serviced with shares that were purchased, in accordance with the principle of equal treatment, at the stock exchange at the prevailing share price of the Company's share in Xetra trading (or a comparable successor system) at the time of the purchase on the stock exchange.

The Management 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 10% of the issued share capital at the time of said authorisation becoming effective or being exercised. 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.

The authorisation to purchase treasury shares is granted for a five-year period; it 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 or employees in the event of a takeover offer

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

Annual Financial Statements

Income statement of Aareal Bank AG for the period from 1 January to 31 December 2012

€ mn			2012		2011
Expenses					
Interest expenses			**1,111.6**		1,179.0
Commission expenses			**12.0**		34.8
General administrative expenses					
a) Staff costs					
aa) Wages and salaries	89.3			113.9	
ab) Social security contributions, pensions and other employee benefits	17.2	106.5		19.1	
including for pensions 6.9 (2011: 7.7)					
b) Other administrative expenses		105.5	**212.0**	103.4	236.4
Amortisation, depreciation and write-downs of intangible and tangible fixed assets			**4.0**		3.8
Other operating expenses			**20.9**		35.2
Write-downs and valuation allowances of loans and advances and specific securities, as well as additions to loan loss provisions			**215.7**		239.2
Amortisation and write-downs on participations, interests in affiliated companies, and investment securities			**-**		27.7
Expenses for assumption of losses			**23.1**		1.0
Net income taxes			**-15.4**		24.8
Other taxes not reported under other operating expenses			**0.2**		0.4
Net income			**5.0**		20.0
Total expenses			**1,589.1**		**1,802.3**
Net income / net loss			**5.0**		20.0
Profit carried forward from the previous year			**-**		-
Withdrawals from retained earnings					
from the reserves for treasury shares			**-**		-
from other retained earnings			**-**		-
Transfer to retained earnings					
to the reserve for treasury shares			**-**		-
to other retained earnings			**-**		10.0
Net retained profit			**5.0**		**10.0**

€ mn		2012		2011
Income				
Interest income from				
a) Lending and money market transactions	1,101.6		1,221.3	
b) Fixed-income securities and debt register claims	398.9	**1,500.5**	447.3	1,668.6
Current income from				
a) Equities and other non-fixed-income securities	0.2		6.1	
b) Participating interests	0.0		0.0	
c) Interests in affiliated companies	-	**0.2**	3.9	10.0
Income from profit pools, profit transfer agreements and partial profit transfer agreements		**0.8**		28.3
Commission income		**65.9**		77.7
Income from write-ups to participating interests, shares in affiliated companies and securities held as fixed assets		**2.1**		-
Other operating income		**19.6**		17.7
Total income		**1,589.1**		**1,802.3**

Balance sheet of Aareal Bank AG as at 31 December 2012

€ mn			2012		2011
Assets					
Cash funds					
a) Cash on hand		0.0		0.0	
b) Balances with central banks		3,666.7	**3,666.7**	588.2	588.2
including: with Deutsche Bundesbank 3,639.0 (2011: 542.1)					
Loans and advances to banks					
a) Loans secured by charges on real property		9.0		12.4	
b) Loans to local authorities		112.3		127.6	
c) Other loans and advances		1,639.7	**1,761.0**	2,786.6	2,926.6
including: payable on demand 1,239.1 (2011: 2,271.2)					
Loans and advances to customers					
a) Loans secured by charges on real property		20,851.0		23,100.7	
b) Loans to local authorities		1,329.1		1,371.9	
c) Other loans and advances		2,139.5	**24,319.6**	884.9	25,357.5
Debt and other fixed-income securities					
a) Money market instruments		-		-	
b) Bonds and notes					
ba) Public-sector issuers	7,583.9			5,475.5	
including: with Deutsche Bundesbank 7,190.9 (2011: 5,054.0)					
bb) Other issuers	3,304.5	10,888.4		3,609.9	
including: with Deutsche Bundesbank 2,691.9 (2011: 3,284.6)					
c) Own bonds		1,416.5	**12,304.9**	1,942.5	11,027.9
Nominal amount: 1,411.8 (2011: 1,937.6)					
Equities and other non-fixed income securities			**145.7**		464.6
Participating interests			**1.4**		2.2
including: interests in banks 0.8 (2011: 0.8)					
interests in financial services providers - (2011: -)					
Interests in affiliated companies			**645.7**		589.6
including: interests in banks 9.0 (2011: 1.8)					
interests in financial services providers - (2011: -)					
Trust assets			**102.8**		126.3
including: Trustee loans 101.2 (2011: 124.8)					
Intangible assets					
a) Internally generated industrial property rights and similar rights and assets		-		-	
b) Purchased concessions, industrial property rights and similar rights and assets as well as licences in such rights and assets		2.1		2.7	
c) Goodwill		0.0		0.4	
d) Advance payments made		-	**2.1**	-	3.1
Tangible fixed assets			**10.8**		9.6
Other assets			**31.7**		52.0
Prepaid expenses			**89.6**		107.1
Deferred tax assets			**120.0**		75.9
Total assets			**43,202.0**		**41,330.6**

€ mn			2012		2011
Equity and liabilities					
Liabilities to banks					
a) Outstanding registered mortgage Pfandbriefe		251.8		132.0	
b) Outstanding registered public sector Pfandbriefe		82.9		112.6	
c) Other liabilities		3,116.0	**3,450.7**	2,847.4	3,092.0
including: payable on demand 914.3 (2011: 730.8)					
Liabilities to customers					
a) Outstanding registered mortgage Pfandbriefe		3,252.1		3,279.2	
b) Outstanding registered public sector Pfandbriefe		2,807.0		2,863.8	
c) Savings deposits					
ca) With an agreed notice period of three months	-			-	
cb) With an agreed notice period of more than three months	-	-		-	
d) Other liabilities		19,928.9	**25,988.0**	18,175.4	24,318.4
including: payable on demand 5,226.2 (2011: 4,029.2)					
Certificated liabilities					
a) Bonds issued					
aa) Mortgage Pfandbriefe	6,637.5			6,223.9	
b) Public sector Pfandbriefe	35.0			101.5	
ac) Other debt securities	3,033.6	9,706.1		3,059.4	
b) Other certificated liabilities		-	**9,706.1**	-	9,384.8
including: money market instruments - (2011: -)					
Trust liabilities			**102.8**		126.3
including: Trustee loans 101.2 (2011: 124.8)					
Other liabilities			**358.4**		589.6
Deferred income			**83.3**		97.2
Deferred tax liabilities			**22.0**		32.6
Provisions					
a) Provisions for pensions and similar obligations		82.2		83.1	
b) Tax provisions		8.1		14.8	
c) Other provisions		99.1	**189.4**	124.5	222.4
Subordinated liabilities			**780.9**		712.4
including: maturing within two years 136.3 (2011: 154.3)					
Profit-participation certificates			**210.5**		450.0
including: maturing within two years 135.0 (2011: 225.0)					
Fund for general banking risks			**167.6**		167.6
Equity					
a) Subscribed capital		179.6		179.6	
Contributions by silent partners		520.2		520.2	
b) Capital reserve		727.8		727.8	
c) Retained earnings					
ca) Legal reserve	4.5			4.5	
cb) Reserve for treasury shares	-			-	
cc) Statutory reserves	-			-	
cd) Other retained earnings	705.2	709.7		695.2	
d) Net retained profit		5.0	**2,142.3**	10.0	2,137.3
Total equity and liabilities			**43,202.0**		**41,330.6**

€ mn		2012		2011
Contingent liabilities				
a) Contingent liabilities from discounted forwarded bills	-		-	
b) Liabilities from guarantees and indemnity agreements	626.5		686.9	
c) Liability from the pledging of collateral for third-party liabilities	-	**626.5**	-	686.9
Other commitments				
a) Repurchase obligations from securities repurchase agreements	-		-	
b) Placement and underwriting obligations	-		-	
c) Irrevocable loan commitments	2,234.0	**2,234.0**	1,618.3	1,618.3

Notes

Basis of accounting

The financial statements of Aareal Bank AG for the financial year 2012 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”).

Accounting and valuation principles

Loans and advances

Loans and advances to banks and customers are carried at amortised cost, including deferred interest. Premiums and discounts are shown under deferred items, in accordance with section 340e (2) of the HGB. Credit risks are accounted for by setting aside provisions in the amount of the expected loss, using prudent estimates.

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

Securities

Bonds and other fixed-income securities, as well as equities and other non-fixed income securities, are measured strictly at the lower of cost or market value, as prescribed for current assets, taking into account hedging instruments. Where the reasons for the write-down no longer apply, write-ups are made in accordance with section 253 (5) of the HGB. Investment securities are valued at the lower of cost or market. Differences between cost and amounts repayable are amortised in income.

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

Participating interests, interests in affiliated companies and tangible 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 impairments in value deemed to be other than temporary.

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

The option to disclose a net amount, pursuant to section 340c (2) of the HGB has been exercised. The relevant amount was reported in an expense or income line item.

Deferred taxes

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

Liabilities

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

Provisions

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

Provisions for pensions have to be recognised at the settlement amount, taking into account future wage, salary and pension trends. The amount recognised has to be discounted pursuant to the provisions set out in section 253 (2) of the HGB. Provisions for pensions and similar obligations are determined in accordance with actuarial principles.

Provisions for taxes and other provisions have been set aside for existing legal or constructive obligations in the settlement amount, as required by prudent commercial judgement.

Currency translation

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

The bank has classified all foreign exchange transactions as “specific cover” and measured these using the middle spot rate (ECB reference middle rate) in accordance with section 340h of the HGB. Hence, income and expenses from currency translation were recognised in the income statement.

The bank decomposes foreign exchange forward transactions into an agreed spot base and the swap rate, recognising a deferred liability (reported under other liabilities) 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 other operating income/expense.

Trading portfolio

There were no financial instruments of the trading portfolio as at the balance sheet date.

Hedging relationships

The bank establishes hedging relationships within the meaning of section 254 of the HGB. Accordingly, fixed-income securities of the liquidity reserve in the amount of € 4,782.14 million are hedged against changes in value attributable to interest rate risk, on the basis of so-called "micro hedges". In this context, the underlying transaction and the hedge generally are acquired within the framework of so-called "asset swap packages", i.e. they are so-called "perfect hedges" where all value-affecting factors between the hedged portion of the underlying transaction substantially correspond to the hedging portion of the hedge. The prospective effectiveness of the hedging relationship, which refers to the period until the security's final maturity, is proven, based on the so-called "critical terms match method". Regression and correlation coefficients are used as criteria to measure retrospective effectiveness.

This is presented in the financial statements using the so-called "net hedge presentation method" (*Einfrierungsmethode*). Under this method, the cumulative changes in the value of the underlying transaction is determined on the basis of the hedged risk, and compared to the changes in the value of the hedge. The hedged risk amounts to € 658.4 million and corresponds to the cumulative increase of the fair value of assets since inception of the hedging relationship. This increase is not shown in the income statement on a net basis, after including hedge transactions. Any previously existing ineffectiveness based on the hedged risk is reflected in a provision for hedging relationships. The changes in value attributable to the hedged risk are reflected on a portfolio basis, in the form of a write-down on the security concerned.

The bank continues to establish hedging relationships between repurchased own bonds in a nominal amount of € 1,411.27 million and the corresponding securitised liabilities.

Fair value measurement of interest rate instruments of the banking book

In addition, Aareal Bank AG recognises derivative financial instruments of the banking book (non-trading book) for the purpose of controlling various risks as part of overall management of the bank. In accordance with HGB, these instruments represent "pending transactions" which are not recognised in the balance sheet. They form a "hedging relationship", together with the recognised assets and liabilities. No provision for anticipated losses had been recognised as at the balance sheet date. The present value of the banking book is positive as at 31 December 2012.

Derivatives

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

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

Acquired as well as issued structured products are 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 RechKredV.

€ mn	2012	2011
Germany	1,430.2	1,590.5
Europe/Americas/Asia	156.0	183.5
Total	**1,586.2**	**1,774.0**

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

Other operating income totals € 19.6 million (2011: € 17.7 million) and largely comprises income from the reversal of provisions in the amount of € 6.6 million, income from tax refunds amounting to € 2.8 million as well as income under agency contracts for other Group subsidiaries in the amount of € 1.7 million.

Other operating expenses total € 20.9 million (2011: € 35.2 million) and include expenses for subsidiaries in the amount of € 13.7 million, of which € 6.8 million are attributable to agency contracts for other Group companies. In addition, the item includes expenses in the amount of € 1.4 million from unwinding of the discount of provisions, after offsetting with income from plan assets used for pension obligations pursuant to section 246 (2) sentence 2 of the HGB.

Net income taxes

The net income tax position amounts to an income of € 15.4 million (2011: expense of € 24.8 million), of which an expense of € 36.3 million included in current taxes is payable in Germany: this figure comprises € 17.8 million in corporation tax and solidarity surcharge and € 8.4 million in trade tax payable for the current year, as well as € 10.1 million in tax expense for previous years. The net income tax position also includes € 54.1 million in income from the capitalisation of deferred taxes and € 2.4 million in expenses for the bank's foreign branch offices.

The tax reconciliation is used to determine why the tax expense (current taxes and deferred taxes) reported in the income statement differs from the expense calculated using the expected tax rate of 31.2% (2011: 31.2%), which represents the current tax rate in Germany (trade tax rate of 15.4%, corporation tax rate of 15% and solidarity surcharge of 0.8%).

€ mn	31 Dec 2012	31 Dec 2011
Income before income taxes	-10.4	44.8
Expected income tax expenses; tax rate: 31.2% (unchanged yoy) (of which: trade tax rate of 15.4%, corporation tax rate of 15% and solidarity surcharge of 0.8%)	-3.3	14.0
Reconciliation		
Different foreign tax burden	-4.3	13.3
Tax attributable to tax-exempt income	-17.0	-11.9
Tax attributable to non-deductible expenses	17.9	14.2
Remeasurement of deferred taxes	2.2	0.0
Prior-period actual taxes	-10.9	-4.9
Effect of changes in tax rates	0.0	0.0
Other tax effects	0.0	0.1
Reported income tax expenses	-15.4	24.8
Effective tax rate (%)	147.9	55.4

Prohibition of distribution

A total amount of € 101.8 million in profits is subject to a prohibition of distribution, pursuant to section 268 (8) of the HGB, of which € 99.2 million is attributable to the balance resulting from recognised deferred tax assets and recognised deferred tax liabilities. A prohibition of distribution applies to a net amount of € 2.6 million (after fair-value netting of assets), pursuant to section 246 (2) sentence 2 of the HGB.

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 (excluding pro-rata interest):

	Listed	Unlisted
€ mn	31 Dec 2012	31 Dec 2012
Debt and other fixed-income securities	12,041.0	50.0
Equities and other non-fixed income securities	0.4	3.1
Participating interests	-	-
Interests in affiliated companies	-	-

Hedging relationships as defined by section 254 of the HGB have been created with respect to negotiable securities in an aggregate amount of € 6,193.4 million (2011: € 4,915.4 million).

Bonds and notes of € 12,304.9 million (2011: € 11,027.9 million) (including accrued interest) reported under debt and other fixed-income securities include € 1,005.6 million (2011: € 746.8 million) in securities which are not eligible as collateral with Deutsche Bundesbank. Of that amount, € 342.9 million (2011: € 371.3 million) relate to sovereign foreign-currency bonds, which are eligible for securities lending.

Bonds of selected European countries

The following table is an overview of the bonds issued by public-sector entities and bank bonds of selected European countries, included in the item "debt securities and other fixed-income securities":

Bond values as at 31 Dec 2012

€ mn		Greece	Ireland	Italy	Portugal	Spain	Total
Bonds issued by public-sector entities (liquidity reserve)*							
	amount			410		25	**435**
	value			368		26	**394**
	Fair value			424		27	**451**
Bonds issued by public-sector entities (securities held as fixed assets) *							
	amount			839	155	312	**1,306**
	value			859	156	314	**1,329**
	Fair value			856	135	233	**1,224**
Covered bank bonds (liquidity reserve)							
	amount			70	60	100	**230**
	value			70	49	100	**219**
	Fair value			73	58	105	**236**
Covered bank bonds issued by public-sector entities (securities held as fixed assets) *							
	amount					501	**501**
	value					514	**514**
	Fair value					512	**512**
Senior unsecured bank bonds (liquidity reserve)							
	amount			13			**13**
	value			12			**12**
	Fair value			13			**13**
Senior unsecured bank bonds (securities held as fixed assets) *							
	amount			23			**23**
	value			23			**23**
	Fair value			24			**24**
Total	**Nominal amount**		**0**	**1,355**	**215**	**938**	**2,508**

* All bonds issued by public-sector debtors, including government-guaranteed bonds.

Bond values as at 31 Dec 2011

€ mn		Greece	Ireland	Italy	Portugal	Spain	Total
Bonds issued by public-sector entities (liquidity reserve)*							
	amount			360		25	**385**
	value			279		26	**305**
	Fair value			312		27	**339**
Bonds issued by public-sector entities (securities held as fixed assets) *							
	amount			839	155	312	**1,306**
	value			860	156	314	**1,330**
	Fair value			687	93	268	**1,048**
Covered bank bonds (liquidity reserve)							
	amount			70	60	100	**230**
	value			62	37	97	**196**
	Fair value			63	42	100	**205**
Covered bank bonds issued by public-sector entities (securities held as fixed assets) *							
	amount					516	**516**
	value					531	**531**
	Fair value					506	**506**
Senior unsecured bank bonds (liquidity reserve)							
	amount			13			**13**
	value			12			**12**
	Fair value			13			**13**
Senior unsecured bank bonds (securities held as fixed assets) *							
	amount			23			**23**
	value			23			**23**
	Fair value			23			**23**
Total	**Nominal amount**			**1,305**	**215**	**953**	**2,473**

* All bonds issued by public-sector debtors, including government-guaranteed bonds.

Investment fund units

€ mn	Book value 31 Dec 2012	Market value 31 Dec 2012	Book value 31 Dec 2011	Market value 31 Dec 2011
AllianzGI MMS I-Globalfonds	0.0	0.0	327.0	327.2
DBB INKA	101.5	101.5	92.9	92.9
Arsago Multistrategie	40.7	40.7	40.7	41.3
As at 31 Dec 2012	**142.2**	**142.2**	**460.6**	**461.4**

DBB INKA is an investment fund as defined under German law (Sondervermögen) which invests in assets permitted under the German Investment Act (Investmentgesetz – "InvG"), observing the principle of risk diversification. AllianzGI MMS I-Globalfonds was liquidated in 2012. The Arsago Multistrategie fund is a multi-strategy hedge fund which uses derivative instruments to gain exposure to various interest rate, currency and macro strategies.

Daily fund unit redemption is subject to certain restrictions. The value of investment fund units as defined by section 36 of the InvG is € 142.2 million. Distributions made by DBB INKA amounted to € 0.2 million during the financial year.

Subordinated assets

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

€ mn	31 Dec 2012	31 Dec 2011
Loans and advances to banks	-	-
Loans and advances to customers	10.5	17.6
Debt and other fixed-income securities	-	-
Equities and other non-fixed income securities	0.4	0.8
Other assets	-	-

Movements in fixed assets:

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

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

					Tangible assets	
€ mn	Debt and other fixed-income securities	Participating interests	Interests in affiliated companies	Intangible assets	Office furniture and equipment	Land and buildings
Cost						
Balance as at 1 Jan 2012	5,836.3	2.4	672.4	38.6	32.2	0.1
Additions	0.0	0.1	56.0	0.6	3.9	0.0
Disposals	510.5	0.0	12.4	1.7	1.4	0.0
Changes in inventory / transfers	0.0	0.0	0.0	0.0	0.0	0.0
As at 31 Dec 2012	**5,325.8**	**2.5**	**716.0**	**37.5**	**34.7**	**0.1**
Depreciation, amortisation and write-downs						
Balance as at 1 Jan 2012	**0.0**	**0.2**	**82.8**	**35.5**	**22.8**	0.0
Depreciation and amortisation	0.0	0.0	0.0	1.5	2.5	0.0
Write-downs	0.0	0.9	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	12.4	1.6	1.3	0.0
Transfers	0.0	0.0	0.0	0.0	0.0	0.0
Write-ups	0.0	0.0	0.1	0.0	0.0	0.0
As at 31 Dec 2012	**0.0**	**1.1**	**70.3**	**35.4**	**24.0**	**0.0**
Book value as at 31 Dec 2012	**5,325.8**	**1.4**	**645.7**	**2.1**	**10.7**	**0.1**
Book value as at 31 Dec 2011	5,836.3	2.2	589.6	3.1	9.5	0.1

As at 31 December 2012, 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 Eastern and Southern European debtors. Securities with a nominal amount of € 5,342.9 million were not measured at the lower of cost or market. An examination of cost vs. market values as at 31 December 2012 did not indicate any permanent impairment.

€ mn	Book value 31 Dec 2012	Market value 31 Dec 2012	Book value 31 Dec 2011	Market value 31 Dec 2011
Asset-backed securities	262.9	206.5	360.3	278.7
Bank bonds	743.2	785.0	927.5	940.0
Covered bonds	995.3	1,033.5	1,010.5	1,023.4
Public-sector issuer	3,324.4	3,476.4	3,538.0	3,417.2
Total	**5,325.8**	**5,501.4**	**5,836.3**	**5,659.3**

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 Pfandbrief Bank AG to Aareal Bank AG, goodwill has been capitalised and will be amortised over the associated useful life of ten years.

Any other goodwill reported under intangible assets will be amortised over the expected useful life of five years.

Other assets

Other assets include, in particular, receivables from profit and loss transfer agreements as well as € 1.2 million in receivables from profit distributions and € 23.8 million in tax receivables.

In the previous year, other assets included, in particular, € 16.9 million in tax receivables and € 32.5 million in receivables from profit and loss transfer agreements.

Deferred taxes

As at 31 December 2012, € 120.0 million (2011: € 75.9 million) in deferred tax assets and € 22.0 million (2011: € 32.6 million) in deferred tax liabilities were reported in the balance sheet. Deferred taxes are recorded in the amount of the assumed tax burden or relief in coming financial years, and are measured using the company- and country-specific tax rates expected to apply at the time of the realisation of temporary differences and the offsetting of loss carryforwards. For Germany, we generally used a corporate income tax rate (including solidarity surcharge) of 15.8% and a municipal trade tax rate, depending on the multiplier set by the relevant local authorities. This results in a tax rate of 31.2% for Germany. Deferred taxes for foreign permanent establishments are measured on the basis of country-specific tax rates.

Deferred tax assets were largely recognised for loss carryforwards of € 6.4 million (2011: € 7.5 million), valuation differences for debt and fixed-income securities compared to their tax base, provisions for impending losses from executory contracts, as required under German commercial law, on flat-rate specific provisions for loans and advances to customers, on off-balance sheet corrections related to earnings from special funds as well as on provisions for pensions.

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

Other liabilities

Other liabilities include, in particular, € 270.8 million in liabilities recognised from currency translation, and € 34.2 million in interest liabilities on silent participations.

In the previous year, other liabilities included, in particular, € 511.1 million in liabilities recognised from currency translation, and € 37.4 million in interest liabilities on silent participations.

Provisions for pensions and similar obligations

The values determined in the actuarial pension report are based on the following methods and assumptions:

	31 Dec 2012	31 Dec 2011
Actuarial method applied:	Projected unit credit method	Projected unit credit method
Fundamental assumptions for calculation:		
Discount rate in %	5.06	5.13
Expected wage and salary increases in %	2.25	2.25
Mortality tables used	"Richttafeln 2005G" mortality tables by Prof Dr Klaus Heubeck	"Richttafeln 2005G" mortality tables by Prof Dr Klaus Heubeck

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

€ mn	31 Dec 2012	31 Dec 2011
Pension obligation	126.5	120.1
Fair value of plan assets	44.3	37.0
Cost of plan assets	40.4	36.0
Provisions for pensions and similar obligations	**82.2**	**83.1**

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

€ mn	31 Dec 2012	31 Dec 2011
Fund units	11.5	9.0
Bonds	13.5	10.3
Reinsurance cover	19.3	17.7
Fair value of plan assets	**44.3**	**37.0**

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

€ mn	31 Dec 2012	31 Dec 2011
Interest cost on pension obligations	6.0	4.6
Income from plan assets	3.8	0.4
Net interest cost (-)	**2.2**	**4.2**

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 € 42.2 million include € 13.1 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. The amount exceeds 10% of the aggregate nominal value of all subordinated liabilities; this bears an interest of 7.135%. These subordinated funds are due for repayment on 31 December 2026. The bank has had a right to terminate, on a quarterly basis, since 31 December 2006; the creditors do not have any early termination rights.

Profit-participation certificates

The profit-participation certificates issued comply with the requirements of section 10 (5) of the KWG and represent liable equity capital for the bank. It comprises the following profit-participation certificates issued by Aareal Bank AG:

€ mn	Nominal amount	Issue currency	Interest rate (% p.a.)	Maturity
Bearer profit-participation	60.0	EUR	6.125	2003 - 2013
	60.0			
Registered profit-participa	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, possibly down to zero, creating a claim for backpayment during the term of the certificates at the same time.

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

€ 21.5 million in interest expenses were incurred in 2012 with respect to profit-participation certificates issued.

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

Purchase of treasury shares

The Management Board was authorised by the Annual General Meeting held on 19 May 2010 pursuant to section 71 (1) no. 7 of the German Stock Corporation Act (AktG) to purchase and sell treasury shares until 18 May 2015 for the purposes of securities trading at prices that may not be higher or lower than 10% than the average closing price of the shares in Xetra (or a comparable successor system) of the Frankfurt Stock Exchange during the three trading days prior to purchase. The volume of shares acquired for this purpose must not exceed 5% of the share capital of Aareal Bank AG at the end of any day.

The General Meeting held on 19 May 2010 also authorised the Management Board, pursuant to Section 71 (1) No. 8 of the AktG, up to 18 May 2015, to acquire and sell treasury shares for purposes other than securities trading, up to a maximum volume of 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. Where acquisition is effected via the use of derivatives in the form of put or call options, or a combination of both, the option terms must ensure that said options are only serviced with shares that were purchased, in accordance with the principle of equal treatment, at the stock exchange at the prevailing share price of the Company's share in Xetra trading (or a comparable successor system) at the time of the purchase on the stock exchange.

The Management Board is authorised – subject to certain conditions and subject to exclusion of shareholders' pre-emptive rights – to effect the sale of any treasury shares acquired in accordance with this authorisation, via channels other than the stock exchange or an offer to all shareholders. 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.

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

€ mn	Subscribed capital	Capital reserves	Retained earnings: Legal reserve	Retained earnings: Other retained earnings	Net retained profit	Equity
Balance as at 1 Jan 2012	**699.8**	**727.8**	**4.5**	**695.2**	**10.0**	**2,137.3**
(of which: contributions by silent partners)	(520.2)	-	-	-	-	(520.2)
Transfer from net retained profit 2011	-	-	-	10.0	-10.0	-
Transfer from net income 2012	-	-	-	0.0	5.0	5.0
As at 31 Dec 2012	**699.8**	**727.8**	**4.5**	**705.2**	**5.0**	**2,142.3**
(of which: contributions by silent partners)	(520.2)	-	-	-	-	(520.2)

Subscribed capital amounts to € 179.6 million (2011: € 179.6 million) and is divided into 59,857,221 (2011: 59,857,221) bearer shares with a proportionate share in the nominal share capital of € 3.00 per share.

On 31 March 2009, the German Financial Markets Stabilisation Fund (SoFFin) provided the € 525.0 million silent participation to Aareal Bank AG, agreed upon as part of the package of support measures on 15 February 2009. This perpetual silent participation bears interest at 9% p.a. On 16 July 2010, Aareal Bank AG repaid a first tranche of € 150.0 million of the € 525.0 million silent participation provided by the German Financial Markets Stabilisation Fund (SoFFin). On 28 April 2011, Aareal Bank AG made the second partial repayment, in the amount of € 75 million.

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 23 May 2012. Accordingly, the Management Board is authorised to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 89,785,830 (Authorised Capital 2012) by issuance of new bearer shares for contribution in cash or in kind, subject to the approval of the Supervisory Board; this authority will expire on 22 May 2017. In the event of a capital increase against cash contributions, the shareholders shall be granted a subscription right, unless the Management Board exercises its authority to exclude shareholder's pre-emptive subscription rights. The Management Board may exclude shareholders' subscription rights, subject to approval by the Supervisory Board and the conditions set out below:

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

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

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

(d) 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.

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

The authorised capital has not been utilised.

Conditional capital

The share capital is subject to a conditional capital increase of up to € 30 million by means of issuing up to ten 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 19 May 2010. Said resolution authorised the Management Board, subject to the consent of the Supervisory Board, to issue, on one or more occasions until 18 May 2015, 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 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

The bank has off-balance contingent liabilities and irrevocable loan commitments. During the term of these obligations, the bank regularly reviews whether any losses can be expected from the utilisation of such contingent liabilities. This assessment is primarily made due to the credit risk analysis. Any losses that can be expected according to this analysis are recognised in the balance sheet as provisions.

The contingent liabilities primarily result from guarantee and indemnity agreements with banks in the amount of € 380.3 million (2011: € 376.1 million). These include € 40.7 million (2011: € 53.9 million) in maximum default guarantees extended to DEPFA Deutsche Pfandbriefbank AG (within the scope of splitting the former DEPFA Group), for the purpose of providing cover against risks of default with respect to the property loan portfolio held by pbb Deutsche Pfandbriefbank AG.

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

Irrevocable loan commitments are made up of credit and loan commitments. Of the total amount, € 234.6 million (2011: € 87.3 million) relates to domestic borrowers and € 1,999.4 million (2011: € 1,531.0 million) to foreign borrowers.

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

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

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

Remaining terms

€ mn	31 Dec 2012	31 Dec 2011
Loans and advances to banks	**1,761.0**	**2,926.6**
Payable on demand	1,239.1	2,271.2
Up to 3 months	-	-
Between 3 months and 1 year	9.8	27.9
Between 1 year and 5 years	99.3	96.5
More than 5 years	17.9	33.3
Pro rata interest	394.9	497.7
Loans and advances to customers	**24,319.6**	**25,357.5**
Up to 3 months	1,630.2	1,141.2
Between 3 months and 1 year	2,939.5	3,165.3
Between 1 year and 5 years	15,581.2	15,381.1
More than 5 years	4,028.0	5,524.8
Indefinite maturity	-	-
Pro rata interest	140.7	145.1
Debt and other fixed-income securities maturing in the following year (nominal amount)	**1,313.2**	**487.4**
Liabilities to banks	**3,450.7**	**3,092.0**
Payable on demand	914.3	730.8
Up to 3 months	361.4	1,086.1
Between 3 months and 1 year	262.9	334.5
Between 1 year and 5 years	1,275.6	314.5
More than 5 years	337.6	284.0
Pro rata interest	298.9	342.1
Savings deposits with agreed notice period	**0.0**	**0.0**
Up to 3 months	0.0	0.0
Between 3 months and 1 year	0.0	0.0
Between 1 year and 5 years	0.0	0.0
Pro rata interest	0.0	0.0
Other deposits from customers	**25,988.0**	**24,318.4**
Payable on demand	5,226.2	4,029.2
Up to 3 months	3,773.3	4,172.7
Between 3 months and 1 year	3,808.6	2,198.5
Between 1 year and 5 years	4,347.0	4,312.2
More than 5 years	8,501.9	9,263.0
Pro rata interest	331.0	342.8
Bonds issued maturing in the following year (nominal amount)	**1,314.4**	**2,911.0**
Other certificated liabilities	**0.0**	**0.0**

Prepaid expenses and deferred income

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

Prepaid expenses in the amount of € 89.6 million (2011: € 107.1 million) primarily include € 6.8 million (2011: € 3.4 million) in premiums on originated loans, in accordance with section 340e (2) sentence 3 of the HGB and € 34.8 million (2011: € 33.0 million) in discounts on bonds issued and borrowings pursuant to section 250 (3) of the HGB. The item also includes € 46.1 million (2011: € 68.9 million) from upfront payments/option premiums in connection with derivatives.

€ 14.7 million (2011: € 7.8 million) of deferred income (total 2012: € 83.3 million; total 2011: € 97.2 million) refers to discounts on originated loans, in accordance with section 340e (2) sentence 2 of the HGB, and to upfront payments/option premiums in connection with derivatives in the amount of € 66.6 million (2011: € 87.3 million).

Trust business

€ mn	Trust assets 31 Dec 2012
Loans and advances to banks	0.0
Loans and advances to customers	101.3
Equities and other non-fixed income securities	1.5
Total	**102.8**

€ mn	Trust liabilities 31 Dec 2012
Liabilities to banks	24.4
Liabilities to customers	78.4
Total	**102.8**

€ mn	Trust assets 31 Dec 2011
Loans and advances to banks	-
Loans and advances to customers	124.8
Equities and other non-fixed income securities	1.5
Total	**126.3**

€ mn	Trust liabilities 31 Dec 2011
Liabilities to banks	29.2
Liabilities to customers	97.1
Total	**126.3**

Notes on affiliated companies and enterprises with a participatory interest

	Affiliated companies 2012		Enterprises with a participatory interest 2012		Affiliated companies 2011		Enterprises with a participatory interest 2011	
€ mn	Certificated	Not certificated	Certificated	Not certificated	Certificated	Not certificated	Certificated	Not certificated
Loans and advances to banks	-	-	-	-	-	-	-	-
Loans and advances to customers	-	1,680.8	-	-	-	1,994.9	-	-
Debt and other fixed-income securities	-	0.0	-	-	-	0.0	-	-
Liabilities to banks	-	0.0	-	-	-	0.0	-	-
Liabilities to customers	-	353.2	-	0.1	-	343.7	-	0.7
Certificated liabilities	-	-	-	-	-	-	-	-
Subordinated liabilities	-	250.0	-	-	-	250.0	-	-

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

Shareholdings

As at 31 December 2012, Aareal Bank AG holds interests in the following companies within the meaning of section 271 (1) of the HGB. In contrast to the disclosure on the balance sheet, this list includes companies in which the bank holds an indirect interest (section 285 no. 11 of HGB).

No.	Company name	Registered office	Share in capital in %	Equity € mn	Results € mn
1	Aareal Bank AG	Wiesbaden	100.0		
2	1st Touch Ltd	Southampton	100.0	1.3	0.2
3	Aareal Bank Asia Limited	Singapore	100.0	18.4 mn S $	2.3 mn S $ 1)
4	Aareal Bank Capital Funding LLC	Wilmington	100.0	250.0	0.0
5	Aareal Bank Capital Funding Trust	Wilmington	100.0	0.0	0.0
6	Aareal Capital Corporation	Wilmington	100.0	196.2 mn USD	15.1 mn USD
7	Aareal Estate AG	Wiesbaden	100.0	2.8	0.0 3)
8	Aareal First Financial Solutions AG	Mainz	100.0	3.2	0.0 3)
9	Aareal Gesellschaft für Beteiligungen und Grundbesitz Erste mbH & Co. KG	Wiesbaden	94.9	2.1	0.1 1)
10	Aareal IT Beteiligungen GmbH	Wiesbaden	100.0	145.5	0.0 3)
11	Aareal Partecipazioni S.p.A.	Rome	100.0	6.8	0.0 1)
12	Aareal Property Services B.V.	Amsterdam	100.0	29.8	0.6 1)
13	Aareal Valuation GmbH	Wiesbaden	100.0	0.5	0.0 3)
14	Aareal Financial Service, spol. s r.o.	Prague	100.0	30.9 mn CZK	3.4 mn CZK 2)
15	Aareon AG	Mainz	100.0	61.4	8.3
16	Aareon Deutschland GmbH	Mainz	100.0	32.2	0.0 3)
17	Aareon France S.A.S.	Meudon-la Forêt	100.0	4.9	1.5
18	Aareon Immobilien Projekt GmbH	Essen	51.0	0.5	0.8
19	Aareon Softw are Handelsgesellschaft mbH	Mainz	100.0	-0.3	0.0
20	Aareon UK Ltd.	Coventry	100.0	3.8	0.9
21	Aareon Wodis GmbH	Dortmund	100.0	2.0	0.0 3)
22	arsago Alternative Investments SPC	Grand Cayman	67.0	n/a	n/a
23	Aufbaugesellschaft Prager Straße mbH	Wiesbaden	100.0	0.1	0.0 1)
24	BauBo Bau- und Bodenverw ertungs- und -verw altungsgesellschaft mbH	Wiesbaden	100.0	10.4	0.0 3)
25	BauContact Immobilien GmbH	Wiesbaden	100.0	27.9	1.0
26	BauGrund Immobilien-Management GmbH	Bonn	100.0	0.5	0.0 3)
27	BauGrund TVG GmbH	Munich	100.0	0.1	-0.1
28	BauSecura Versicherungsmakler GmbH	Hamburg	100.0	2.8	2.7
29	berlinbiotechpark Management GmbH	Berlin	100.0	0.1	0.1 1)
30	berlinbiotechpark Verw altung GmbH	Berlin	89.6	0.2	0.0 1)
31	Capital Funding GmbH & Co. KG	Frankfurt	100.0	0.0	0.0 5)
32	Deutsche Bau- und Grundstücks-Aktiengesellschaft	Berlin	100.0	2.2	0.7
33	Deutsche Structured Finance GmbH	Frankfurt	100.0	1.8	0.9 1)
34	Deutsche Structured Finance GmbH & Co. Alphard KG	Frankfurt	100.0	1.0	0.1 1)
35	Deutsche Structured Finance GmbH & Co. Deneb KG	Frankfurt	100.0	0.8	-2.5 1)
36	Deutsche Structured Finance GmbH & Co. Titan KG i.L.	Frankfurt	100.0	0.0	0.0
37	DSF Anteils GmbH	Frankfurt	100.0	0.1	0.0 1)
38	DSF berlinbiotechpark Verw altungsgesellschaft mbH	Frankfurt	50.0	0.1	0.0 1)
39	DSF Beteiligungsgesellschaft mbH	Frankfurt	100.0	0.1	0.0 1)

1) Preliminary figures as at 31 December 2012; 2) Equity and results as at 31 December 2011; 3) Profit transfer agreement/control and profit transfer agreement; 4) Different financial year; 5) 10% of voting rights, diverging from the equity interests held; n/a No data

No.	Company name	Registered office	Share in capital in %	Equity € mn	Results € mn
40	DSF Dritte Verwaltungsgesellschaft mbH	Frankfurt	100.0	0.0	0.0
41	DSF Elfte Verwaltungsgesellschaft mbH	Frankfurt	100.0	0.0	0.0 [1)]
42	DSF Energia Naturale S.r.l.	Rome	100.0	0.0	0.0 [1)]
43	DSF Flugzeugportfolio GmbH	Frankfurt	100.0	0.0	0.6 [3)]
44	DSF Fünfzehnte Verwaltungsgesellschaft mbH	Frankfurt	100.0	0.1	0.0 [1)]
45	DSF German Office Fund GmbH & Co. KG	Frankfurt	94.0	1.8	-3.3 [1)]
46	DSF Immobilienverwaltung GmbH	Frankfurt	100.0	0.0	0.0 [1)]
47	DSF LUX INTERNATIONAL S.à.r.l	Luxembourg	100.0	0.1	0.0 [1)]
48	DSF Neunte Verwaltungsgesellschaft mbH	Frankfurt	100.0	0.0	0.0 [1)]
49	DSF Solar Italien GmbH & Co. KG	Frankfurt	100.0	0.0	0.0 [4)]
50	DSF Treuhand GmbH	Frankfurt	100.0	0.1	0.0
51	DSF Verwaltungsgesellschaft mbH	Frankfurt	100.0	0.0	0.0 [1)]
52	DSF Vierte Verwaltungsgesellschaft mbH	Wiesbaden	100.0	1.7	-3.5 [1)]
53	DSF Zwölfte Verwaltungsgesellschaft mbH	Frankfurt	100.0	0.3	0.0 [1)]
54	GEV GmbH	Wiesbaden	100.0	52.9	0.0 [3)]
55	IMMO Consulting S.p.A.	Rome	95.0	0.3	-0.2 [1)]
56	IV Beteiligungsgesellschaft für Immobilieninvestitionen mbH	Wiesbaden	100.0	2.0	0.0 [1)]
57	Izalco Spain S.L.	Madrid	100.0	9.5	0.0 [3)]
58	Jomo S.p.r.l.	Brussels	100.0	-2.8	-2.8 [2)]
59	La Sessola Holding GmbH	Wiesbaden	100.0	0.0	0.0
60	La Sessola S.r.l.	Rome	100.0	49.3	-9.0 [1)]
61	Main Triangel GmbH	Frankfurt	75.0	72.9	-2.6 [1)]
62	Main Triangel Gastronomie GmbH	Wiesbaden	100.0	0.5	-0.1 [1)]
63	Mercadea S.r.l.	Rome	100.0	4.2	0.1 [1)]
64	Mirante S.r.l.	Rome	100.0	4.4	-1.5 [1)]
65	PLP Holding GmbH	Wiesbaden	100.0	14.8	-0.8 [1)]
66	Real Verwaltungsgesellschaft mbH	Idstein	100.0	28.0	0.9 [1)]
67	Rehabilitationsklinik Barby Besitzgesellschaft mbH	Wiesbaden	100.0	-5.6	0.9 [1)]
68	Rehabilitationsklinik Templin Besitzgesellschaft mbH	Wiesbaden	100.0	-3.7	0.0 [1)]
69	SG Automatisering B.V.	Emmen	100.0	13.6	4.0
70	SG | Facilitor B.V.	Enschede	100.0	0.8	0.5
71	SG | stravis B.V.	Emmen	100.0	0.1	0.0
72	Sole Giano S.r.l. & Co. S.a.s.	Rome	100.0	-0.2	-0.1 [1)]
73	Sustainable Solar Future - Hellas Limited Liability Company	Athens	99.0	0.0	0.0 [1)]
74	Sustainable Solar Future Northern - Hellas Limited Liability Company	Athens	99.0	0.0	0.0 [1)]
75	Sustainable Solar Thermal Future East - Crete Limited Liability Company	Heraklion	99.0	0.5	0.0 [1)]
76	Terrain-Aktiengesellschaft Herzogpark	Wiesbaden	99.9	4.7	0.0 [3)]
77	ZMP Zentral Messepalast Entwicklungsgesellschaft mbH	Wiesbaden	100.0	129.3	0.0 [3)]

[1)] Preliminary figures as at 31 December 2012; [2)] Equity and results as at 31 December 2011; [3)] Profit transfer agreement/control and profit transfer agreement; [4)] Different financial year; [5)] 10% of voting rights, diverging from the equity interests held; n/a No data

No.	Company name	Registered office	Share in capital in %	Equity € mn	Results € mn
78	B & P / DSF Windpark GbR	Frankfurt	50.0	0.4	0.4
79	Bavaria Solar I Verwaltungsgesellschaft mbH	Frankfurt	24.0	0.0	0.0 1)
80	Deutsche Operating Leasing AG	Frankfurt	19.2	1.0	-0.8 4)
81	DSF PP Justizzentrum Thüringen GmbH & Co. KG	Frankfurt	48.4	0.5	0.0 1)
82	DSF Vierzehnte Verwaltungsgesellschaft mbH	Frankfurt	50.0	0.2	0.0
83	DSF Zehnte Verwaltungsgesellschaft mbH	Frankfurt	50.0	0.1	0.0 1)
84	Fachklinik Lenggries GmbH	Lenggries	49.0	0.0	0.0 2)
85	Rehabilitationsklinik Uckermark GmbH i.L.	Templin	49.0	n/a	n/a
86	SG2ALL B.V.	Huizen	50.0	0.4	0.2
87	Westhafen Haus GmbH & Co. Projektentwicklungs KG	Frankfurt	25.0	-0.2	0.0 2)
88	Westhafen-Gelände Frankfurt am Main GbR	Frankfurt	33.3	0.1	0.0 2)
89	Windpark Ahlerstedt Verwaltungsgesellschaft mbH	Frankfurt	20.0	0.0	0.0 1)
90	Windpark Borsum Verwaltungsgesellschaft mbH	Rhede	20.0	0.0	0.0 1)
91	Windpark Portfolio Verwaltungs GmbH	Freiburg	20.0	0.0	0.0 1)

1) Preliminary figures as at 31 December 2012; 2) Equity and results as at 31 December 2011; 3) Profit transfer agreement/control and profit transfer agreement; 4) Different financial year; 5) 10% of voting rights, diverging from the equity interests held; n/a No data

Assets pledged as collateral

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

€ mn	31 Dec 2012	31 Dec 2011
Liabilities to banks	4,059.3	3,051.6
Liabilities to customers	0.0	0.0
Total	**4,059.3**	**3,051.6**

Repurchase agreements

As at 31 December 2012, no bonds were used as part of repurchase agreements (2011: € 876.3 million).

Assets and liabilities in foreign currencies

The aggregate equivalent amount of assets denominated in foreign currencies, calculated pursuant to the German Solvency Regulation (Solvabilitätsverordnung), was € 10,442.9 million (2011: € 11,845.3 million) at the balance sheet date, while liabilities totalled € 10,477.1 million (2011: € 11,849.4 million).

Forward transactions

The following forward transactions had been entered into as at 31 December 2012:

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

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

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

€ mn	Up to 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	31 Dec 2012
31.12.2012					
Interest rate instruments					
Interest rate swaps					
Cash inflows	244.8	714.7	2,138.5	863.4	3,961.4
Cash outflows	233.8	453.1	1,779.2	884.2	3,350.3
Swaptions					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Caps, floors					
Cash inflows	0.7	4.9	10.9	1.3	17.8
Cash outflows	0.7	4.9	10.9	1.3	17.8
Currency-related instruments					
Spot and forward foreign exchange transactions					
Cash inflows	1,539.0	-	-	-	1,539.0
Cash outflows	1,527.5	-	-	-	1,527.5
Cross-currency swaps					
Cash inflows	571.3	1,874.6	5,290.8	404.0	8,140.7
Cash outflows	623.8	1,979.8	5,546.6	401.2	8,551.4
Other transactions					
Credit default swaps					
Cash inflows	0.3	0.7	2.5	-	3.5
Cash outflows	-	-	-	-	-
Total cash inflows	**2,356.1**	**2,594.9**	**7,442.7**	**1,268.7**	**13,662.4**
Total cash outflows	**2,385.8**	**2,437.8**	**7,336.7**	**1,286.7**	**13,447.0**

€ mn	Up to 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total 31 Dec 2011
31.12.2011					
Interest rate instruments					
Interest rate swaps					
Cash inflows	337.0	955.9	2,851.0	943.0	5,086.9
Cash outflows	339.7	749.3	2,428.4	967.9	4,485.3
Swaptions					
Cash inflows	-	0.1	-	-	0.1
Cash outflows	-	-	-	-	0.0
Caps, floors					
Cash inflows	1.0	3.8	12.7	0.8	18.3
Cash outflows	1.0	3.9	12.7	0.8	18.4
Currency-related instruments					
Spot and forward foreign exchange transactions					
Cash inflows	2,317.6	162.5	-	-	2,480.1
Cash outflows	2,401.7	166.4	-	-	2,568.1
Cross-currency swaps					
Cash inflows	784.7	1,886.7	5,304.0	313.1	8,288.5
Cash outflows	809.2	1,955.6	5,662.7	304.8	8,732.3
Other transactions					
Credit default swaps					
Cash inflows	0.3	0.7	3.2	0.3	4.5
Cash outflows	-	-	-	-	-
Total cash inflows	**3,440.6**	**3,009.7**	**8,170.9**	**1,257.2**	**15,878.4**
Total cash outflows	**3,551.6**	**2,875.2**	**8,103.8**	**1,273.5**	**15,804.1**

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. Fair values including accrued interest are given for derivative financial instruments not recognised at fair value as at 31 December 2012.

€ mn	Nominal amount as at 31 Dec 2012	Market value as at 31 Dec 2012		Market value as at 31 Dec 2011	
		positive	negative	positive	negative
Interest rate instruments					
OTC products					
Interest rate swaps	44,288.3	2,849.9	2,372.0	2,183.2	1,848.0
Swaptions	16.0	0	0	-	-
Caps, floors	4,411.0	17.3	17.3	16.8	16.8
Total interest rate instruments	**48,715.3**	**2,867.2**	**2,389.3**	**2,200.0**	**1,864.8**
Currency-related instruments					
OTC products					
Spot and forward foreign exchange transact	1,538.4	13.1	1.2	1.9	88.3
Cross-currency swaps	8,104.0	60.8	435.2	43.9	495.1
Total currency-related instruments	**9,642.4**	**73.9**	**436.4**	**45.8**	**583.4**
Other transactions					
OTC products 1)					
Credit default swaps	350.0	0.1	15.8	-	43.2
Total other transactions	**350.0**	**0.1**	**15.8**	**0.0**	**43.2**
Total	**58,707.7**	**2,941.2**	**2,841.5**	**2,245.8**	**2,491.4**

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

Derivatives have been entered into with the following counterparties:

€ mn	Market value as at 31 Dec 2012		Market value as at 31 Dec 2011	
	positive	negative	positive	negative
OECD public-sector authorities				
OECD banks	2,542.8	2,815.0	1,988.0	2,484.5
Non-OECD banks				
Companies and private individuals	398.3	26.4	257.8	6.9
Total	**2,941.1**	**2,841.4**	**2,245.8**	**2,491.4**

Remuneration report

Remuneration for members of the Management Board

Principles of remuneration

The Supervisory Board determines the structure and amount of remuneration for members of the Management Board. Aareal Bank AG has entered into fixed-term service contracts with the members of its Management Board.

Against the background of the German Act on the Appropriateness of Management Board Compensation (Gesetz zur Angemessenheit der Vorstandsvergütung – "VorstAG") of 31 July 2009 and the German Regulation Governing Supervisory Requirements for Remuneration Systems of Financial Institutions (Instituts-Vergütungsverordnung – "InstitutsVergV") of 6 October 2010, the remuneration system for members of the Management Board of Aareal Bank AG was examined, also using the support of external advisors, and adjusted with effect from 1 January 2012, regardless of the existing contract terms.

Besides their fixed annual salary, Management Board members receive a performance-related bonus (variable remuneration) that is determined using an assessment basis extending over several years. The level of this performance-related bonus is determined by reference to the personal performance of each Management Board member which is measured by the degree to which targets set in advance by the Supervisory Board are achieved, based on contractually agreed initial values. The targets which are relevant for performance-related bonuses include annual targets and three-year targets. The weighting of annual targets to three-year targets is fixed for each financial year, with a 60%/40% weighting taken as a guideline.

In terms of substance, annual and three-year targets are derived from the overall strategy and the annual and medium-term planning of Aareal Bank Group, each of which are agreed upon with the Supervisory Board. The targets comprise quantitative components and qualitative components, which are also related to non-financial parameters. In this context, the bank's overall performance, the performance of the relevant section, and the individual performance contributions of the Management Board member concerned are all taken into consideration.

The amount of the initial value of the performance-related bonus increases - depending on the Management Board member's degree of target achievement - up to a maximum of 200%. If the target achievement exceeds a level of 200%, the initial value of the performance-related bonus will not increase any further (cap). If target achievement is 0%, no performance-related bonus will be awarded for the financial year concerned. The initial value is fixed at 100% for target achievement levels between 90% and 110%.

To ensure that the remuneration system provides long-term incentives, performance-related bonuses are awarded at the end of the financial year, according to the following principles:

20% of the initial value of the performance-related bonus is disbursed as a cash bonus directly after the financial year has concluded. A further 20% of the performance-related bonus is awarded as a share bonus[9] in the form of phantom shares directly after the end of the financial year and are the subject of the Share Bonus Plan. 30% of the performance-related bonus is deferred as a cash deferral (Cash Deferral). The remaining 30% of the performance-related bonus is deferred as a share deferral[9] and are the subject of the Share Deferral Plan.

With regard to the portion of the performance-related bonus that is deferred initially as a cash deferral or a share deferral, the Supervisory Board makes a decision regarding the granting of one third of the amount as well as the associated interest in the three years following the determination of the performance-related bonus (retention period). If the deferred remuneration components for the Management Board members are actually awarded, the cash deferral is paid out in cash and the share deferral is converted into virtual shares, subject to a two-year holding period.

In making its determination about the amount to be awarded, the Supervisory Board primarily takes into account any negative aspects of the Management Board member's performance, his section as well as any negative overall performance of Aareal Bank AG or the Group as a whole. The final amount may be awarded in full, partially or not at all. If the full amount is not awarded, the remaining sum is forfeited, i.e. it is not carried forward into subsequent years. No bonus may be awarded if BaFin makes an official ruling against the

[9] Please refer to the subsection "Cash-settled share-based payment" in this Remuneration Report for further explanations related to the structure of the Share Bonus Plan and the Share Deferral Plan.

bank pursuant to section 45b (2) of the German Banking Act (Kreditwesengestz – "KWG") due to shortcomings relating to capital adequacy or liquidity issues. If a case of serious individual misconduct by a member of the Management Board is identified afterwards in the financial year in which the remuneration components were awarded as a cash deferral and a share deferral, the retained remuneration components are cancelled in full. Members of the Management Board may not undertake to limit or hedge the risk orientation of the performance-related bonus themselves (hedging ban).

Remuneration

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

€	Year	Fixed remuneration	Variable remuneration				Other [1)]	Total remuneration
			Cash component		Share-based component			
			Cash bonus	Cash deferral	Share bonus	Share deferral		
Dr Wolf Schumacher	2012	1,100,000.00	330,000.00	495,000.00	330,000.00	495,000.00	26,026.59	2,776,026.59
	2011	800,000.00	2,012,500.00	-	562,500.00	-	26,632.46	3,401,632.46
Dirk Große Wördemann[2)]	2012	650,000.00	158,800.00	238,200.00	158,800.00	238,200.00	31,189.76	1,475,189.76
	2011	650,000.00	178,875.00	267,750.00	178,875.00	267,750.00	27,060.92	1,570,310.92
Hermann J. Merkens	2012	700,000.00	195,600.00	293,400.00	195,600.00	293,400.00	53,909.48	1,731,909.48
	2011	650,000.00	1,137,500.00	-	562,500.00	-	55,309.91	2,405,309.91
Thomas Ortmanns	2012	700,000.00	195,600.00	293,400.00	195,600.00	293,400.00	26,695.09	1,704,695.09
	2011	650,000.00	937,500.00	-	562,500.00	-	38,042.53	2,188,042.53
Total	**2012**	3,150,000.00	880,000.00	1,320,000.00	880,000.00	1,320,000.00	137,820.92	**7,687,820.92**
	2011	2,750,000.00	4,266,375.00	267,750.00	1,866,375.00	267,750.00	147,045.82	**9,565,295.82**

[1] Other remuneration includes payments (in particular for company cars) in the amount of € 85,521.76 in 2012 (2011: € 78,817.13) as well as benefits related to social security contributions totalling € 45,231.36 for 2012 (2011: € 44,974.08).

[2] The cash deferral and share deferral components relate to the financial year reported. Based on a Supervisory Board resolution, Mr Große Wördemann receives a payout in the amount of € 91,766.85 relating to the cash deferral retained in the past financial year as well as a payout amounting to € 91,766.85 which is converted to virtual shares pursuant to the Share Deferral Plan, with the shares being subject to a holding period of two years.

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

€	Reference values for variable remuneration 2012	Reference values for variable remuneration 2011
Dr Wolf Schumacher	1,650,000.00	1,400,000.00
Dirk Große Wördemann	794,000.00	794,000.00
Hermann J. Merkens	978,000.00	800,000.00
Thomas Ortmanns	978,000.00	800,000.00
Total	**4,400,000.00**	**3,794,000.00**

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

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

	Year	Share-based payment Value (€)	Share-based payment Quantity (number)[1]
Dr Wolf Schumacher	2012	825,000.00	52,514.32
	2011	562,500.00	40,221.67
Dirk Große Wördemann	2012	397,000.00	25,270.53
	2011	446,625.00	31,936.00
Hermann J. Merkens	2012	489,000.00	31,126.67
	2011	562,500.00	40,221.67
Thomas Ortmanns	2012	489,000.00	31,126.67
	2011	562,500.00	40,221.67

[1] The stated number of virtual shares granted for 2012 is a preliminary figure, based on the price of Aareal Bank AG's share on 31 December 2012 (€ 15.71). The final conversion rate may only be determined after publication of the 2012 annual report.

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 AG. Accordingly, they are entitled to receive pension payments after completing their 60th year of age, or earlier in case of a permanent disability of service. For members of the Management Board appointed on or after 1 November 2010, this rule applies only from the beginning of the second term of office.

The following overview shows the pension claims of the members of the Management Board and the changes of the corresponding pension provisions during the period under review:

	2012			2011		
€ thousands	Pension claims p.a.[1]	Balance of pension obligations as at 31 Dec 2012	Increase of pension obligations in 2012	Pension claims p.a.[1]	Balance of pension obligations as at 31 Dec 2011	Increase of pension obligations in 2011
Dr Wolf Schumacher	364	3,079	675	350	2,404	443
Dirk Große Wördemann[2]	-	351	125	-	226	198
Hermann J. Merkens	209	1,387	261	200	1,126	129
Thomas Ortmanns	210	1,457	376	200	1,081	210
Total	**783**	**6,274**	**1,437**	**750**	**4,837**	**980**

[1] The pension claims were calculated for pension benefits paid after completing the 60th year of age.
[2] Mr Große Wördemann currently does not meet the contractually agreed vesting criteria for the pension claims.

The pension claims are adjusted to take account of the development of standard wages within the private banking sector as from the beginning of actual payments of pensions, to the extent that these are based on defined benefit plans. If the payments refer to defined contribution plans, the guaranteed amount is adjusted by 1% p.a. The pension paid to widows amounts to 60% of the pension of the member of the Management Board, while pensions to half-orphans and orphans amount to 10% and not more than 25%, respectively. Service cost incurred in financial year 2012 in connection with the pension claims of members of the Management Board totalled € 1.4 million (2011: € 0.8 million). The present value of the pension obligations for current members of the Management Board as well as for former members of the Management Board and their surviving dependants increased by € 7.9 million in the year under review (2011: € 0.3 million). The total present value of the pension obligations amounted to € 26.6 million (2011: € 18.7 million). Of that amount,

€ 18.0 million related to former members of the Management Board and their surviving dependants (2011: € 14.1 million). Payments to former Management Board members of Aareal Bank AG and their surviving dependants totalled € 0.9 million (2011: € 0.6 million).

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

In the case of a retirement due to a change of control, the members affected receive, in settlement of their total remuneration, a monthly payment, as agreed in their employment contracts, as well as a contractually agreed fixed one-off payment. Depending on the type of the change of control - termination by the Company or termination by the respective Board member –, the agreed benefits are as follows:

€ per month of remaining contract term [1]	Terminated by the company	Terminated by the Board member
Dr Wolf Schumacher	141,667.00	70,833.00
Dirk Große Wördemann	120,833.00	54,167.00
Hermann J. Merkens	120,833.00	54,167.00
Thomas Ortmanns	120,833.00	54,167.00

[1] Upon request of the Board member, the benefits may be paid in form of a one-off payment. In this case, the amount is discounted using the interest rate of the ECB for one-year deposits of private households in the month of payment.

The claims resulting from the early termination of the Board activities due to a change of control are capped to an equivalent of three years' remuneration.

During the term of a SoFFin stabilisation measure, Management Board members are not entitled to any severance pay in the event of an early termination or a change of control. The fulfilment of a Management Board member's contractual remuneration claims arising from the employment contract are not limited by the framework agreement entered into with SoFFin.

Remuneration of the Supervisory Board

Remuneration for the services of the Supervisory Board members is specified in Article 9 of the Memorandum and Articles of Association of Aareal Bank AG. The Annual General Meeting held on 18 May 2011 resolved to adjust the system for Supervisory Board's remuneration in order to reflect the ongoing discussions related to a remuneration system that is appropriate in view of corporate governance aspects. In doing so, Aareal Bank AG follows the current status of the discussions related to the proper structure for remuneration systems for supervisory boards according to which supervisory board members should receive a fixed remuneration only.

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

The fixed remuneration is € 30,000 p.a. for each Supervisory Board member. The Chairman of the Supervisory Board shall receive two and a half times this amount, while the deputy shall receive one and a half times as much as a normal member. The fixed remuneration shall be increased by € 15,000 p.a. for each membership in a committee (with the exception of the Nomination Committee, which is an exclusively advisory committee, and the Committee for Urgent Decisions, which is part of the Risk Committee). The fixed remuneration shall be increased by € 30,000 p.a. for the chairmanship of a committee (with the exception of the Nomination Committee and the Committee for Urgent Decisions).

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

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

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

€	Year	Fixed remuneration	Attendance fees	Total remuneration
Hans W. Reich, Chairman	2012	178,500.00	26,180.00	204,680.00
	2011	151,130.00	14,280.00	165,410.00
Erwin Flieger, Deputy Chairman	2012	89,250.00	19,040.00	108,290.00
	2011	77,845.84	10,710.00	88,555.84
York-Detlef Bülow, Deputy Chairman	2012	89,250.00	21,420.00	110,670.00
	2011	77,845.84	10,710.00	88,555.84
Christian Graf von Bassewitz	2012	71,400.00	21,420.00	92,820.00
	2011	62,276.66	9,520.00	71,796.66
Manfred Behrens	2012	35,700.00	5,950.00	41,650.00
	2011	31,138.34	2,380.00	33,518.34
Thomas Hawel	2012	35,700.00	9,520.00	45,220.00
	2011	31,138.34	3,570.00	34,708.34
Dieter Kirsch	2012	53,550.00	14,280.00	67,830.00
	2011	46,707.50	5,950.00	52,657.50
Marija Korsch	2012	16,759.16	4,760.00	21,519.16
	2011	-	-	-
Dr Herbert Lohneiß	2012	53,550.00	13,090.00	66,640.00
	2011	46,707.50	7,140.00	53,847.50
Joachim Neupel	2012	89,250.00	21,420.00	110,670.00
	2011	77,845.84	10,710.00	88,555.84
Prof Dr Stephan Schüller	2012	71,400.00	19,040.00	90,440.00
	2011	62,276.66	9,520.00	71,796.66
Wolf R. Thiel	2012	13,387.50	3,570.00	16,957.50
	2011	46,707.50	7,140.00	53,847.50
Helmut Wagner	2012	35,700.00	8,330.00	44,030.00
	2011	31,138.34	3,570.00	34,708.34
Total	**2012**	**833,396.66**	**188,020.00**	**1,021,416.66**
	2011	**742,758.36**	**95,200.00**	**837,958.36**

The members of the Supervisory Board did not provide any consulting or agency services, or other personal services in 2012. Therefore, no additional remuneration was paid.

Cash-settled share-based payment

a) Description of cash-settled share-based payment

Within Aareal Bank AG, there are various forms of share-based payment arrangements. Among other things, differences between these plans can be found as regards their term and the vesting conditions as well as regarding the group of beneficiaries.

Management Board

Share Bonus Plan

According to the rules for the share bonus plan, a portion of the variable remuneration will be converted into an equivalent number of virtual shares and credited to the beneficiary. The calculation of the number of virtual shares is based on the weighted average price on the basis of five trading days (Xetra) after publication (ad-hoc release) of the annual financial statements adopted by the Supervisory Board (subscription price). The date of publication of the respective financial statements is used as the reference date. Not earlier than three years after the reference date, the beneficiary may exercise the virtual shares granted either in whole or in part within five business days after the publication of the quarterly report (holding period). Any virtual shares not exercised may be exercised either in whole or in part at a later date, in each case within five business days after the publication of a quarterly report. 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 time period between the reference date and the exercise date, a payout is made as a salary component in an amount equivalent to the dividends and the proportion of the virtual shares.

Share Deferral Plan

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

Negative performance contributions of the beneficiary or of the organisational units for which he is responsible for or a negative overall performance of Aareal Bank Group lead to a reduction of the payout, in some cases even to zero. No bonus may be awarded if BaFin makes an official ruling against the bank pursuant to section 45b (2) of the KWG.

If less than 100% of the third of the share deferral eligible for conversion (including interest) is converted into virtual shares, the amount not converted is forfeited and is not carried forward to future years. The rules for the calculation of the number of virtual, their exercise and the other rights and obligations associated with the granting of virtual shares correspond to those applicable for share bonuses, with the exception that (instead of three-year holding period) a holding period of two years applies.

Phantom Share Plan

The Phantom Share Plan applied to virtual shares granted until (and including) the financial year 2011.

According to the rules for the Phantom Share Plan, a portion of the variable remuneration will be converted into an equivalent number of virtual shares. The conversion is based on the weighted average price (XETRA) of Aareal Bank AG's share as notified by Bloomberg, on the five trading days following the publication (ad-hoc release) of the financial statements as approved by the Supervisory Board. The entitlement to the remuneration, i.e. the award, arises after the Supervisory Board has used its discretion with regard to the amount of variable remuneration within the applicable range. One fourth of the awarded virtual shares become exercisable each year. This also applies for the year in which they are awarded. Virtual shares not exercised in a particular year are accumulated. The phantom shares may be exercised either in whole or in part within five business days after the publication of a quarterly report. The relevant price for exercising these phantom shares is the weighted average price according to Bloomberg on the exercise date.

There are no exercise hurdles in form of a minimum stock price appreciation target or other market or performance-related criteria. Virtual shares that have not been exercised carry full dividend rights, i.e. the beneficiaries receive for each virtual share not yet exercised a cash payment equivalent to the amount of the approved dividend. The term of the plan is not limited.

Further share-based payment models

Virtual shares are granted to senior executives and the so-called "risk takers" of Aareal Bank AG, as defined by the German Regulation Governing Supervisory Requirements for Remuneration Systems of Institutions (Instituts-Vergütungsverordnung – "InstitutsVergV"), as well as to managing directors and management board members of Aareal Bank AG's subsidiaries on the basis of the following share-based payment models.

Share Bonus Plan

According to the rules for the share bonus plan, a portion of the variable remuneration will be converted into an equivalent number of virtual shares. The conversion is based on the weighted average price (XETRA) of Aareal Bank AG's share according to Bloomberg, on the five trading days following the publication of the annual report for the reference period. The entitlement to the remuneration occurs at the end of the reference period. The share bonus is paid out after a minimum holding period of two years, beginning on the date on which entitlement arose. The payout amount is calculated by multiplying the number of virtual shares allocated with the share price upon payout. The share price upon payout corresponds to the weighted average price on XETRA of Aareal Bank AG's share according to Bloomberg, on the five trading days following the publication of the annual report for the financial year preceding the payout date. The actual payout date for the share bonus may be determined individually, based on an option right. For this purpose, the beneficiary must inform the bank whether he will use the option right by notifying the bank accordingly not later than until the tenth day after the publication of the annual report for the financial year preceding the planned payout date. The option right expires after not less than three years, from the end of the calendar quarter of the earliest payout date. The option right may only be exercised as at 31 March, 30 June or 30 September of a calendar year; exercise of the option has to be notified to the bank not later than at the tenth day after publication of the quarterly financial results. The conversion of the virtual shares for the purpose of determining the payout amount is made at the weighted average price on XETRA according to Bloomberg, for the five trading days following the publication of the latest quarterly financial results for the selected option date.

There are no exercise hurdles in form of a minimum stock price appreciation target or other market or performance-related criteria. Virtual shares carry fully dividend rights, i.e. the beneficiaries receive for each virtual share not yet exercised a cash payment equivalent to the amount of the approved dividend. The maximum term of the plan – in relation to the grant date – is three years (six years in case of an option for late payout).

Restricted Virtual Share Award Plan

According to the rules for the Restricted Virtual Share Award (RVSA), a portion of the variable remuneration will be converted into an equivalent number of virtual shares. The conversion is based on the weighted average price (XETRA) of Aareal Bank AG's share according to Bloomberg, on the five trading days following the publication of the annual report for the reference period. The amount granted within the scope of the RVSA is only awarded on a provisional basis. The entitlement to the RVSA vests over a period of three years at one third of the original award each year, starting one year after the end of the reference period, provided that certain conditions (penalty rules) are met. The RVSA is paid out after a holding period of one year starting on the date on which entitlement arose. When the holding period is expired, the beneficiary has an option right to postpone the RVSA payout by not more than three years. The payout may only be made as at 31 March, 30 June or 30 September of a calendar year; exercise of the option has to be notified to the bank not later than at the tenth day after publication of the quarterly financial results.

The payout amount is calculated by multiplying the number of the exercised virtual shares with the weighted average price on XETRA of Aareal Bank AG's share according to Bloomberg, on the five trading days following the publication of the quarterly financial results.

According to the penalty rules, the bank is entitled to reduce the amount of the portion of the RVSA for which no entitlement has been earned in an appropriate manner, possibly down to zero. The reasons for a reduction of the RVSA are described in section 45 of the German Banking Act (Kreditwesengesetz, KWG): when, until the relevant payout date, Aareal Bank's regulatory capital does not meet the requirements of section 10 (1) and (1b) or of section 45b (1) of the KWG or the investment of its funds does not comply with the requirements of section 11 (1) of the KWG or the development of Aareal Bank AG's financial position and financial performance justifies the assumption that it will not be able to meet these requirements permanently. The reasons for a reduction of the RVSA also exist when cases of serious individual misconduct prior to the entitlement of the RVSA, or parts of it, are identified afterwards. Examples are cases of misconduct which give rise to extra-ordinary termination of employment relationships, a breach of the prohibition of hedge transactions, even after the termination of the employment relationships, as well as a material breach of internal guidelines (e.g. Code of Conduct or compliance rules).

In addition, the amount of the RVSA for which no entitlement has arisen may be reduced when the so-called success factor for determining the bonus pool for variable remuneration for the employees of Aareal Bank AG is below zero. The success factor is determined based on the target planned and agreed by Aareal Bank AG's Management Board and Supervisory Board for the operating result before taxes of Aareal Bank Group, net of non-recurring effects. The basis for the determination of the target is the bank's medium-term planning, taking into account capital employed. The success factor may range from -0.7 and +2.0.

There are no further exercise hurdles, other than the penalty rules, in form of a minimum stock price appreciation target or other market or performance-related criteria. Virtual shares carry fully dividend rights, i.e. the beneficiaries receive for each virtual share not yet exercised a cash payment equivalent to the amount of the approved dividend. The maximum term of the plan – in relation to the grant date – is five years (eight years in case of an option for late payout).

Virtual share plan

According to the rules for the virtual share plan, a portion of the variable remuneration will be converted into an equivalent number of virtual shares. The conversion rate corresponds to the weighted average price (XETRA) of Aareal Bank AG's share according to Bloomberg, on the four trading days following the publication of the annual report for the reference period.

The virtual shares are automatically exercised in the three years following the reference year, with one third being exercised in each year. The exercise is based on the weighted average price on XETRA of Aareal Bank AG's share according to Bloomberg, on the publication date of the annual report for the financial year preceding the exercise and the four following trading days. For virtual shares granted from 1 January 2011, the beneficiary has an option right to postpone the payout of the virtual shares by not more than three years. The payout may only be made as at 31 March, 30 June or 30 September of a calendar year; exercise of the option has to be notified to the bank not later than at the tenth day after publication of the quarterly financial results.

There are no exercise hurdles in form of a minimum stock price appreciation target or other market or performance-related criteria. With respect to virtual shares that have not been exercised, the beneficiaries receive for each virtual share a cash payment equivalent to the amount of the approved dividend. The maximum term of the plan – in relation to the grant date – is four years (seven years in case of an option for late payout).

b) Valuation model and valuation assumptions

The obligations resulting from all of the described share-based payment arrangements as of the balance sheet date correspond to the remuneration granted, discounted to the balance sheet date. The discount period corresponds to the period from the balance sheet date to the earliest exercise or payout date per plan and per tranche. The discount is based on the Euribor swap rate applicable as at the relevant balance sheet date, depending on the term.

c) Amount of cash-settled share-based payment transactions

The total amount of outstanding virtual shares in relation to the above mentioned share-based payment arrangements changed as follows:

Quantity (number)	2012	2011
Balance (outstanding) at 1 January	**406,431**	**572,352**
Granted	284,856	61,535
of which: vested	210,848	61,535
of which: awarded on a provisional basis	74,008	-
Expired	-	-
Exercised	68,792	227,456
Balance (outstanding) at 31 December	**622,495**	**406,431**
of which: exercisable	290,478	208,978

The fair value of the virtual shares granted during the reporting period amounts to € 5,817,278 (2011: € 1,271,472) as at the balance sheet date.

The virtual shares exercised in the reporting period were converted at a weighted average price of the Aareal Bank AG share in the amount of € 14.50 (2011: € 23.15).

The virtual shares outstanding at 31 December 2012 have a limited contract term. The weighted average remaining contract term of these virtual shares amounts to 655.94 days (2011: 695.81 days).

d) Effects on financial position and performance

The total amount expensed for share-based payment transactions was € 7.1 million during the financial year 2012 (2011: € 6.3 million). The portion of the total amount expensed attributable to members of the Management Board amounts to € 2.2 million (2011: € 2.0 million) and can be broken down to the individual members of the Management Board as follows.

€	2012	2011
Dr Wolf Schumacher	825,000	443,525
Dirk Große Wördemann	397,000	446,625
Hermann J. Merkens	489,000	484,831
Thomas Ortmanns	489,000	665,188

The intrinsic value of the virtual shares exercisable at the reporting date amounted to € 4.6 million (2011: € 7.4 million). The obligation from share-based payment transactions as at 31 December 2012 amounts to € 13.6 million (2011: € 5.8 million). It is reported in the balance sheet in the line item "Provisions".

Remuneration for key executives

The definition of executives in key positions within Aareal Bank Group includes members of management or supervisory bodies of Aareal Bank AG and its subsidiaries, plus first-level managers and experts of Aareal Bank AG (other related parties).

Total remuneration of executives in key positions is analysed below:

€ thousands	1 Jan-31 Dec 2012	1 Jan-31 Dec 2011
Short-term employee benefits	13,787	15,881
Post-employment benefits	2,033	1,831
Other long-term benefits	2,204	-
Termination benefits	580	1,417
Share-based payment	3,826	981
Total	**22,430**	**20,110**

Other disclosures

Disclosures in accordance with the German Pfandbrief Act (section 28)

Total amount and related cover assets pool of outstanding mortgage Pfandbriefe and public-sector Pfandbriefe

€ mn	Cover assets pool	Pfandbriefe outstanding	Excess cover
31 Dec 2012			
Mortgage Pfandbriefe			
Nominal value	11,819.5	9,555.2	2,264.3
Present value	12,675.2	10,563.3	2,111.9
Public-sector Pfandbriefe			
Nominal value	3,176.0	2,859.5	316.5
Present value	3,849.8	3,565.2	284.6

€ mn	Cover assets pool	Pfandbriefe outstanding	Excess cover
31 Dec 2011			
Mortgage Pfandbriefe			
Nominal value	10,716.1	8,872.0	1,844.1
Present value	11,415.8	9,248.2	2,167.6
Public-sector Pfandbriefe			
Nominal value	3,336.9	3,006.2	330.7
Present value	3,820.7	3,541.5	279.2

€ mn	Share of derivatives in cover assets pool 2012	Share of derivatives in cover assets pool 2011	Share of derivatives in covered bonds 2012	Share of derivatives in covered bonds 2011
Nominal value				
Mortgage Pfandbriefe	19.7	13.1	160.8	176.8
Public-sector Pfandbriefe	0.0	0.0	0.0	0.0
Present value				
Mortgage Pfandbriefe	129.5	46.2	0.0	0.0
Public-sector Pfandbriefe	130.7	104.6	0.0	0.0

€ mn	Share of further cover assets 2012	Share of further cover assets 2011
Mortgage Pfandbriefe	1,104.4	497.9
Public-sector Pfandbriefe	0.0	0.0

€ mn	Cover assets pool	Pfandbriefe outstanding	Excess cover
31 Dec 2012			
Risk-adjusted net present value			
Mortgage Pfandbriefe	12,808.6	10,896.2	1,912.4
Public-sector Pfandbriefe	3,849.8	3,565.2	284.6

€ mn	Cover assets pool	Pfandbriefe outstanding	Excess cover
31 Dec 2011			
Risk-adjusted net present value			
Mortgage Pfandbriefe	11,481.5	9,661.4	1,820.1
Public-sector Pfandbriefe	4,183.5	3,925.1	258.4

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

€ mn	Cover assets pool	Pfandbriefe outstanding
31 Dec 2012		
Mortgage Pfandbriefe		
Up to 1 year	2,155.1	1,833.8
Between 1 year and 2 years	2,212.9	1,524.1
Between 2 year and 3 years	1,598.8	1,172.8
Between 3 year and 4 years	2,478.7	1,468.8
Between 4 year and 5 years	1,228.1	1,131.0
Between 5 years and 10 years	2,092.4	2,138.6
More than 10 years	53.5	286.1
Total	**11,819.5**	**9,555.2**
Public-sector Pfandbriefe		
Up to 1 year	525.9	625.3
Between 1 year and 2 years	242.9	210.6
Between 2 year and 3 years	172.0	72.1
Between 3 year and 4 years	185.8	97.2
Between 4 year and 5 years	137.4	164.3
Between 5 years and 10 years	871.6	794.8
More than 10 years	1,040.4	895.2
Total	**3,176.0**	**2,859.5**

€ mn	Cover assets pool	Pfandbriefe outstanding
31 Dec 2011		
Mortgage Pfandbriefe		
Up to 1 year	1,781.5	1,473.6
Between 1 year and 2 years	1,750.2	1,843.7
Between 2 year and 3 years	2,178.4	1,490.5
Between 3 year and 4 years	1,358.0	972.8
Between 4 year and 5 years	1,693.9	636.9
Between 5 years and 10 years	1,900.6	1,995.5
More than 10 years	53.5	459.0
Total	**10,716.1**	**8,872.0**
Public-sector Pfandbriefe		
Up to 1 year	188.0	156.6
Between 1 year and 2 years	597.6	635.3
Between 2 year and 3 years	244.6	210.6
Between 3 year and 4 years	148.7	72.1
Between 4 year and 5 years	162.4	97.2
Between 5 years and 10 years	806.0	841.8
More than 10 years	1,189.6	992.6
Total	**3,336.9**	**3,006.2**

Loans and advances used to cover mortgage Pfandbriefe

€ mn	Cover assets pool 2012	Cover assets pool 2011
Distribution of the amounts measured at nominal value by volume		
Up to € 300 thousand	14.6	15.7
Between € 300 thousand and € 5 million	584.6	742.5
More than € 5 million	10,096.2	9,446.9
Total	**10,695.4**	**10,205.1**

As at the balance sheet date, the loans and advances used for lending against Mortgage Pfandbriefe included payment arrears of 90 days or more in the amount of € 9.7 million (2011: € 1.8 million), of which € 9.7 million refer to Italy and € 0.0 million to Germany. In the comparable period of the previous year, payment arrears of 90 days or more referred to Belgium (€ 0.3 million), Germany (€ 0.0 million), Denmark (€ 0.5 million), France (€ 0.5 million), and Italy (€ 0.5 million).

Distribution of the amounts measured at nominal value and used to cover mortgage Pfandbriefe by countries in which the real property collateral is located:

	Commercial property							Residential property						
€ mn	Building plots only	New buildings not yet yielding returns	Office buildings	Retail property	Industrial	Other	Total	Building plots only	New buildings not yet yielding returns	Single family homes	Multi family homes	Flats/apartments	Total	Total cover assets pool
31.12.2012														
Belgium			172.6	96.6	9.0	30.9	309.1							309.1
Denmark	3.7		70.3	13.2	5.7	67.2	160.1	2.3	1.6		8.7	4.2	16.8	176.9
Germany			349.4	176.6	468.0	228.7	1,222.7	0.8		4.7	634.7	0.9	641.1	1,863.8
Estonia				26.8			26.8							26.8
Finland			28.6	215.8	5.4	20.5	270.3							270.3
France		83.0	523.9	72.2	190.7	283.2	1,153.0				4.7		4.7	1,157.7
UK			180.1	469.7	158.9	307.1	1,115.8							1,115.8
Italy	74.5	9.0	712.9	390.3	50.9	107.2	1,344.8				83.6		83.6	1,428.4
Japan						56.5	56.5							56.5
Canada			50.8			90.1	140.9							140.9
Luxembourg			4.5				4.5							4.5
Netherlands			190.1	41.2	152.3	168.7	552.3				155.0		155.0	707.3
Poland		9.1	314.7	188.7	105.5	-	618.0							618.0
Sweden			367.1	126.4	237.4	33.1	764.0							764.0
Switzerland			20.0	16.8		185.2	222.0							222.0
Slovakia					6.6	-	6.6							6.6
Spain		20.6	40.0	475.1	21.1	50.2	607.0							607.0
Czech Republic	3.8		99.6	10.2	15.7	62.6	191.9							191.9
USA		188.4	326.2	247.4	19.2	163.3	944.5				83.4		83.4	1,027.9
Total	**82.0**	**310.1**	**3,450.8**	**2,567.0**	**1,446.4**	**1,854.5**	**9,710.8**	**3.1**	**1.6**	**4.7**	**970.1**	**5.1**	**984.6**	**10,695.4**

	Commercial property							Residential property						
€ mn	Building plots only	New buildings not yet yielding returns	Office buildings	Retail property	Industrial	Other	Total	Building plots only	New buildings not yet yielding returns	Single family homes	Multi family homes	Flats/apartments	Total	Total cover assets pool
31.12.2011														
Belgium		3.4	187.6	56.8	9.0	35.8	292.6							292.6
Denmark	3.7	11.4	82.3	22.3	7.3	67.6	194.6	10.4	15.4	0.6		4.2	30.6	225.2
Germany			313.7	58.2	435.7	242.5	1,050.1	0.8		4.7	669.6	0.9	676.0	1,726.1
Estonia			2.3	26.8			29.1							29.1
Finland			33.3	220.8	5.4	20.5	280.0							280.0
France	10.0		544.8	74.7	209.4	317.4	1,156.3				10.1		10.1	1,166.4
UK			234.9	203.5	145.7	225.5	809.6							809.6
Italy	74.5	9.0	758.4	353.8	53.9	92.8	1,342.4				84.2		84.2	1,426.6
Japan			-			64.1	64.1							64.1
Canada			80.2			117.0	197.2							197.2
Luxembourg			4.5				4.5							4.5
Netherlands			210.1	41.2	168.0	169.9	589.2				100.0		100.0	689.2
Norway			-	11.4	6.9	-	18.3							18.3
Poland			208.2	246.3	82.0		536.5							536.5
Sweden			368.9	130.5	238.2	35.3	772.9				57.8		57.8	830.7
Switzerland			40.5	41.6	3.6	183.9	269.6							269.6
Slovakia					6.6		6.6							6.6
Spain		20.6	40.0	417.6	21.1	49.8	549.1							549.1
Czech Republic	3.8		99.7	10.0	15.7	62.3	191.5							191.5
USA		178.6	221.5	284.2	21.8	64.8	770.9				121.3		121.3	892.2
Total	**92.0**	**223.0**	**3,430.9**	**2,199.7**	**1,430.3**	**1,749.2**	**9,125.1**	**11.2**	**15.4**	**5.3**	**1,043.0**	**5.1**	**1,080.0**	**10,205.1**

In the financial year 2012, the bank did not acquire any properties for the purpose of loss prevention (2011: none).

As at 31 December 2012, there were no foreclosures or forced administration procedures pending, and neither had any foreclosures been carried out.

As at 31 December 2012, interest payments were overdue in the amount of € 6.2 million (2011: € 6.4 million) for commercial property and in the amount of € 0.1 million (2011: € 0.1 million) for residential property.

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

€ mn	Sovereigns	Public-sector entities regional	Public-sector entities municipal	Other	Total
31.12.2012					
Germany	13.7	1,770.5	26.9	574.3	2385.4
EU institutions	-	-	-	111.4	111.4
France	-	-	-	100.0	100.0
Italy	114.0	-	-	-	114.0
Japan	-	-	20.0	50.0	70.0
Austria	125.2	25.0	-	80.0	230.2
Poland	50.0	-	-	-	50.0
Spain	-	115.0	-	-	115.0
Total	**302.9**	**1,910.5**	**46.9**	**915.7**	**3,176.0**

€ mn	Sovereigns	Public-sector entities regional	Public-sector entities municipal	Other	Total
31.12.2011					
Germany	12.2	1,774.0	28.9	668.7	2,483.8
EU institutions	-	-	-	118.9	118.9
France	-	-	-	100.0	100.0
Italy	114.0	-	-	-	114.0
Japan	-	-	20.0	50.0	70.0
Austria	125.2	25.0	-	80.0	230.2
Poland	50.0	-	-	-	50.0
Portugal	-	30.0	-	25.0	55.0
Spain	-	115.0	-	-	115.0
Total	**301.4**	**1,944.0**	**48.9**	**1,042.6**	**3,336.9**

Neither at balance sheet date nor in the comparable period of the previous year did loans and advances used for lending against public-sector Pfandbriefe 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, DSF Zwölfte Verwaltungsgesellschaft 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 million, Aareal Bank AG has call commitments of up to € 6 million. In addition, Aareal Bank AG has a pro-rata principal liability in the event of non-fulfilment of call commitments by other co-shareholders, who hold aggregate interests of € 63 million.

Consolidated financial statements

As the parent company of Aareal Bank Group, Aareal Bank AG, Wiesbaden, prepares consolidated financial statements. The consolidated financial statements will be deposited with the Register of Companies at the Wiesbaden District Court (Amtsgericht, HRB 13 184) and will also be available from Aareal Bank AG in Wiesbaden, Germany.

Loans to executive bodies of Aareal Bank

Throughout the financial year 2012, the bank has reported purchases and sales subject to reporting requirements under No. 6.6 of the German Corporate Governance Code, as well as under section 15a of the German Securities Trading Act (WpHG) to BaFin, the German financial services regulatory agency, without delay, and also published such details on its website. Furthermore, Aareal Bank AG has undertaken in its Code to disclose on its website, without delay, each reported purchase or sale by members of the Management Board or the Supervisory Board.

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

€ mn	31 Dec 2012	31 Dec 2011
Management Board	-	-
Supervisory Board	0.6	0.9
Other related parties	1.6	1.7
Total	2.2	2.6

Loans extended to members of the Supervisory Board generally have a term between 10 and 18 years, and bear interest at (nominal) rates between 4.71% and 5.66%. Collateral was provided in line with usual market practice. In the year under review, repayments amounted to € 0.3 million.

Loans extended to other related parties generally have a term between 14 and 16 years, and bear interest at (nominal) rates between 2.65% and 3.65%. Collateral was also provided in line with usual market practice. In the year under review, repayments amounted to € 0.1 million. As at 31 December 2012, there was one liability to another related party, in the amount of € 10 million; specifically, this involved a ten-year promissory loan with an interest rate of 4.11%.

Employees

The average staffing level is shown below:

Yearly average	1 Jan-31 Dec 2012	1 Jan-31 Dec 2011
Salaried employees	893	932
Executives	28	32
Total	**921**	**964**
of which: Part-time employees	167	174

Auditors' fees

The total fees charged by the auditor are as follows:

€ thousands	
Category	
Auditing fees	2.412,2
Other assurance services	42,3
Tax advisory services	48,3
Other services	2.020,8
Total	**4.523,6**

Notice pursuant to section 21 (1) of the WpHG

Pursuant to the German Securities Trading Act (WpHG), any investor whose shareholding in a listed company reaches, exceeds or falls short of certain threshold values in terms of voting rights (whether by purchase, sale or by any other means) must notify the Company and the German Federal Financial Supervisory Authority. The lowest threshold for this notification requirement is 3%. 71.1% of Aareal Bank AG shares are held in free float. The largest shareholder of the Company is Aareal Holding Verwaltungsgesellschaft mbH, Düsseldorf, with an interest of 28.9%.

During the year, we received several notifications on voting rights from Fidelity Group, Boston, Massachusetts, USA, since the share of voting rights held exceeded or fell below the 3% threshold. The last notification from this group of companies as at 11 May 2012 and 8 May 2012 was issued since the share of voting rights had fallen below the 3% threshold. The notification referred to the following entities:

- Fidelity Investment Trust, Boston, Massachusetts, USA, 2.97% (1,774,969 voting rights) as at 8 May 2012
- Fidelity Management & Research Company, Boston, Massachusetts, USA, 2.99% (1,795,347 voting rights) as at 8 May 2012, attribution of all voting rights pursuant to section 22 (1) sentence 1 No. 6 of the WpHG.
- FMR LLC, Boston, Massachusetts, USA, 2.90% (1,734,810 voting rights) as at 11 May 2012, attribution of all voting rights pursuant to section 22 (1) sentence 1 No. 6 in conjunction with sentence 2 of the WpHG.

Deutsche Bank London, United Kingdom, sent us a notification for its subsidiary DWS Investment GmbH, Frankfurt, as at 27 February 2012 since the share of voting rights has fallen below the 3% threshold to 2.889% (1,729,068 voting rights).

Dimensional Group, Austin, Texas, USA, notified us on 29 May 2012 that its share of voting rights had exceeded the 3% threshold. The following entities were affected:

- Dimensional Fund Advisors LP, Austin, Texas, USA, 3.04% (1,820,026 voting rights) as at 29 May 2012, attribution of all voting rights pursuant to section 22 (1) sentence 1 No. 6 of the WpHG.
- Dimensional Holdings Inc., Austin, Texas, USA, 3.04% (1,820,026 voting rights) as at 29 May 2012, attribution of all voting rights pursuant to section 22 (1) sentence 1 No. 6 in conjunction with section 22 (1) sentence 2 of the WpHG.

The company most recently named Allianz Global Investors Europe GmbH, Frankfurt issued several notifications of voting rights during 2012. The last notification, which was issued on 10 December 2012, reported a share of voting rights of 5.06% (3,028,655 voting rights). Of this share of voting rights, 1.07% of the total number of voting rights (corresponding to 640,082 of a total of 59,857,221 voting rights) are attributable pursuant to section 22 (1) sentence 1 No. 6 of the WpHG. Allianz Global Investors Europe GmbH, Frankfurt, also notified us that the share of voting rights as at 14 January 2013 fell to 4.84% (2,894,403 voting rights). Of this share of voting rights, 0.95% of the total number of voting rights (corresponding to 567,031 of a total of 59,857,221 voting rights) are attributable pursuant to section 22 (1) sentence 1 No. 6 of the WpHG.

BlackRock Group, USA, notified us on 21 November 2012 that the 3% threshold had been exceeded. The following entities were affected:

- BlackRock Financial Management, Inc., New York, USA, 3.09% (1,846,966 voting rights) as at 21 November 2012, attribution of all voting rights pursuant to section 22 (1) sentence 1 No. 6 in conjunction with section 22 (1) sentence 2 of the WpHG.
- BlackRock Financial Management, Inc., New York, USA, 3.09% (1,846,966 voting rights) as at 21 November 2012, attribution of all voting rights pursuant to section 22 (1) sentence 1 No. 6 in conjunction with section 22 (1) sentence 2 of the WpHG.
- BlackRock Financial Management, Inc., New York, USA, 3.09% (1,846,966 voting rights) as at 21 November 2012, attribution of all voting rights pursuant to section 22 (1) sentence 1 No. 6 in conjunction with section 22 (1) sentence 2 of the WpHG.

Universal-Investment-Gesellschaft mbH, Frankfurt, notified us on 17 December 2012 that its share of voting rights had fallen below the 3.0% threshold down to 1.98% (1,184,258 voting rights) at that date. 1.72% (corresponding to 1,032,230 voting rights) thereof are attributable to Universal-Investment-Gesellschaft mbH pursuant to section 22 (1) sentence 1 No. 6 of the WpHG.

Corporate Governance Code

The declaration regarding the German Corporate Governance Code, pursuant to section 161 of the AktG, has been submitted and has been 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 of Aareal Bank AG proposes to the Annual General Meeting that the net retained profit of Aareal Bank AG in the amount of € 5,000,000.00 for the financial year 2012, as reported under the German Commercial Code (HGB), be transferred to other retained earnings. For reasons of commercial prudence, we believe that this is necessary in view of the weak growth impetus on a macroeconomic level and the persisting risks of further disruptions to the market and to the financial system in order to secure the positioning of Aareal Bank for the near future. Write-downs on our securities portfolio of the liquidity reserve cannot be ruled out, particularly if volatility on the financial and capital markets rises again.

Executive bodies of Aareal Bank AG
Offices held in accordance with section 285 no. 10 of the German Commercial Code (HGB) in conjunction with section 125 (1) sentence 5 of the German Stock Corporation Act (AktG)

Supervisory Board

Hans W. Reich, Chairman of the Supervisory Board		
Chairman of the Supervisory Board of Citigroup Global Markets Deutschland AG		
Aareal Bank AG	Chairman of the Supervisory Board	
Citigroup Global Markets Deutschland AG	Chairman of the Supervisory Board	
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	
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	until 5 June 2012
OVB Holding AG	Deputy Chairman of the Supervisory Boa	since 5 June 2012
OVB Vermögensberatung AG	Member of the Supervisory Board	
SIGNAL IDUNA Allgemeine Versicherung AG	Member of the Supervisory Board	
SIGNAL IDUNA Holding AG	Member of the Supervisory Board	
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	
AWD Allgemeiner Wirtschaftsdienst AG	President of the Board of Directors	
tecis Finanzdienstleistungen AG	Chairman of the Supervisory Board	
Thomas Hawel *		
Aareon Deutschland GmbH		
Aareal Bank AG	Member of the Supervisory Board	
Aareon Deutschland GmbH	Deputy Chairman of the Supervisory Board	
Dieter Kirsch *		
Aareal Bank AG		
Aareal Bank AG	Member of the Supervisory Board	
Marija G. Korsch		
Former Executive at Bankhaus Metzler seel. Sohn & Co. Holding AG		
Aareal Bank AG	Member of the Supervisory Board	since 11 July 2012
Just Software AG	Member 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	Deputy Chairman of the Supervisory Board	
Universal-Investment-Gesellschaft mbH	Member of the Supervisory Board	
Wolf R. Thiel		
Former President and Chairman of the Management Board of Versorgungsanstalt des Bundes und der Länder (until 31 March 2012)		
Aareal Bank AG	Member of the Supervisory Board	until 31 March 2012
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	until 31 March 2012
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		
Corporate Communications, Investor Relations, Corporate Development, Human Resources, Legal, Tax, Compliance, Audit and Operations		
Aareon AG	Member of the Supervisory Board	
EBS European Business School gGmbH	Member of the Supervisory Board	since 1 Jan 2012
Dirk Große Wördemann, Member of the Management Board		
Structured Property Financing, International Sales Units		
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. i.L.	Member of the Supervisory Board	
Aareon AG	Member of the Supervisory Board	
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Deputy Chairman of the Supervisory Board	
Hermann Josef Merkens, Member of the Management Board		
Finance, Risk Controlling, Credit Management and Workout		
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	
Aareon AG	Member of the Supervisory Board	
CredaRate Solutions GmbH (formerly RMS Risk Management Solutions GmbH)	Member of the Supervisory Board	until 13 Feb 2012
CredaRate Solutions GmbH (formerly RMS Risk Management Solutions GmbH)	Deputy Chairman of the Supervisory Board	since 13 Feb 2012
Thomas Ortmanns, Member of the Management Board		
Institutional Housing Unit, Treasury, Organisation, Information Technology		
Aareal First Financial Solutions AG	Chairman of the Supervisory Board	
Aareon AG	Chairman of the Supervisory Board	
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Chairman of the Supervisory Board	
HypZert GmbH	Member of the Supervisory Board	

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

Ulf Ekelius, Bank Director		
Aareal Financial Service spol. s r.o. i.L.	Member of the Supervisory Board	
Dunya Heß		
Aareal Property Services B.V.	Member of the Supervisory Board	since 1 March 2012
Uli Gilbert		
Terrain-Aktiengesellschaft Herzogpark	Member of the Supervisory Board	
Hans-Ulrich Kron, Bank Director		
Aareal Estate AG	Deputy Chairman of the Supervisory Board	
Terrain-Aktiengesellschaft Herzogpark	Deputy Chairman 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	
Terrain-Aktiengesellschaft Herzogpark	Chairman of the Supervisory Board	
Dirk Pasewald		
Aareal Property Services B.V.	Member of the Supervisory Board	
Markus Schmidt		
Aareal Property Services B.V.	Member of the Supervisory Board	
Christine Schulze Forsthövel, Bank Director		
Aareal-Financial Service spol. s r.o. i.L.	Member of the Supervisory Board	

Composition of Supervisory Board's committees

Executive Committee	
Hans W. Reich	Chairman
Erwin Flieger	Deputy Chairman
York-Detlef Bülow	Deputy Chairman
Prof Dr Stephan Schüller	

Committee for Urgent Decisions	
Hans W. Reich	Chairman
Dr Herbert Lohneiß	
Christian Graf von Bassewitz	
Erwin Flieger	
Joachim Neupel	

Accounts and Audit Committee	
Joachim Neupel	Chairman
Prof Dr Stephan Schüller	Deputy Chairman
Christian Graf von Bassewitz	
York-Detlef Bülow	
Hans W. Reich	

Nomination Committee
Hans W. Reich
Erwin Flieger

Risk Committee	
Hans W. Reich	Chairman
Dr Herbert Lohneiß	Deputy Chairman
Christian Graf von Bassewitz	
Erwin Flieger	
Dieter Kirsch	
Joachim Neupel	

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, 26 February 2013

The Management Board

Dr Wolf Schumacher	**Dirk Große Wördemann**	**Hermann J. Merkens**	**Thomas Ortmanns**

Auditors’ Report

We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system, and the management report of Aareal Bank AG, Wiesbaden, for the business year from 1 January to 31 December, 2012. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law are the responsibility of the Company’s Board of Managing Directors. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

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

Our audit has not led to any reservations.

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

Frankfurt/Main, 4 March 2013

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Roland Rausch	**ppa. Kai Böhm**
Wirtschaftsprüfer	**Wirtschaftsprüfer**
German Public Auditor	**German Public Audito**

Report of the Supervisory Board of Aareal Bank AG, Wiesbaden

Dear shareholders,

During the financial year under review, Aareal Bank AG once again enjoyed commercial success and achieved a good result despite a market environment that is still challenging. As was forecast at the start of the year, the bank generated consolidated operating profit that was down only slightly on the successful previous year.

This means that Aareal Bank AG has generated positive quarterly results on each occasion since the outbreak of the international crisis affecting financial markets and the economy back in 2008. The Supervisory Board considers these results as evidence for the viability and operative strength of the Group's business model.

The European sovereign debt crisis continued to impact upon developments on the international financial and capital markets during 2012. The struggle to find a permanent and viable solution for the debt problems of the countries in question was at the forefront of intensive discussions. The associated high level of market uncertainty generated sharp price fluctuations on the international exchanges. The willingness of the European Central Bank (ECB) in the third quarter of 2012 to buy government bonds on the secondary market under certain conditions drove down the risk premiums (spreads) for government bonds from the euro zone periphery countries.

The macro-economic environment in 2012 was also defined largely by the European sovereign debt crisis. This had negative implications for sentiment in the real economy and led to a weak or even declining economy in many locations. Economies in North America and Asia developed more favourably. The budget dispute in the US and related unresolved issues were highly significant, and also impaired the business climate there.

Against the background of the developments outlined above, Aareal Bank adhered to its cautious and forward-looking business policy, in the usual manner: at the outset of the year, the bank first secured the funding for its planned volume of new business. As a result, Aareal Bank AG had sufficient liquidity and a sound funding base at all times during the 2012 financial year.

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

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

Activities of the plenary meeting of the Supervisory Board

Eight plenary meetings of the Supervisory Board were held during the year under review, of which five were scheduled meetings. Some of the extraordinary meetings were convened as telephone conferences. During the meetings, the members of the Supervisory Board received reports and explanations by the members of the Management Board, and discussed these in detail. Proceedings and reports during all scheduled meetings focused on the way the bank dealt with the challenges posed by the European sovereign debt crisis, and the resulting high levels of uncertainty and volatility on the financial and capital markets.

In its discussions, the Supervisory Board also concerned itself with changes to the regulatory framework, in great detail. During the year under review, these included the decisions taken by the newly-established European Banking Authority (EBA), and the implementation of amended Minimum Requirements for Risk Management (MaRisk).

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

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

The focal points of the various Supervisory Board meetings are presented below:

One meeting in February focused exclusively on Aareal Bank's strategic options, and on the challenges presented in the prevailing market environment.

In the March meeting, the Supervisory Board concerned itself in detail with the financial statements and consolidated financial statements presented for the 2011 financial year, and with the auditors' report. The relevant facts were presented in the Supervisory Board report for the previous year. In addition, the proposal regarding the selection and subsequent appointment of the external auditor for the Annual General Meeting was discussed. This also included the scope and focal points of the audit for the 2012 financial year, as defined by the Supervisory Board. Other issues covered in the meeting in March included the preparations for the Annual General Meeting in May 2012. The meeting also discussed the annual reports of Internal Audit and the Compliance Officers; in accordance with the German Ordinance on Remuneration in Financial Institutions, the contracts with the members of the Management Board were submitted to the Supervisory Board and a resolution passed on the content of these contracts.

The purpose of the May meeting of the Supervisory Board was to follow up on the Annual General Meeting of Aareal Bank AG, which preceded the meeting. The focal aspects of the audit for the 2012 financial year, as specified by the Supervisory Board, were discussed once again.

An extraordinary meeting was convened in June, during which the plenary meeting concerned itself with the proposal of the Nomination Committee to put forward Marija Korsch to the registrar of companies as a judicial appointment to succeed Wolf R. Thiel. Following an in-depth exchange of advice amongst its members, the Supervisory Board approved the proposal of the candidate. The appointment of Marija Korsch was conducted by the Wiesbaden local court with effect from 11 July 2012.

Another topic of discussion in the aforementioned meeting in June was a potential acquisition of a shareholding by subsidiary Aareon AG. This topic was discussed in more depth and agreed at a further extraordinary meeting held in July.

During the September meeting, topics related to the German Corporate Governance Code were presented and discussed, alongside other regulatory issues. The Supervisory Board also concerned itself with questions about the audit of the financial statements.

Within the scope of a further extraordinary meeting in October, the Supervisory Board discussed the strategic options currently available to Aareal Bank AG.

In the December meeting, the Management Board reported on the Group's corporate planning. The Management Board submitted and explained the corporate planning in detail to the Supervisory Board. Corporate governance issues were discussed as well: in this context, the Supervisory Board adopted the regular Declaration of Compliance, pursuant to section 161 of the AktG, for the year 2010, which was subsequently published on the bank's website.

In accordance with good corporate governance practice, the Supervisory Board also regularly examines the efficiency of its activities in order to identify any areas requiring improvement. The results of the efficiency examination conducted during the 2012 financial year were acknowledged by the members of the Supervisory Board, and were discussed in detail. No concrete need for action was identified.

Strategy documents were regularly submitted to, and discussed by the Supervisory Board, in accordance with the Minimum Requirements for Risk Management in Banks (MaRisk). In this context, the Supervisory Board received a report on the status and implementation of the latest amendments to the MaRisk. The results of the regular review of the Company's remuneration system were reported to the Supervisory Board. The Supervisory Board determined that the Company's remuneration system is appropriate.

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

Any Supervisory Board decisions which were taken by way of circulation were discussed at the subsequent meeting, to ensure that the members were able to reconcile the implementation of such decisions.

As part of preparing Supervisory Board decisions, a routine examination is carried out as to whether there are any conflicts of interest. No potential conflicts of interest that would need to be considered in the context of decision-making processes were identified during the financial year under review. The members of the Supervisory Board have declared in writing that no conflicts of interest pursuant to section 5.5.2 of the Corporate Governance Code arose during the financial year under review, with one exception: namely a resolution on a loan that required the approval of the Supervisory Board. Given the interdependency between the Supervisory Board member and the anchor tenant of the financed property, the member of the Supervisory Board abstained from voting.

In addition to its regular meetings, the Supervisory Board convened for a separate meeting during which auditors PricewaterhouseCoopers provided information on current changes and deliberations in the regulatory and legal framework. This meeting provided the opportunity for a more detailed analysis and discussion of key topics, outside the regular work of the Supervisory Board.

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 Risk Committee, the Committee for Urgent Decisions, the Accounts and Audit Committee, and the Nomination Committee.

The Executive Committee of the Supervisory Board convened for three scheduled meetings and one extraordinary meeting. In the scheduled meetings, the Executive Committee prepared the proposed resolutions of the plenary meetings of the Supervisory Board. Matters pertaining to the Management Board were discussed in the extraordinary meetings.

The Risk Committee held four meetings during the year under review. The Management Board submitted detailed reports to the committee, covering all markets in which the bank is active in the property finance business, as well as supplementary reports regarding the bank's investments in securities portfolios. The committee members discussed these reports and market views in detail. The committee discussed the banking environment and the situation of the bank's competitors. The committee also regularly dealt with loans requiring approval and transactions subject to reporting requirements. The committee discussed individual exposures of material importance to the bank, which were presented and explained by the Management Board. Also, detailed reports were given regarding the bank's liquidity status and funding.

The committee regularly discussed reports on the bank's risk situation, which were submitted and explained by the Management Board. Having discussed the contents with the Management Board, these were duly noted and approved by the members of the committee. Besides credit and country risks, the committee concerned itself with market risks, liquidity risks, and operational risks. The committee discussed in detail the developments of the debt crisis and their implications for the business environment of Aareal Bank, the consideration of Aareal Bank's risk-bearing capacity and the detailed account of its capital ratios, as well as the implementation of the requirements in accordance with Basel III. It also reported on the additional amendments to MaRisk. The committee also decided on any other transactions requiring the Supervisory Board’s approval pursuant to the Company’s Memorandum and Articles of Association or the internal rules of procedure.

The Committee for Urgent Decisions is a sub-committee of the Risk Committee. It approves loans subject to approval requirements by way of circulation; for this reason, it did not hold any meetings. Any decisions which were taken between meetings of the Risk Committee were discussed at the subsequent meeting.

The Accounts and Audit Committee held six meetings during the year under review. During its meeting in March 2012, the Accounts and Audit Committee received the external auditors' report on the 2011 financial year and discussed the results with the auditors in detail. The committee members read the audit reports provided; they formed their own judgement of the audit results on the basis of these reports, and by way of extensive discussions with the external auditors. In accordance with its duties under the Memorandum and Articles of Association, the Accounts and Audit Committee also discussed the selection of external auditors and the focal aspects of the audit for 2012 during the same meeting.

Proceedings at the meetings in August and November included information given to the committee regarding the progress of audit activities for the 2012 financial year. In addition to a further updated report on the audit progress, the Management Board presented and explained the updated Group planning to the committee during its December meeting. The committee also received reports submitted by Internal Audit and by the Compliance Officer, requesting and receiving detailed explanations. It discussed and duly noted the review of the internal control system, which was carried out in accordance with applicable law.

Furthermore, during the committee meetings in February, May, August and November 2012, the Management Board presented the quarterly results for the financial year, as well as the preliminary full-year results for 2011 prior to publication, in accordance with the German Corporate Governance Code; the committee members discussed the reports with the Management Board. As in the financial year under review, the preliminary results for 2012 were discussed at a meeting in February 2013.

In its meeting on 20 March 2013, the Accounts and Audit Committee received the external auditors' detailed report on the audit and audit results for the 2012 financial year, and discussed these results extensively with the auditors and the Management Board.

The Nomination Committee convened twice in 2012. The task of the committee is to coordinate and carry out the search for new shareholder representatives on the Supervisory Board, if a member representing shareholders retires from the Supervisory Board. Wolf R. Thiel resigned from his office with effect from 31 March 2012 during the financial year under review.

Where members of the Supervisory Board were unable to attend a meeting, they had announced their absence in advance, giving reasons. If material decisions were on the agenda, these Supervisory Board members submitted written instructions for the casting of their votes, or cast their votes afterwards, in writing.

Attendance of Supervisory Board members at meetings is shown in the table below.

Member oft he Supervisory Board	Number of meetings attended/number of meetings (plenary and committee meetings)
Hans W. Reich	24 of 24
Erwin Flieger	18 of 18
York-Detlef Bülow *	18 of 18
Christian Graf von Bassewitz	18 of 18
Manfred Behrens	5 of 8
Thomas Hawel *	8 of 8
Dieter Kirsch *	12 of 12
Marija Korsch**	4 of 4
Dr Herbert Lohneiß	11 of 12
Joachim Neupel	18 of 18
Prof Dr Stephan Schüller	16 of 18
Wolf R. Thiel **	3 of 3
Helmut Wagner *	7 of 8

* employee representative; ** member of the Supervisory Board for only part of the financial year

Financial statements and consolidated financial statements

The Supervisory Board instructed PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt/Main, who were elected as auditors by the Annual General Meeting 2012, with the audit of the financial statements. The external auditors appointed submitted a statement regarding their independence to the Supervisory Board, who duly noted it. The Supervisory Board has no reason to doubt the accuracy of this statement of independence. Fulfilling their duties as commissioned by the Supervisory Board, PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft audited the financial statements prepared in accordance with the German Commercial Code (HGB) and the consolidated financial statements prepared in accordance with IFRS, as well as the Management Report and the Group Management Report. Based on the results of their audit, PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft issued an unqualified audit opinion for the financial statements and consolidated financial statements.

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

The financial statements and management report of Aareal Bank AG, prepared in accordance with the HGB; and the consolidated financial statements prepared in accordance with IFRS and the proposal of the Management Board regarding the appropriation of profit and the audit report were examined in detail. No objections were raised to the audit results. In its meeting on 27 March 2013, the Supervisory Board approved the results of the audit. The Supervisory Board approved the financial statements and the Management Report of Aareal Bank AG, prepared in accordance with the HGB, together with the consolidated financial statements and the Group Management Report prepared in accordance with IFRS, which are thus confirmed. 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.

Personnel matters

On 31 March 2012, Wolf R. Thiel resigned from his office as member of the Supervisory Board. The Supervisory Board thanks Mr. Thiel for his long-standing and successful contributions to the bank's Supervisory Board. At the same time, the Supervisory Board welcomes new member Marija Korsch and looks forward to a fruitful and successful cooperation. Marija Korsch has many years of experience in the international banking business. Amongst other things, she held management positions at Vereins- und Westbank AG and in Bankers Trust, both in Germany and in the US. The most recent position she held was partner with responsibility for the corporate finance business at Bankhaus Metzler seel. Sohn & Co. Holding AG. The Supervisory Board is delighted to have acquired a proven expert in her field, who can offer her extensive experience in the international banking business to the work of the Supervisory Board.

In conclusion, the Supervisory Board would like to thank the Management Board and all of the Company’s employees for their strong commitment and successful work during the 2012 financial year, which was once again eventful. Throughout the year, it was thanks to the motivation and contribution of Aareal Bank Group staff that enabled the Company to successfully master the challenges of recent months.

Kronberg, March 2013

For the Supervisory Board

Hans W. Reich (Chairman)

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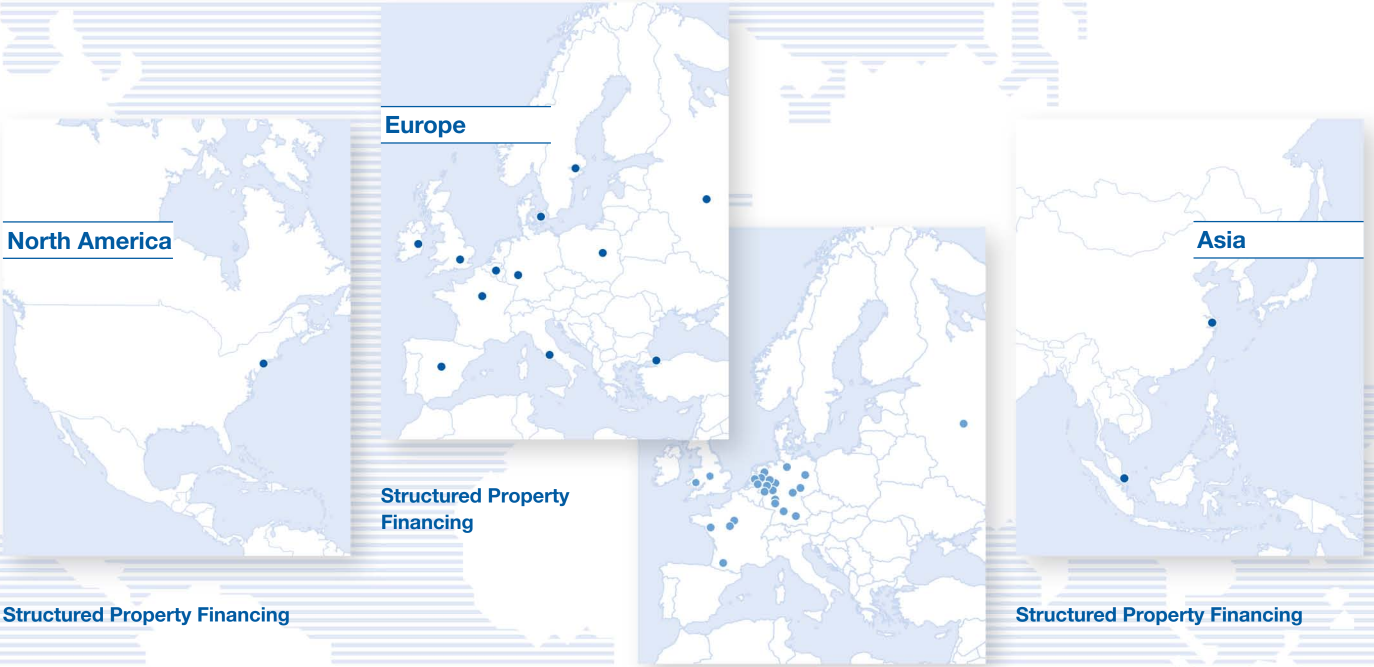
Financial Calendar

7 May 2013	Presentation of interim report as at 31 March 2013
22 May 2013	Annual General Meeting – Kurhaus Wiesbaden
August 2013	Presentation of interim report as at 30 June 2013
November 2013	Presentation of interim report as at 30 September 2013



Structured Property Financing (North America)

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