Prepared for tomorrow

AAREAL BANK GROUP – INTERIM REPORT
1 JANUARY TO 30 JUNE 2020

Aareal
YOUR COMPETITIVE ADVANTAGE.

Key Indicators

	1 Jan - 30 Jun 2020	1 Jan - 30 Jun 2019
Results		
Operating profit (€ mn)	13	122
Consolidated net income (€ mn)	16	81
Consolidated net income allocated to ordinary shareholders (€ mn)[1]	7	72
Cost/income ratio (%)[2]	58.6	56.9
Earnings per ordinary share (€)[1]	0.11	1.20
RoE before taxes (%)[1) 3) 4]	0.0	8.8
RoE after taxes (%)[1) 3) 4]	0.5	5.7

	30 Jun 2020	31 Dec 2019
Statement of Financial Position		
Property finance (€ mn)[5]	25,571	25,882
Equity (€ mn)	2,847	2,861
Total assets (€ mn)	45,322	41,137
Regulatory Indicators[6]		
Risk-weighted assets (€ mn)	11,702	11,195
Common Equity Tier 1 ratio (CET1 ratio) (%)	19.8	19.6
Tier 1 ratio (T1 ratio) (%)	22.4	22.3
Total capital ratio (TC ratio) (%)	29.5	29.9
Common Equity Tier 1 ratio (CET1 ratio) (%) – Basel IV (estimated) –[7]	14.2	13.5
Emloyees	2,903	2,788

	30 Jun 2020	31 Dec 2019
Moody's[8]		
Issuer rating	A3	A3
Bank deposit rating	A3	A3
Outlook	Negative	Stable
Mortgage Pfandbrief Rating	Aaa	Aaa
Fitch Ratings[9]		
Issuer Default Rating	BBB+	A-
Senior Preferred	A-	A
Senior Non Preferred	BBB+	A-
Deposit ratings	A-	A
Outlook	Negative	Negative
Sustainability Ratings[10]		
MSCI	AA	AA
ISS-ESG	prime (C+)	prime (C+)
CDP	Awareness Level C	Awareness Level C

[1] The allocation of earnings is based on the assumption that net interest payable on the AT1 bond is recognised on an accrual basis.
[2] Structured Property Financing and Consulting/Services Bank (formerly: Bank division Housing Industry) segments, in line with the strategic development; the previous year's figure was adjusted accordingly.
[3] On an annualised basis
[4] "Other reserves" were included in equity, in line with the further development of segment reporting; the previous year's figure was adjusted accordingly.
[5] Excluding € 0.4 billion in private client business (31 December 2019: € 0.4 billion) and € 0.3 billion in local authority lending business by the former Westdeutsche ImmobilienBank AG (WestImmo) (31 December 2019: € 0.4 billion)
[6] 31 December 2019: excluding dividends for 2019 (in line with original proposal for appropriation of profits) and incorporating the pro-rata accrual of net interest payable on the AT1 bond
30 June 2020: including dividends for 2019 (in line with original proposal for appropriation of profits) and interim profits for 2020, and incorporating the pro-rata accrual of net interest payable on the AT1 bond
The expected relevant impact of the TRIM exercise on commercial property financings, and of the SREP recommendations concerning the NPL inventory as well as the ECB's NPL guidelines for exposures newly classified as NPLs, were taken into account.
[7] Underlying estimate, given a 72.5 % output floor based on the final Basel Committee framework dated 7 December 2017. The calculation of the material impact upon Aareal Bank is subject to the outstanding EU implementation as well as the implementation of additional regulatory requirements (CRR II, EBA requirements etc.).
[8] Moody's Investors Service confirmed the issuer rating and bank deposit rating on 21 April 2020. At the same time, Moody's set the outlook for the issuer rating and bank deposit rating to "negative", given deterioration in the operating environment on account of the Covid-19 pandemic.
[9] The ratings reported as at 31 December 2019 were published on 10 January 2020. Fitch Ratings had changed the outlook to "negative" in connection with the introduction of revised bank rating criteria. On 27 March 2020 the rating was changed, as expected. Due to the Covid-19 pandemic, Fitch Ratings lowered its rating outlook to negative (RWN – Rating Watch Negative), also on 27 March 2020.
[10] Please refer to our website (www.aareal-bank.com/en/responsibility/reporting-on-our-progress/) for more details.

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

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Interim Group Management Report

Report on the Economic Position

Report on the Economic Position

The Covid-19 pandemic and the measures taken to contain it very quickly plunged the global economy into the deepest recession witnessed in post-World War II history, with extensive monetary and fiscal policy measures being put in place in response to the crisis. This produced extreme values for some economic indicators in the first six months of the year, especially as the events emerged abruptly. Nevertheless, the first signs of a recovery had started to emerge in some sub-segments towards the end of the first half of the year.

Economy

After economic output had already plummeted in the first quarter, the slump became even more pronounced in the second quarter, as many countries had waited until March before taking measures to contain the pandemic; the subsequent easing measures took effect late – and for the most part very slowly – in the further course of the second quarter. Since June, some of the restrictions have been relaxed in many markets, pushing the leading indicators back up again, with increasing signs that the economic slump has passed the trough.

Fiscal policy responded by launching generous support packages, in some cases prompting an immediate increase in the budget deficits affected. Monetary policy also launched comprehensive programmes in a quest to ensure sufficient liquidity.

Gross domestic product in the euro zone dipped by 3.1 % year-on-year in the first quarter and by 15.3 % in the second quarter as a result of the Covid-19 pandemic. Overall, total economic output in the first six months of the year was down by 9.2 % on the same period of the previous year, the biggest drop in economic output in the history of the single currency area. The most substantial declines were reported in France, Italy and Spain, while the contraction in Germany was less severe at 6.6 % in the first half of the year. The EMU countries reacted to the pandemic by launching fiscal aid measures of a varying scale and structure. Some countries, for example, introduced moratoria on rent and principal repayments. Germany, France and the Netherlands took the most generous direct fiscal stimulus measures in relation to gross domestic product. Spain and Italy, on the other hand, opted to focus on indirect measures such as guarantees. On 21 July, the European heads of government agreed on a € 750 billion plan of subsidies and loans aimed at financing the economic recovery. The programme is expected to provide considerable cyclical impetus for the upturn and reduce the economic damage caused by the pandemic, especially for some of the hardest hit countries. The leading indicators suggest that the economic downturn began to bottom out from May onwards. The purchasing managers' indices, in particular, had started to climb again up to the beginning of July, and were once again above their long-term average.

The UK was hit by a historically unparalleled drop in economic output in the first half of the year. By the end of the first six months, gross domestic product was 12.0 % lower than in the same period of the previous year. In addition to the impact of the pandemic, which was the main reason behind the development, the trend was also exacerbated by the uncertainty surrounding the country's future relationship with the EU, which remained undecided at the mid-point of the year. The UK has, however, made it clear that it intends to end the current transition period at the close of the year. Economic output in other European countries outside the euro zone, such as Poland and Sweden, also declined in the first six months, even though Sweden has adopted a more liberal approach to controlling the pandemic.

Economic output in the US had fallen by 4.3 % year-on-year by the middle of the year. This development was due, in particular, to the implications of the Covid-19 pandemic, which was particularly severe in places including New York and dealt a negative blow to economic development at the end of the first half of the year as infection figures started to edge up again. Adding to this, a deadly police operation in June triggered social and political unrest, which gave rise to the ongoing ”Black Lives Matter” movement. The drop in oil prices also had a negative impact on oil-producing industries. Alongside the pandemic, this factor also placed a significant burden on the Canadian economy. In Canada, gross domestic product at the end of the first six months was down by 7.6 % on the same period of the previous year.

As the Covid-19 pandemic originated in China, the Chinese economy was also the first to be affected. This meant that measures to ease restrictions took effect earlier, with a positive knock-on effect on economic output in the second quarter. Whereas economic output had fallen by 6.8 % in the first quarter, the second quarter saw gross domestic product rise by 1.5 % as against the previous year. All in all, economic output for the first half of the year as a whole was down by 2.4 % in a year-on-year comparison.

In Australia, economic output in the first six months was 3.1 % lower than in the previous year due to lower domestic consumption as a result of the Covid-19 pandemic.

The recession resulted in a sharp decline in employment across the globe. In many of the world’s advanced economies, rising unemployment is being mitigated by lay-off and short-time working programmes. Large-scale redundancies have, however, been seen in countries that do not have programmes like these in place. In the US in particular, the number of people registering as unemployed for the first time rose dramatically within a short period. In April, for example, the unemployment rate came to 14.7 % compared with 3.5 % at the end of 2019. By the middle of the year, however, it dropped back to 11.1 %.

Financial and capital markets, monetary policy and inflation

The Covid-19 pandemic was the dominant topic on the financial markets, too. In the short term, the crisis triggered higher volatility and pushed interest rates up. Exchange rates, on the other hand, showed more stable development. Fast action taken by central banks in response to the crisis, however, increasingly reassured the markets.

In the first half of 2020, the European Central Bank (ECB) tweaked its monetary policy to promote favourable financing conditions for the real economy in times of heightened uncertainty. While the key interest rate remained unchanged at zero per cent in the first half of the year, in March 2020 the Asset Purchase Programme (APP), which was launched back in September 2019 for an indefinite period, was ramped up by € 120 billion until the end of 2020 and expanded to include a Pandemic Emergency Purchase Programme (PEPP) for bonds issued by public-sector and private borrowers. Initially, this programme was launched with a volume of € 750 billion and was set to last until the end of the year. The PEPP was increased by € 600 billion in June to total € 1.35 trillion and its term extended until at least June 2021. The ECB will be maturing principal payments from securities purchased under the PEPP at least until the end of 2022. In addition, more attractive conditions for the third series of the ECB’s targeted longer-term refinancing operations (TLTRO 3) were offered in March and April. TLTRO 3 operations were conducted in this form for the first time in the second half of June. If the banks participating in these refinancing operations manage to achieve positive net lending to non-financial companies and private individuals in the euro zone in the period from 1 March 2020 to 31 March 2021, this provides an attractive refinancing option with a negative interest rate that is limited to a period of around one year and exceeds the ECB’s deposit rate. There are also a number of other conditions attached to this programme.

The US Federal Reserve (FED) also took extensive measures in the first half of 2020 to support lending to households and the corporate sector and to free up liquidity in the banking system. Two interest rate cuts implemented on 3 and 15 March lowered the key interest rate by a total of 150 basis points to a corridor of 0 – 0.25 %. As a further stimulus, the FED made the decision on 15 March to increase its purchase programme for government bonds and mortgage-backed securities to an unlimited volume. Numerous lending programmes were also launched in the period between March and May to provide private and public-sector borrowers alike with liquidity and to help ensure that the credit markets could continue to function.

Short-term interest rates at the end of the first half of 2020 were virtually unchanged in the euro zone and in Swedish krona as against the end of 2019. In US dollars and Canadian dollars, they fell by around 160 basis points. The drop in pounds sterling was less pronounced at around 65 basis points.

Long-term interest rates fell in all of the currency areas that are relevant to Aareal Bank. The decline in the euro zone was the smallest at just under 15 basis points by the end of the first half of the year, whereas the decline in pounds sterling came to around 35 basis points. The decline in US dollars was the most pronounced at around 100 basis points, starting at a significantly higher interest rate level compared with the euro zone.

Government bonds with a ten-year maturity painted a mixed picture in the first half of 2020. While yields in Germany, the UK and the US fell compared with the beginning of the year, yields on Italian and Spanish bonds initially rose before falling back to more or less the level seen at the start of the year. Spreads over German bonds widened by a good 20 basis points for Spain and Italy during the same period.

In the period from 31 December 2019 to 30 June 2020, the euro remained stable against the US dollar (at USD 1.12 per euro), and strengthened against the Canadian dollar from CAD 1.46 per euro to CAD 1.53 per euro. During the same period, the euro also made gains against the pound sterling, rising from GBP 0.85 per euro to 0.91 per euro, and against the Swedish krona with an increase from SEK 10.43 per euro to SEK 10.48 per euro. The euro remained virtually stable against the Australian dollar, at AUD 1.62 per euro during the first half of the year.

Compared with the fourth quarter of 2019, inflation in the euro zone dipped by 1.3 percentage points to -0.3 % at the end of the first half of 2020. This was due primarily to lower energy prices and the curbing of economic activity in the wake of the Covid-19 pandemic. The same factors pushed inflation in the US down by 2.4 percentage points to -0.3 % in the first half of the year. The same applies to the UK, where inflation fell by 0.7 percentage points to 0.7 % in the first six months.

Regulatory environment

The environment in which banks are operating continues to be defined by highly dynamic regulatory requirements, as well as by changes in banking supervision. This includes, in particular, the implementation of the final draft of the Basel III framework into EU law (known as "Basel IV"), which was endorsed by the Basel Committee's Group of Governors and Heads of Supervision (GHOS). Furthermore, the EU Commission's revision of supervisory regimes (CRR II, CRD V, BRRD II and SRMR) at EU level as well as the EBA documents (Guidelines on PD and LGD estimation, treatment of defaulted exposures, and determination of downturn LGD), brought about further regulatory changes. The provision put forward by the ECB, EBA and the EU Commission on the treatment of non-performing loans must also be taken into account. With regard to Covid-19, the IASB and relevant regulatory authorities such as the EBA, the ECB and ESMA formulated recommendations for implementation in the processes and for risk quantification, which we have taken into consideration accordingly. In addition, new reporting requirements such as Covid-19 reporting as well as relief measures such as the CRR Quick Fix, in which the date of application for selected topics, such as the SME Supporting Factor, were brought forward. We plan to implement the latter by 30 September 2020.

Moreover, both national and European regulators are imposing various new requirements – including in connection with IT/information security risks, or regarding the prevention of money laundering, tax evasion and terrorist financing. Furthermore, politics and the banking supervision deem it necessary to establish sustainability more strongly with society, and as a regulatory requirement within the economy. As such, the EU's Technical Expert Group on Sustainable Finance published the "Taxonomy Technical Report", and BaFin issued its "Guidance Notice on Dealing with Sustainability Risks" at the end of 2019. The ECB also released its draft Guide on climate-related and environmental risks for consultation, setting out its expectations relating to risk management and disclosures.

The ECB's Supervisory Review and Evaluation Process (SREP) ensures a common approach on the supervisory review of banks, within the framework of Pillar 2. The SREP is built around a business model analysis, an assessment of governance, as well as of the capital and liquidity risks. The re-sults of the individual areas are aggregated in a score value, from which the ECB derives supervisory measures on holding additional capital and/or additional liquidity buffers.

Sector-specific and business developments

Structured Property Financing segment

The Covid-19 pandemic also had an impact on the commercial property markets in the first half of the year. Transactions were postponed or cancelled as the transaction process was hampered by contact and travel restrictions. This was exacerbated by uncertainty surrounding future economic developments. In this environment, global transaction volumes initially rose in the period leading up to March. By the middle of the year, they were then down by 30% on the previous year, due in particular to declining activity in North America and the Asia/Pacific region. The year-on-year drop in the number of transactions was even more dramatic than the decline in transaction volumes, which was still supported by a number of very large transactions, especially in Europe.

Office properties remained stable in the first six months in spite of the economic uncertainty. They were only affected indirectly by the Covid-19 pandemic, as were logistics properties. In most markets, yields remained on a very low level until mid-2020. On average, rents offered remained more or less stable in Europe, the US and Australia.

By contrast, the first half of 2020 saw an average increase of 50 basis points in investment yields[1) on retail properties in certain sub-markets. While rents offered fell by a low single-digit percentage in Europe, the Asia-Pacific region and the US on average, the markets also proved stable depending on the sub-category of retail property. The lockdown led to a considerable decline in sales, especially amongst consumer goods retailers, allowing for rent payments – supported by government moratoria – to be suspended temporarily in some markets.

Hotel properties were directly affected by the Covid-19 pandemic in the first half of the year. Many hotels around the world stayed closed completely from mid-March onwards, and in China as early on as in the course of January, due to regulations imposed by the authorities. On average, occupancy rates per available room fell accordingly to a low double-digit percentage in the first half-year, meaning that hotels were unable to generate sufficient revenues per available room to cover their costs. While the regulations imposed by the authorities were eased in a large number of markets from June onwards, the recovery remained muted by the mid-point of the year. Average occupancy rates in the first half of the year, for example, were down by around 47% in Europe, 33% in the US and 44% in the Asia/Pacific region in a year-on-year comparison. Average revenues per available room were 52% lower in Europe, 42% lower in the US and 52% lower in the Asia/Pacific region than the revenues achieved a year earlier.

In spite of the Covid-19 pandemic, market participants remained willing to provide financing in the first half of the year. There were only partial restrictions, for example for retail properties in peripheral locations. As a result, and with a smaller

[1)] Rising yields tend to come hand-in-hand with falling property values and vice versa.

number of transactions, competition for commercial property financing remained intense. Margins initially remained stable. As the Covid-19 crisis intensified and uncertainty on the financial markets started to mount, refinancing costs rose, taking customer margins along with them. When the situation started to ease later on in the first half of the year, however, the trend reversed and both refinancing costs and client margins started to drop back again, albeit not quite to their pre-crisis levels. The loan-to-value ratios for new business remained stable.

In an environment overshadowed by the Covid-19 pandemic, Aareal Bank generated new business of € 2.7 billion during the first half of the year (H1 2019: € 3.2 billion). After a good first quarter, newly-originated loans were low in April and May in particular due to the contact and travel restrictions referred to above, decisions to postpone transactions and, as a result, a small number of transactions. The volume of newly-originated loans rose again in June, leading to an overall figure of € 2.1 billion for the first half of the year (H1 2019: € 2.0 billion).

At 57.5 %, the highest proportion of the financing volume was in Europe (H1 2019: 48.9 %), followed by North America, at 38.6 % (H1 2019: 45.0 %). The Asia-Pacific region accounted for a share of 3.9 % in the first six months of the year (H1 2019: 6.1 %).

In terms of property types, office properties dominated new business with 38.1 %, followed by hotel properties with 35.7 % and logistics properties with a share of 13.4 %. Retail properties accounted for an 8.6 % share, residential properties for 3.9 %, while other types of property accounted for 0.3 % of aggregate new business volume.

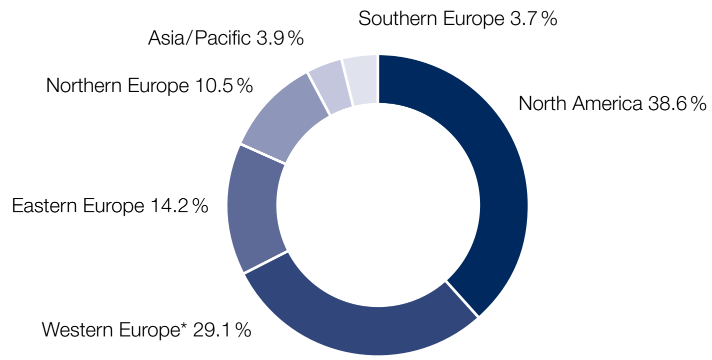
Europe

The volume of market transactions in Europe dipped by around 20 % year-on-year in the first half of 2020. This drop was less pronounced than in other regions, in particular due to a number of large-scale transactions. The decline was more pronounced when looking at the number of transactions, due in particular to fewer cases concerning low-volume deals. Cross-border and institutional investors were mainly on the buyer's side, while REITs were more likely to be selling.

The development in office and logistics rents for top-class properties stagnated in the first half of 2020. By contrast, rents for retail properties were on a downward trajectory. The trend towards lower rents was accelerated by the Covid-19 pandemic. The uncertain economic climate left its mark on investment yields. Yields on top-class properties in the office and logistics sectors remained largely stable, rising by a few basis points in some markets, such as Poland or the Netherlands. Yields on prime retail properties, on the other hand, rose by between 25 and 75 basis points, also as a result of government Covid-19 measures. In addition, yield spreads between prime and secondary properties widened as the year progressed.

From mid-March onwards, the official regulations put in place to combat the Covid-19 pandemic led to the complete closure of almost all hotels, with a corresponding impact on revenues. In many markets, the restrictions were not eased until June, meaning that the recovery remained muted at the end of the first half.

New business[1] 1 January – 30 June 2020
by region (%)
Total volume: € 2.7bn



* Including Germany
[1] New business, excluding private client business and local authority lending business of former WestImmo

In Europe, the Bank originated new business of € 1.6 billion (H1 2019: € 1.6 billion). Most of this business was done in Western Europe, followed by Northern and Eastern Europe. The Bank only originated a small amount of new business in Southern Europe.

North America

In North America, transaction volumes in the first half of 2020 were down by around 25 % year-on-year following an increase in the first quarter. The consequences of the Covid-19 pandemic were still being clearly felt at the end of the first half of the year. The number of properties changing hands was very small in the retail and hotel segments in particular. Cross-border and institutional investors were on the buy side for the most part, whilst REIT structures and private investors – who had been mostly buyers in the previous year – tended to be sellers.

Rents for first-class offices in US metropolitan areas remained virtually stable in the first half of the year, consolidating the slowdown in the rental market. Developments did, however, vary from market to market. While markets in the technology-focused regions and the Sun Belt painted a more positive picture, the trend in energy-heavy markets was less rosy. The development in rents for prime retail properties varied depending on the property sub-type. Shopping malls, which were already under high competitive pressure before the pandemic hit, reported a further drop in rents up to the end of the first half, although this trend was also influenced by the Covid-19 pandemic. Local suppliers and retailers stocking everyday consumer goods, on the other hand, proved to be robust.

Yields for first-class offices in the US managed to escape the pandemic unscathed in the first half of the year and were unchanged as against the start of the year thanks to high levels of liquidity and readiness to provide financing. Yields on retail properties were stable compared with the beginning of the year, although the calculation was only based on a small number of transactions: these observations thus also tended to reflect top-class properties.

In North America, too, official restrictions led to the closure of almost all hotels from mid-March onwards, with only a slow trend towards subsequent relaxations. Although improvements in occupancy rates and average revenue per available room were starting to emerge at the mid-point of the year, an increase in the number of new Covid-19 infections once again put a damper on the trend towards the end of June.

In North America, the Bank originated new business of € 1.0 billion (H1 2019: € 1.4 billion), almost all of which was attributable to the US.

Asia/Pacific

Transaction volumes for commercial property in the Asia/Pacific region were only about half as high as in the same period of the previous year, owing to the Covid-19 pandemic. Fewer retail and hotel properties, in particular, changed hands in Asia/Pacific, too. Investor positions were similar to the previous year, with cross-border and institutional investors tending to be on the buyer's side, while REIT structures and private investors were more likely to be the sellers.

The development of prime office rents stagnated in the first half of 2020 in Australia, China and Singapore. Rents for logistics properties rose in Beijing and Shanghai, while they remained stable in Australia. By contrast, rents for retail properties were on a downward trajectory.

With low transaction volumes, yields on first-class properties were stable.

As the place where the pandemic emerged, hotels in Asia, and particularly in China, were affected by containment measures, leading to almost complete closures, early on in the year. This also meant, however, that relaxation measures were taken earlier than in other regions. While occupancy rates in China showed a rising trend thanks to domestic demand, they were still down noticeably year-on-year.

The Bank originated new business of € 0.1 billion in the Asia/Pacific region in the first half of 2020 (H1 2019: € 0.2 billion).

Consulting/Services Bank segment

The residential and commercial property sectors are proving to be stable market segments, even in light of the Covid-19 pandemic. In general, steady rental income generated from a high occupancy status continues to guarantee a secure foundation. New-build rents once again rose by 3 % at the beginning of the year, compared with the beginning of 2019.

Despite individual rent deferrals, no significant decline in rental income has been witnessed on the housing market so far. It is currently impossible to predict how serious the impact will be and a lot will depend on how the Covid-19 pandemic unfolds. Even before the pandemic hit, there were signs that the current housing market cycle was coming to an end: although the number of construction permits for apartments increased by 4 % year-on-year in the first quarter of 2020 to 78,600 units, 293,000 new apartments were also completed. While this is not sufficient to eradicate the existing construction backlog (approved non-completed new residential buildings), which has amounted to a good 770,000 apartments since 2008, the annual additional demand is largely covered – also due to what is now lower immigration of only around 200,000 people a year. As many of those searching for accommodation turn to the outskirts of Germany's urban centres and to alternative cities, the pressure on Class A locations is becoming less intense. As a result, the current level of housing completions matches demand.

The current 2020 financial year saw the Consulting/Services Bank segment strengthen its market position again via the acquisition of new clients. We also consistently intensified the cross-sector collaboration with our clients from the energy and waste disposal industry. This is accomplished especially through interface products such as BK01 eConnect and BK01 immoconnect, which extend across sectors and can be linked to housing industry products, such as the BK01 Invoice Data Processing, in order to facilitate for example accounting documentation and invoicing of energy supplies. This brought in more business partners from the housing industry during the first half of the year – managing just under 110,000 residential units between them – for the payments and deposit-taking businesses.

We once again strengthened our range of property industry services this year and at the same time extended the range of digital solutions for the housing industry and its clients. One example is the planned acquisition of a stake in the start-up objego, a joint venture with ista Deutschland GmbH, which provides software to private landlords with up to 250 units, allowing them to manage their rented apartments in an efficient and straightforward manner. However, this acquisition is still subject to the approval of antitrust authorities.

At present, around 4,000 clients throughout Germany are using our process-optimising products and banking services. The volume of deposits from housing industry clients averaged at around € 10.7 billion in the first half of 2020 (H1 2019: € 10.7 billion). All in all, this reflects the strong trust our clients continue to place in Aareal Bank. Additionally, despite the challenging environment we were able to increase net commission income in the Consulting/Services Bank segment to € 12 million (H1 2019: € 10 million).

Aareon segment

Aareon is a consultancy and IT systems house for the property industry and its partners in Europe. It pursues a profitable growth strategy. Key factors to its success are client orientation, the growth in digital solutions, further strengthening of the ERP systems and exploration of new relevant markets and related sectors associated with the property industry. In the course of Aareon's forward-looking orientation and further intensification of research and development, a strategic investment programme focusing on digital solutions is being implemented. Aareon's sustainable business model paid off during the first half of the year, as it could be flexibly adopted to changed conditions even in challenging circumstances.

Aareon provided its clients – including Aareal Bank – with strong and reliable IT infrastructure and applications. For instance, this enabled virtually all employees of Aareal Bank Group to work from home and thus to fully maintain business operations.

Furthermore, Aareon provided special products and services to its clients throughout the crisis, as well as numerous webinars, to enable clients to continue their business operations in a digital manner. Companies with a higher degree of digitalisation were already at an advantage during the crisis. Client events were conducted successfully online, to the extent possible, while larger events, such as the German Aareon Congress in particular, one of the top events in the industry, were cancelled. Despite the Covid-19 pandemic, sales revenue including CalCon Group increased to € 126 million (H1 2019: € 122 million). Adjusted EBITDA[1] amounted to only € 26 million due to the Covid-19 pandemic (H1 2019: € 29 million). The decline was due to a lower level of consultancy business and a reduced number of contracts concluded. Revenue growth for digital solutions amounted to 27 % compared to the previous year. This significant increase was due, among other things, to the takeover of CalCon Group on 1 January. The high share of recurring revenues thus underlines the importance of the digital orientation of the business model.

Additional clients were acquired for the Wodis Sigma ERP solution in the DACH region (Germany, Austria and Switzerland). As expected, the favoured version is the one that uses Wodis Sigma as a service from the exclusive Aareon Cloud. Migration projects are being continued digitally during the Covid-19 pandemic. The last migration projects from GES to other ERP solutions were concluded successfully on 1 July 2020. GES operations will be discontinued in Aareon's IT centre on 31 December 2020. The business volumes conducted with Wodis Sigma as well as with SAP® solutions and Blue Eagle are more or less on a par with the prior-year level. On the other hand, due to the Covid-19 pandemic, consulting revenue was down slightly in a year-on-year comparison despite increased demand for "green consulting" – a digital consulting service – during the Covid-19 pandemic in particular. The lockdown period was used to conduct additional internal product trainings for digital solutions in order to be able to meet the expected future increase in demand.

Additional commercial property clients were acquired for the RELion ERP solution, resulting in higher licence and consulting revenue. The positive trend in the outsourcing business continued unabated. BauSecura's insurance business has been running slightly above the previous year's level.

In the Netherlands, marketing of the new ERP product generation Tobias 365 based on Microsoft® Dynamics® 365 continued. The first few clients have opted for this new solution and a pilot client has already gone live. The distribution of the Dutch REMS ERP solution for the commercial property business was in line with the previous year. REMS has been rolled out into production for a major new client as scheduled. Prompted by the Covid-19 pandemic, Aareon France published a white paper to support its clients and market relevant products. Upcoming mergers of housing companies will have a positive impact on the ERP business in France. A major French client has opted for a Platinum contract, and further contracts were concluded in the UK. Sales activities were successfully stepped up in the Nordic countries, allowing the company to attract new clients.

Digitalisation is becoming increasingly important for the property industry. The Covid-19 acted as a catalyst in this respect. With its Aareon Smart World digital ecosystem, Aareon offers integrated solutions for automating the business processes and networking business partners and market participants. The digital transformation process for customers is therefore focused on creating added value. Aareon continues to steadily expand this offer, and benefits from the transfer of international know-how in research and development, as well as from the exchange with the proptech and start-up scene. The rollout of the Aareon Smart Platform, launched

[1] "Earnings before interest, taxes, depreciation and amortisation" excluding strategic investments and non-recurring effects

on the market during the fourth quarter of 2019, continued. In the second quarter of 2020, Aareon announced, and started marketing, the AI-based virtual assistant Neela in Germany. Neela is set to make maintaining relationships with tenants more convenient and will help to further simplify processes between housing companies, tenants and tradesmen. Additional clients from the German utilities market have opted for the Aareon Occupant Change Management solution. In the Netherlands, Aareon Nederland launched an app for digital apartment handovers, an area that is attracting keen interest among clients. As far as strategic investments are concerned, two potential development partners are being considered – in addition to Aareon Smart Platform and Neela (virtual assistant) – in two cases. The OFI Group, as the first venture of the Ampolon Ventures subsidiary, successfully completed its first transaction. Moreover, Aareon was appointed a partner in the "ForeSight" project during the second quarter: supported by the German Federal Ministry for Economic Affairs and Energy ("BMWi"), the goal of this research and development project is to establish a platform for context-sensitive, intelligent and forward-looking smart-living services.

In November 2019, Aareon had signed the contract to acquire CalCon Group with effect from 1 January 2020. The project for the integration of CalCon Group and its solutions into Aareon Smart World (epiqr for structural condition assessment and the new AIBATROS product generation) was connected to Aaeron Smart World in the course of an integration project.

With a view to potential inorganic growth, Aareon's management conducted a comprehensive screening process looking at potential acquisition targets and identified opportunities that are now being pursued systematically.

Financial Position and Financial Performance

Financial performance

Group

Consolidated operating profit for the first half of 2020 came to € 13 million (H1 2019: € 122 million).

Consolidated net income of Aareal Bank Group

€ mn	1 Jan-30 Jun 2020	1 Jan-30 Jun 2019
Net interest income	245	269
Loss allowance	106	28
Net commission income	111	110
Net derecognition gain or loss	16	27
Net gain or loss from financial instruments (fvpl)	-7	0
Net gain or loss from hedge accounting	2	-1
Net gain or loss from investments accounted for using the equity method	0	0
Administrative expenses	238	256
Net other operating income/expenses	-10	1
Operating profit	**13**	**122**
Income taxes	-3	41
Consolidated net income	**16**	**81**
Consolidated net income attributable to non-controlling interests	1	1
Consolidated net income attributable to shareholders of Aareal Bank AG	15	80

Net interest income of € 245 million was down on the previous year (€ 269 million), mainly due to a year-on-year decline in the loan and securities portfolios. This was attributable to the previous year's accelerated de-risking involving defaulted loans, a larger exposure to a single borrower and securities in Italy, as well as to lower new business, on account of Covid-19.

Loss allowance of € 106 million (H1 2019: € 28 million) was recognised, largely due to the adverse economic effects related to the Covid-19 pandemic. For this purpose, we have taken the economic forecasts of our "swoosh" scenario into account, which further deteriorated slightly (or were specified in more detail) since the first quarter of 2020. The scenario assumes a continued normalisation of global economic activity commencing from mid-2020, with a marked acceleration of the recovery during 2021 and 2022. Whilst economic recovery will progress at a slower pace than the decline observed, the economy will almost completely return to the starting level by the end of 2022. Essentially, our internal "swoosh" scenario is based on the baseline scenario published by Oxford Economics in June 2020, which is generally in line with the ECB forecast also published in June 2020. The ECB's projections – which are focused on the euro zone – can only be used as an indication or a benchmark for our internationally oriented portfolio. Besides the expected development of the macro-economic environment – as outlined above – the scenario is based on the assumption of interest rates remaining low over the long-term, which had (or should have) a stabilising or positive impact on asset prices in the past, as well as on our expectations for the coming years.

In addition to one newly-defaulted loan during the first quarter and assumptions of extended realisation periods for defaulted financings, the impact of the Covid-19 pandemic also had a specific impact upon determining loss allowance in the second quarter. The general approach to determining loss allowance has not changed (refer to the chapter on Loss allowance within the Accounting policies section of the consolidated financial statements 2019, and to Note 22 of the consolidated interim financial statements for the first half of 2020). The specific features are outlined below:

For non-defaulted loans (Stage 1 and 2), loss allowance for numerous financings directly affected (mainly concerning hotels or retail properties) was determined by updating individual ratings, together with an associated increase in PD if appropriate. When considering the impact of Covid-19 effects on ratings, we have taken the recommendations made by the IASB, and by relevant regulatory authorities such as the EBA, the ECB and ESMA, into consideration. Concerning the scenario analyses to be taken into account when determining individual LGDs, we applied an updated scenario mix, in line with the customary process. This probability-weighted scenario mix reflects the uncertainties as to how the Covid-19 pandemic will develop further and supplements our baseline scenario (swoosh) with the addition of divergent developments over an observation period of three years. Three out of a total of five scenarios reflect less favourable economic development than the baseline scenario.

In order to assess further potential loan losses in the future, which the Bank believes are not adequately reflected in forward-looking information in all individual cases, owing to the current situation, the Bank decided to implement a management overlay. The purpose of this is to also take into account the considerable uncertainties the Covid-19 pandemic could have on developments, and its impact on borrowers, as well as regulatory requirements. The Bank has simulated expected changes to the cash flows of financed properties and the resulting development of property values over a period of three years, in line with our "swoosh" scenario, for the entire portfolio, forecasting their impact upon the measurement parameters PD and LGD. Any additional loss allowance arising from this was taken into consideration in the form of a management overlay. We refer to Note 22 of the consolidated interim financial statements for the first half of 2020 for the underlying macro-economic factors. Based on simulations, the management overlay also accounts for a potential transfer to Stage 2: if the simulation indicates a rating deterioration beyond the threshold for a significant increase in credit risk, the exposure is allocated to Stage 2. Any excess of LTV beyond 90 % was assumed as an additional qualitative criterion for a stage transfer. Overall, the deterioration in economic forecasts will lead to an expected increase of around 50% in the probability of default in the commercial property finance portfolio, and to a net change of around 60 % in the loss allowance in Stage 1 and Stage 2, relative to the level of loss allowance as at the 2019 year-end.

Where defaulted financings (Stage 3) were concerned, due to the impact of Covid-19, it was not always possible to obtain new appraisals where there were indications for a fluctuation in value. Specifically, retail properties were closed well into the second quarter – with hotels being closed beyond this period in some cases. A review of the value of these properties was conducted internally by the Bank. The outcome of this review was included in the valuation scenarios] and taken into account in the calculation of loss allowance, in the form of an additional management overlay. We applied this approach analogously to defaulted property loans whose measurement losses are reflected in net gain or loss from financial instruments (fvpl), due to failure to meet the SPPI criterion.

Furthermore, in spite of the adverse circumstances caused by the lockdown in Italy, we managed to successfully continue our accelerated de-risking exercise, selling two defaulted loan exposures totalling € 141 million in July 2020 in this connection. The related charge of € 9 million was already absorbed in loss allowance for the second quarter.

Net commission income amounted to € 111 million (H1 2019: € 110 million).

The net derecognition gain of € 16 million (H1 2019: € 27 million) was attributable to market-driven effects from early loan repayments, and to repurchases in the Treasury business, as part of market support measures. The higher figure for the previous year reflected structural adjustments to our securities portfolio following the acquisition of former Düsseldorfer Hypothekenbank AG (Düsselhyp).

The net loss from financial instruments (fvpl) and from hedge accounting totalled € -5 million (H1 2019: net loss of € -1 million), largely reflecting the above-described credit-risk induced measurement losses of defaulted property loans which are reflected in net gain or loss from financial instruments (fvpl), due to failure to meet the SPPI criterion.

In spite of rising expenses in connection with Aareon's growth, administrative expenses declined to € 238 million (H1 2019: € 256 million), also due to cost savings incurred in connection with the Covid-19 crisis. The previous year's figure still included running costs and integration expenses incurred in conjunction with the integration of Düsselhyp.

Net other operating income/expenses of € -10 million (H1 2019: € 1 million) was burdened by the impairment of a property held by the Bank, which was based on an internal valuation review, taking our Covid-19 scenario into account.

Overall, this resulted in consolidated operating profit of € 13 million (H1 2019: € 122 million). Taking into consideration tax income of € 3 million (income taxes were positively influenced by the capitalisation of deferred taxes from unused loss carryforwards) and non-controlling interest income of € 1 million, consolidated net income attributable to shareholders of Aareal Bank AG amounted to € 15 million (H1 2019: € 80 million) Incorporating the pro-rata accrual of net interest payable on the AT1 bond, consolidated net income allocated to ordinary shareholders stood at € 7 million (H1 2019: € 72 million). Earnings per ordinary share amounted to € 0.11 (2018: € 1.20) and return on equity (RoE) before taxes stood at 0.0 % (2018: 8.8 %).

Structured Property Financing segment

Operating profit in the Structured Property Financing segment amounted to € 6 million in the first half of 2020 (H1 2019: € 139 million).

Net interest income of € 226 million was down on the previous year (€ 276 million), mainly due to a year-on-year decline in the loan and securities portfolios. This was attributable to the previous year's accelerated de-risking involving defaulted

Structured Property Financing segment result

€ mn	1 Jan - 30 Jun 2020	1 Jan - 30 Jun 2019
Net interest income	226	276
Loss allowance	106	28
Net commission income	3	4
Net derecognition gain or loss	16	27
Net gain or loss from financial instruments (fvpl)	-7	0
Net gain or loss from hedge accounting	2	-1
Administrative expenses	117	140
Net other operating income/expenses	-11	1
Operating profit	**6**	**139**
Income taxes	-5	47
Segment result	**11**	**92**

loans, a larger exposure to a single borrower and securities in Italy, as well as to lower new business, on account of Covid-19. The adjusted transfer pricing and the increased interest rate on residual deposits of the Consulting/Services Bank segment from 1 January onwards led to a decline (see Note 26 of the consolidated interim financial statements for the first half of 2020).

Loss allowance of € 106 million (H1 2019: € 28 million) was recognised, largely due to the adverse economic effects related to the Covid-19 pandemic. Please refer to the section on the Group's financial performance in the Group Management Report regarding calculation details.

The net derecognition gain of € 16 million (H1 2019: € 27 million) was attributable to market-driven effects from early loan repayments, and to repurchases in the Treasury business, as part of market support. The higher figure for the previous year reflected structural adjustments to our securities portfolio following the acquisition of former Düsseldorfer Hypothekenbank AG (Düsselhyp).

The net loss from financial instruments (fvpl) and from hedge accounting totalled € -5 million (H1 2019: net loss of € -1 million), largely reflecting credit-risk induced measurement losses of defaulted property loans which are reflected in net gain or loss from financial instruments (fvpl), due to failure to meet the SPPI criterion.

The decline in administrative expenses, to € 117 million (H1 2019: € 140 million), was due to cost savings in connection with the Covid-19 crisis. The previous year's figure still included running costs and integration expenses incurred in conjunction with the integration of Düsselhyp.

Net other operating income/expenses of € -11 million (H1 2019: € 1 million) was burdened by the impairment of a property held by the Bank, which was based on an internal valuation review, taking our Covid-19 scenario into account.

Overall, operating profit for the Structured Property Financing segment was € 6 million (H1 2019: € 139 million). Taking into consideration income taxes of € -5 million (H1 2019: € 47 million), which were positively impacted by the capitalisation of deferred taxes from unused loss carryforwards, the segment result for the first half of the year amounted to € 11 million (H1 2019: € 92 million).

Consulting/Services Bank segment

The € 20 million year-on-year improvement in net interest income for the Consulting/Services Bank segment was due primarily to adjusted transfer pricing and the increased interest rate on residual deposits from 1 January 2020 onwards (see Note 26 of the consolidated interim financial statements for the first half of 2020). Net interest income continues to be burdened by the negative margin from the deposit-taking business due to the persistently low level of interest rates.

Net commission income of € 12 million showed positive development (H1 2019: € 10 million).

Administrative expenses fell slightly to € 35 million (H1 2019: € 37 million).

Overall, segment operating profit for the first half of 2020 was € -3 million (H1 2019: € -34 million). Taking income taxes into consideration, the segment result amounted to € -2 million (H1 2019: € -23 million).

Aareon segment

Net commission income including CalCon Group amounted to € 102 million (H1 2019: € 101 million) and was thus slightly up despite the Covid-19 pandemic.

Administrative expenses rose to € 92 million (H1 2019: € 84 million), due to business expansion (including CalCon Group) and strategic investments.

Overall, segment operating profit for the first half of 2020 was € 10 million (H1 2019: € 17 million). Taking income taxes into consideration, the segment result for the first half of the year amounted to € 7 million (H1 2019: € 12 million).

Consulting/Services Bank segment result

€ mn	1 Jan-30 Jun 2020	1 Jan-30 Jun 2019
Net interest income	20	-6
Net commission income	12	10
Net gain or loss from financial instruments (fvpl)	0	–
Administrative expenses	35	37
Net other operating income/expenses	0	-1
Operating profit	**-3**	**-34**
Income taxes	-1	-11
Segment result	**-2**	**-23**

Aareon segment result

€ mn	1 Jan-30 Jun 2020	1 Jan-30 Jun 2019
Net interest income	-1	-1
Loss allowance	0	0
Net commission income	102	101
Net gain or loss from financial instruments (fvpl)	0	–
Net gain or loss from investments accounted for using the equity method	0	0
Administrative expenses	92	84
Net other operating income/expenses	1	1
Operating profit	**10**	**17**
Income taxes	3	5
Segment result	**7**	**12**

Financial position

Consolidated total assets of Aareal Bank Group increased to € 45.3 billion as at 30 June 2020 (31 December 2019: € 41.1 billion), reflecting the use of targeted longer-term refinancing operations (TLTROs): this led to increases in cash funds and money-market liabilities.

Property financing portfolio

The volume of Aareal Bank Group's property financing portfolio[1] stood at € 25.6 billion as at 30 June 2020, down by approx. 1.2 percentage points from the 2019 year-end level (€ 25.9 billion).

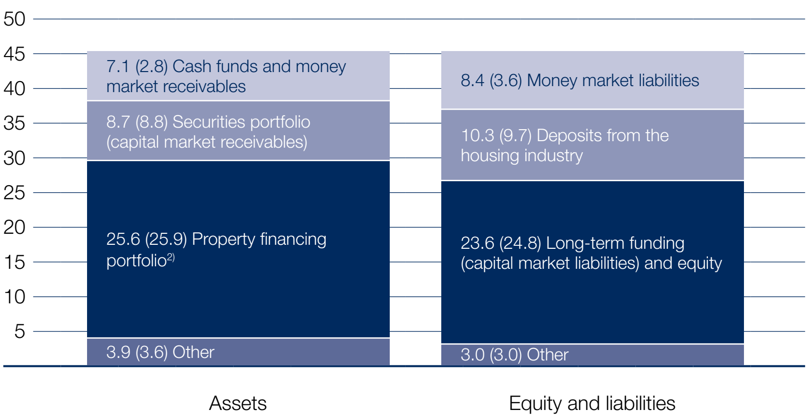
At the reporting date (30 June 2020), Aareal Bank Group's property financing portfolio was composed as shown below, compared to year-end 2019.

Portfolio allocation by region and continent changed only selectively compared to the end of the previous year. Whilst the portfolio share of exposures in North America rose by around 1.5 percentage points, it declined in Western Europe by around 2.6 percentage points, remaining relatively stable for all other regions.

The breakdown of the portfolio by property type did not change significantly during the reporting period. The share of hotel properties increased by around 1 percentage point compared to year-end 2019, whilst the share of residential and retail properties was reduced by approximately 1 percentage point each. The share of office and logistics properties as well as other financings in the overall portfolio remained almost unchanged compared to the year-end 2019.

Balance sheet structure as at 30 June 2020 (31 December 2019)

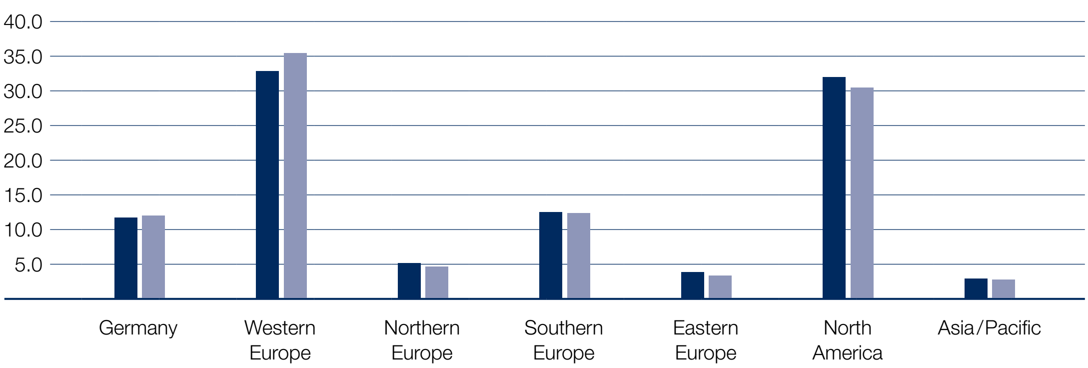
€ bn



[2] Excluding € 0.4 billion in private client business (31 December 2019: € 0.4 billion) and € 0.3 billion in local authority lending business by the former Westdeutsche ImmobilienBank AG (WestImmo) (31 December 2019: € 0.4 billion), and excluding loss allowance

Property financing volume[2] (amounts drawn)

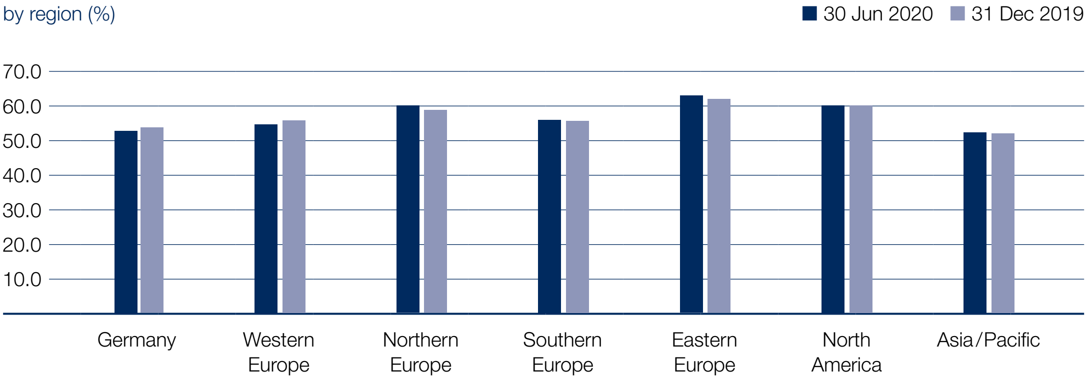
by region (%)



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

Average LTV of property financing[1)]

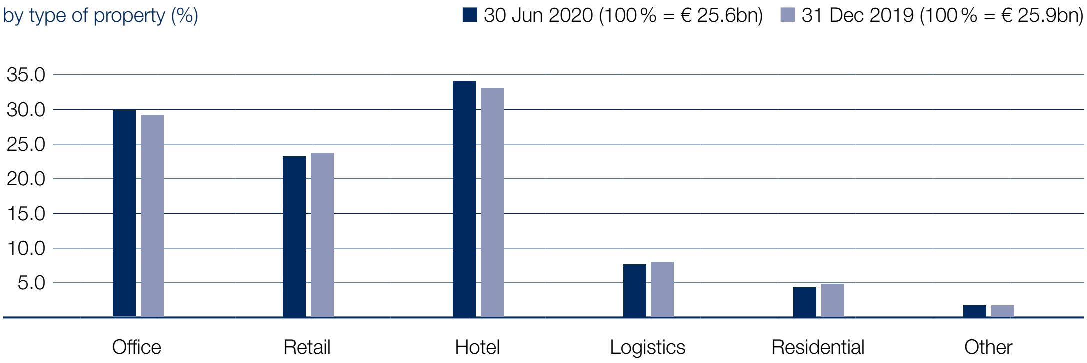
by region (%)



Note that the loan-to-value ratios are calculated on the basis of drawdowns and market values, including supplementary collateral with sustainable value, excluding defaulted property financings. Besides the portfolio changes, this also incorporates changes in value from updated appraisals; due to the impact of Covid-19, however, only a very limited number of such appraisals was available on 30 June 2020 (cf. Note 22 of the consolidated interim financial statements for the first half of 2020). The LtV ratios shown in the chart do not yet incorporate the expected changes in the collateral values of financed properties, as applied within the framework of the management overlay for determining loss allowance.

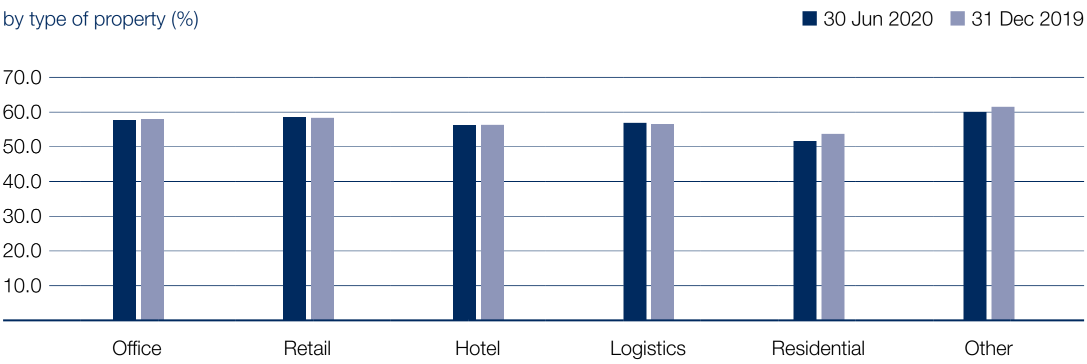
Property financing volume[1)] (amounts drawn)

by type of property (%)



Average LTV of property financing[1)]

by type of property (%)



Note that the loan-to-value ratios are calculated on the basis of drawdowns and market values, including supplementary collateral with sustainable value, excluding defaulted property financings. Besides the portfolio changes, this also incorporates changes in value from updated appraisals; due to the impact of Covid-19, however, only a very limited number of such appraisals was available on 30 June 2020 (cf. Note 22 of the consolidated interim financial statements for the first half of 2020). The LtV ratios shown in the chart do not yet incorporate the expected changes in the collateral values of financed properties, as applied within the framework of the management overlay for determining loss allowance.

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

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

Treasury portfolio

Aareal Bank holds a high-quality treasury portfolio:

Key aspects taken into account for portfolio management are good credit quality and the related value stability, as well as a high degree of liquidity, depending on the intended use.

As at 30 June 2020, the total nominal volume of the Treasury portfolio[1] was € 7.2 billion (31 December 2019: € 7.3 billion).

The portfolio comprises the asset classes public-sector borrowers, covered bonds and bank bonds (financials), with the public-sector asset class accounting for the biggest portion of the portfolio (currently approximately 98 %).

The high creditworthiness requirements are also reflected in the rating breakdown in the portfolio. 99.9 % of the portfolio has an investment grade rating[2], and 81 % of the positions have an AAA to AA- rating.

The portfolio currently comprises almost exclusively (98 %) securities denominated in euros and its average remaining term on the reporting date was 6.6 years.

Financial position

Funding and equity

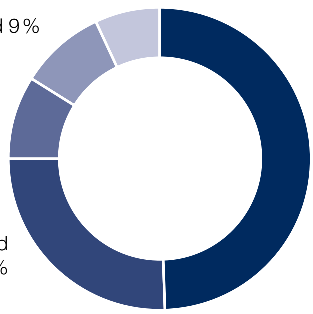
Funding

Aareal Bank Group has remained very solidly funded throughout the first half of the 2020 financial year: Total long-term funding as at 30 June 2020 stood at a nominal amount of € 19.3 billion (31 December 2019: € 20.6 billion), comprising Pfandbrief issues as well as senior unsecured and subordinated issues.

Capital market funding mix as at 30 June 2020

%

Total volume (nominal): € 19.3bn



As at the reporting date, Aareal Bank also had € 10.3 billion at its disposal in deposits generated from the business with the housing industry (31 December 2019: € 9.7 billion). Money market liabilities, including targeted longer-term refinancing operations (TLTROs) of Deutsche Bundesbank, amounted to € 8.4 billion (31 December 2019: € 4.6 billion).

Aareal Bank Group placed € 0.5 billion on the capital market during the first half of 2020, comprising € 0.4 billion senior preferred and € 0.1 billion non-preferred issues. Aareal Bank Group raised € 4.3 billion as part of TLTRO 3.

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

Equity

Aareal Bank Group's total equity as disclosed in the statement of financial position amounted to € 2,847 million as at 30 June 2020 (31 December 2019: € 2,861 million), comprising € 300 million for the Additional Tier 1 (AT 1) bond. Please also refer to the statement of changes in equity, and to our explanations in Note 21 of the consolidated interim financial statements for the first half of 2020.

[1] As at 30 June 2020, the securities portfolio was carried at € 8.7 billion (31 December 2019: € 8.8 billion).
[2] The rating details are based on the composite ratings.

Regulatory indicators[1)2)]

€ mn	30 Jun 2020	31 Dec 2019
Common Equity Tier 1 (CET1)	2,318	2,191
Tier 1 (T1)	2,618	2,491
Total capital (TC)	3,457	3,343
in %		
Common Equity Tier 1 ratio (CET1 ratio)	19.8	19.6
Tier 1 ratio (T1 ratio)	22.4	22.3
Total capital ratio (TC ratio)	29.5	29.9
Common Equity Tier 1 ratio (CET1 ratio) – Basel IV (estimate) –[3)]	14.2	13.5

1) Aareal Bank AG utilises the rules set out in section 2a of the KWG in conjunction with Article 7 of the CRR, pursuant to which regulatory indicators of own funds may only be determined at Group level. In this respect, the following disclosures relate to Aareal Bank Group.
2) 31 December 2019: excluding dividends for 2019 (in line with original proposal for appropriation of profits) and incorporating the pro rata accrual of net interest payable on the AT1 bond
30 June 2020: including dividends for 2019 from the original proposal for the appropriation of profits and including interim profits for 2020, deducting the pro-rata dividend in line with the dividend policy, and incorporating the pro rata accrual of net interest payable on the AT1 bond. The expected relevant impact of the TRIM exercise on commercial property financings, of the SREP recommendations concerning the NPL stock as well as the ECB's NPL guidelines for exposures newly classified as NPLs, were taken into account.
3) Underlying estimate, given a 72.5 % output floor based on the final Basel Committee framework dated 7 December 2017. The calculation of the material impact upon Aareal Bank is subject to the outstanding EU implementation as well as the implementation of additional regulatory requirements (CRR II, EBA requirements etc.).

Analysis of risk-weighted assets (RWA)

€ mn	RWA amounts 30 Jun 2020	Capital requirements 30 Jun 2020	RWA amounts 31 Dec 2019	Capital requirements 31 Dec 2019
Credit risk	**9,554**	**764**	**8,774**	**702**
Credit Risk Standard Approach (CRSA)	531	42	595	48
Of which the advanced IRB (AIRB) approach	8,209	657	7,388	591
Equity under the IRB approach based on the simple risk-weighted approach	815	65	791	63
Counterparty credit risk	**526**	**42**	**486**	**39**
Mark to market	308	25	283	23
Risk exposure amount from contributions to the default fund of a central counterparty	0	0	0	0
Credit Valuation Adjustment	218	17	203	16
Market risk	**34**	**3**	**61**	**5**
Operational risk	**1,236**	**99**	**1,489**	**119**
Basic indicator approach	29	2	44	4
Standard approach	1,207	97	1,445	116
Other receivables (e.g. deferred tax assets)	**352**	**28**	**385**	**31**
Total	**11,702**	**936**	**11,195**	**896**

The regulatory measurement of risk-weighted assets (RWAs) in the area of credit risks is based on both the Advanced Internal Ratings-Based Approach (AIRBA), and on the standardised approach (CRSA).

Risk Report

Aareal Bank Group Risk Management

The Group Management Report 2019 contains a comprehensive description of Aareal Bank Group's risk management approach, including the corresponding organisational structure and workflows in the lending and trading businesses, as well as the methods and procedures used for measuring and monitoring risk exposure. Within the scope of the present Interim Report, we briefly reiterate the key elements of our risk management, also outlining material developments during the period under review. The business policy set by the Management Board, and duly acknowledged by the Supervisory Board, provides the conceptual framework for Aareal Bank Group's risk management. Taking this as a basis, and strictly considering the Bank's risk-bearing capacity, we have formulated detailed strategies for managing the various types of risk. These risk strategies, as well as the Bank's business strategy, are adapted to the changed environment at least once a year, adopted by the Management Board, and duly acknowledged by the Supervisory Board. Appropriate risk management and risk control processes are deployed to implement the risk strategies, and to ascertain the Bank's ability to bear risk. A monthly internal risk report is prepared for all material types of risk, and submitted to the Bank's Management Board and Supervisory Board. The Management has responded to the Covid-19 crisis in a comprehensive manner: the Pandemic Committee established continuously ascertained (IT) operations, including required hygiene and distancing rules. Staffing levels as well as technical equipment have proven to be effective during the crisis, which involved longer hours of working from home. Specific Covid-19 scenarios were developed at an early stage, in order to simulate the potential impact applying different parameters. Reporting frequencies were adjusted as required. The prevailing situation was discussed continuously with all affected stakeholders in the respective bodies. Furthermore, given the changed economic conditions due to the Covid-19 pandemic, we have initiated an event-driven review of our Risk Appetite Framework (including individual risk strategies), which is scheduled to be completed during the third quarter.

Risk-bearing capacity and risk limits

The Bank's ability to carry and sustain risk (as determined within the ICAAP framework) is a core determining factor governing the structure of its risk management system. To ensure its uninterrupted risk-bearing capacity, Aareal Bank Group has adopted a dual management approach comprising two complementary perspectives: the normative and the economic perspective.

The normative perspective aims to ensure Aareal Bank Group's ability to fulfil all of its regulatory requirements over a multi-year period. This perspective thus accounts for all material risks which may impact upon relevant regulatory indicators over the multi-year planning period.

The normative ICAAP perspective is embedded into Aareal Bank Group's planning process, which – in particular – also includes capital planning. Group planning covers three planning years, it comprises both baseline and adverse scenarios. Results of Group planning are shown as a projected consolidated income statement for Aareal Bank Group. Planning also encompasses the balance sheet structure, as well as key regulatory indicators, plus additional internal management indicators.

Besides the planning process itself, intra-year computation adjustments to Aareal Bank Group's planning process also include the ongoing monitoring of management indicators as well as checking whether limits in the normative perspective are being complied with. Management indicators in the normative perspective (which are being monitored, and for which limits have been set) comprise various regulatory ratios.

We are using the ICAAP economic perspective, whose purpose is to safeguard Aareal Bank Group's economic substance and thus, in particular, to protect creditors against economic losses. We predominantly employ proprietary procedures and methods (agreed upon with regulators) in order to identify and quantify potential economic losses, and to determine the required capital backing.

The purpose of internal capital is to serve as a risk-bearing component under the economic perspective. Within Aareal Bank Group, the current regulatory Tier I capital serves as the basis for determining economic aggregate risk cover. Accordingly, available internal capital comprises Common Equity Tier I (CET I) capital, supplemented by Additional Tier I (AT I) capital. Tier 2 capital, as well as projected results to be incurred during the risk analysis horizon, are not taken into account.

Moreover, the value-oriented approach adopted under the economic perspective requires suitable adjustments to be made to regulatory Tier I capital, in order to bring aggregate risk cover into line with the economic assessment. Specifically, this may entail adjustments regarding conservative valuation, or a management buffer.

Aareal Bank Group consistently applies a period of 250 trading days as a risk analysis horizon, as well as for the holding period as part of risk models under the economic perspective. To the extent that risks are measured on the basis of quantitative risk models, a uniform observation period of at least 250 trading days (or at least one year) is applied to the risk parameters used. The appropriateness of model assumptions is verified within the scope of validating the corresponding risk models and parameters.

Looking at correlation effects between material types of risk within the framework of the economic ICAAP perspective, Aareal Bank Group has opted for aggregation of risk levels; accordingly, no risk-mitigating correlation effects are being taken into account. Where we measure risks on the basis of quantitative risk models for the purposes of calculating risk-bearing capacity, these are fundamentally based on a confidence interval of 99.9 %. Please refer to the corresponding subsection for specifics of market price risk.

Limits for specific risk types are determined in such a manner that aggregate limits do not exceed economic aggregate risk cover, less a risk buffer

Risk-bearing capacity of Aareal Bank Group (ICAAP – economic perspective)

€ mn	30 Jun 2020	31 Dec 2019
Tier 1 (T1) capital	2,618	2,491
Economic adjustments	-128	-110
Aggregate risk cover	**2,490**	**2,381**
Utilisation of aggregate risk cover		
Loan loss risks	574	525
Interest rate risk in the banking book (IRRBB)	185	93
Market risks	538	360
Operational risks	102	123
Investment risks	38	30
Property risks	74	60
Business and strategic risks	66	81
Total utilisation	**1,577**	**1,272**
Utilisation (% of aggregate risk cover)	**63 %**	**53 %**

designed to cover risks not explicitly covered by limits (e.g. those risks which cannot be sensibly quantified), and to also absorb other fluctuations of internal capital over time. Individual limits are set on the basis of existing risk exposures and historical levels of potential risks, and to an extent that is in line with the Bank's business and risk strategy. Specific limits have been set in a way that each limit is sufficient for utilisation in line with planned business development, as well as for common market fluctuations.

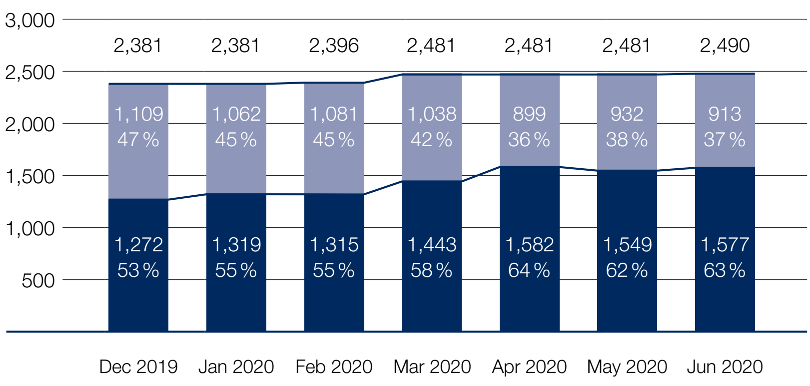
A detailed monthly report provides information regarding the utilisation of individual limits for the material types of risk, as well as on the overall limit utilisation. These are monitored as part of daily reporting. No limit breaches were detected during the period under review. Higher market volatility caused by the Covid-19 pandemic triggered isolated transgressions of early warning thresholds: this indicates that the limit system is adequately calibrated and shows its steering effect, in the sense of being responsive to significant changes in overall conditions. Corresponding countermeasures have been taken; the overall utilisation of risk cover shows that capitalisation is adequate.

Utilisation of risk limits developed during the course of the year as shown in the chart beside.

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

Utilisation of aggregate risk cover

during the course of 2020, € mn



Loan loss risks

Definition

Aareal Bank defines loan loss risk as the risk of losses being incurred due to (i) a deterioration in a business partner's credit quality (migration risk); (ii) a business partner defaulting on contractual obligations; (iii) collateral being impaired; or (iv) 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.

Risk measurement and monitoring

Regulatory requirements are taken into account for the organisation of Aareal Bank's operations and workflows in the credit and trading businesses.

Processes in the credit and trading businesses are designed to consistently respect the clear functional division of Sales units ("Markt") and Credit Management ("Marktfolge"), up to and including senior management level. The independent Risk Controlling division is responsible for identifying, quantifying and monitoring all material risks at portfolio level, and for maintaining a targeted risk reporting system.

Aareal Bank employs different risk classification procedures tailored to the requirements of the respective type of business for the initial, regular, or event-driven assessment of counterparty credit risk. Forward-looking as well as macro-economic information is taken into consideration for risk classification procedures, and in the valuation of collateral. The respective procedures and parameters are subject to permanent review and adjustment. Responsibility for development, quality assurance, and monitoring implementation of procedures, is outside the Sales units.

Against the background of the Covid-19 pandemic, special attention is currently paid to macro-economic forecasts. In the context of this ongoing review, we also rely on projections published by the ECB, apart from those issued by our usual data providers. Yet estimation uncertainties are currently much higher than usual, as the pandemic has provoked a situation unprecedented in recent history. Data and experience are therefore both lacking.

Methods used to measure, control and monitor concentration and diversification effects on a portfolio level include two different credit risk models. Based on these models, the Bank's decision-makers are regularly informed of the performance and risk content of property financing exposures, and of business with financial institutions. The models in question allow the Bank to include in particular, rating changes and correlation effects in the assessment of the risk concentrations.

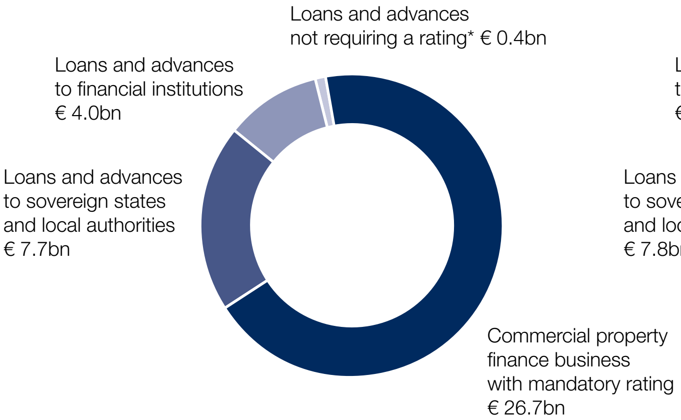
Within the process-oriented monitoring of individual exposures, the Bank uses various tools to monitor exposures on an ongoing basis: besides the tools already described, this includes rating reviews, the monitoring of payment arrears, and the regular, individual analysis of the largest exposures. The intensity of loan coverage is oriented upon the credit risk exposure. Intensified handling triggers recognition of loss allowance, in the amount of lifetime expected credit loss for the financial instrument concerned (Stage 2).

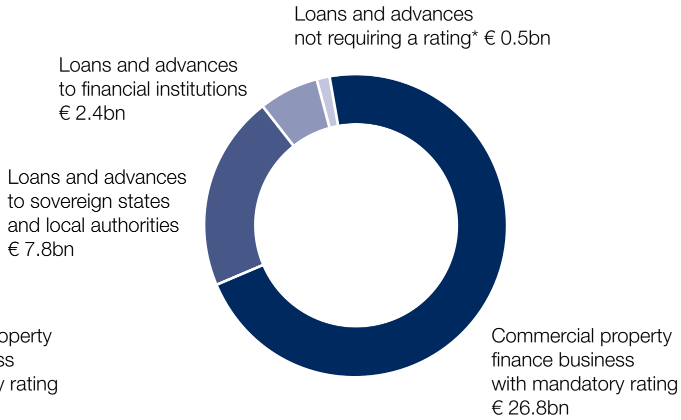
Against the background of the Covid-19 pandemic, Aareal Bank has established contact with national and international property financing clients with mandatory rating, and has amended contractual arrangements to clients' updated business plans, to the extent possible. Given the lock-down, this primarily affected financings of hotels and shopping centres, as well as involving waivers of certain contractual agreements without impact on payments (covenants) affecting lending volume of € 5.8 billion. Our clients and sponsors have provided a significant portion of the required liquidity from their own resources. In addition, funds obtained from government assistance were used and a few clients reduced their exposures. Aareal Bank supported clients by granting forbearance facilities totalling € 76 million as well as liquidity facilities of € 84 million, concerning lending volume of

Breakdown of on-balance sheet and off-balance sheet business (gross carrying amounts)

by rating procedure, € bn

30 Jun 2020 | 31 Dec 2019





* Including the private client business of former WestImmo

€ 5.3 billion. The gross carrying amount of on-balance sheet lending business under government moratoria amounted to € 50 million, whilst the gross carrying amount of on-balance sheet lending business subject to Covid-19-related forbearance measures amounted to € 150 million.

When accounting for these measures, we have taken the recommendations made by the IASB, and by relevant regulatory authorities such as the EBA, the ECB and ESMA, into consideration – with the objective of providing a realistic assessment of expected losses without overstating short-term effects (e.g. from the lock-down). Accordingly, any measures implemented as a result of Covid-19 do not automatically result in a significant credit deterioration or in a default; instead, each individual case is reviewed separately. We have adjusted our processes accordingly. All measures related to Covid-19 were approved by the CRE Credit Risk Committee; they are reported to the Management Board on a regular basis and are closely monitored.

The following tables provide a breakdown of gross carrying amounts of on-balance sheet as well as off-balance sheet credit business, money-market business, and capital markets business, by rating class and loss allowance stages, in line with credit risk management at Group level. Whilst the impact of the Covid-19 pandemic has already led to an increase in Stage 2 loss allowance, this does not yet reflect any anticipated rating changes or stage deteriorations given the management overlay applied to portfolio-based loss allowance. Figures are based on Aareal Bank Group's internal default risk rating classes. The default definition follows the definition pursuant to Article 178 of the CRR, which is decisive for management purposes.

On-balance sheet commercial property finance business with mandatory rating

	30 Jun 2020					31 Dec 2019				
	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
€ mn										
Class 1										
Class 2	62				**62**	62				**62**
Class 3	542				**542**	430			2	**432**
Class 4	1,402			29	**1,431**	1,368				**1,368**
Class 5	3,015			217	**3,232**	3,447			495	**3,942**
Class 6	4,373	19		64	**4,456**	4,300	20		64	**4,384**
Class 7	3,553			262	**3,815**	3,872			75	**3,947**
Class 8	4,948	32		93	**5,073**	6,051	35		209	**6,295**
Class 9	4,179	128		14	**4,321**	2,936			56	**2,992**
Class 10	868	201			**1,069**	860	344			**1,204**
Class 11	282	341			**623**	174				**174**
Class 12	1	76			**77**	1	16			**17**
Class 13							60			**60**
Class 14										
Class 15										
Defaulted			981	130	**1,111**			935	149	**1,084**
Total	23,225	797	981	809	25,812	23,501	475	935	1,050	25,961

[1] fvpl = at fair value through profit and loss (in accordance with IFRSs)

Off-balance sheet commercial property finance business with mandatory rating

	30 Jun 2020					31 Dec 2019				
	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
€ mn										
Classes 1-2										
Class 3						22				**22**
Class 4	47				**47**	25				**25**
Class 5	44			10	**54**	63			17	**80**
Class 6	242				**242**	117				**117**
Class 7	108			24	**132**	141			25	**166**
Class 8	274	4			**278**	271	4			**275**
Class 9	138				**138**	101				**101**
Class 10	27				**27**	34				**34**
Class 11	25				**25**	1				**1**
Classes 12-15										
Defaulted			1		**1**			2		**2**
Total	**905**	**4**	**1**	**34**	**944**	**775**	**4**	**2**	**42**	**823**

[1] fvpl = at fair value through profit and loss (in accordance with IFRSs); commitments for loan portions earmarked for syndication

On-balance sheet loans and advances to financial institutions

	30 Jun 2020					31 Dec 2019				
	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
€ mn										
Class 1	859				**859**	815				**815**
Class 2										
Class 3	174				**174**	172				**172**
Class 4	1,143				**1,143**	82				**82**
Class 5	50				**50**	49				**49**
Class 6										
Class 7	1,329				**1,329**	836				**836**
Class 8	364				**364**	417				**417**
Class 9	36			0	**36**	35				**35**
Class 10	31				**31**	26				**26**
Classes 11-18										
Defaulted										
Total	**3,986**	**–**	**–**	**0**	**3,986**	**2,432**	**–**	**–**	**–**	**2,432**

[1] fvpl = at fair value through profit and loss (in accordance with IFRSs)

On-balance sheet loans and advances to sovereign states and local authorities

	30 Jun 2020					31 Dec 2019				
€ mn	Stage 1	Stage 2	Stage 3	fvpl[1)]	Total	Stage 1	Stage 2	Stage 3	fvpl[1)]	Total
Class 1	2,661				**2,661**	2,505				**2,505**
Class 2	2,826			27	**2,853**	2,680			65	**2,745**
Class 3	618			60	**678**	739			67	**806**
Class 4	51				**51**	100				**100**
Class 5	38				**38**	176				**176**
Class 6	177				**177**	262				**262**
Class 7	153				**153**	189				**189**
Class 8	6				**6**	6				**6**
Class 9	964	119			**1,083**	925	125			**1,050**
Classes 10 - 20										
Defaulted										
Total	**7,494**	**119**	**–**	**87**	**7,700**	**7,582**	**125**	**–**	**132**	**7,839**

[1)] fvpl = at fair value through profit and loss (in accordance with IFRSs)

Monthly reporting covers the material aspects of credit risk; it is supplemented by detailed information – which also fully covers specific credit portfolio developments (broken down by country, property and product type, risk classes, and collateral categories, for example), in line with regulatory requirements – at least on a quarterly basis. Risk concentrations are being taken into account in particular.

Trading activities are restricted to counterparties for whom the requisite limits are in place. 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. Persons holding position responsibility are informed about relevant limits and their current usage, regularly and without delay.

In principle, Aareal Bank pursues a "buy and manage" strategy in managing its credit portfolio – with the primary objective of holding the majority of loans extended on its balance sheet until maturity; at the same time, targeted exit measures (including accelerated de-risking) are deployed for actively managing the portfolio and the risks involved.

In summary, during the period under review, the existing set of tools and methods continued to enable the Bank to adopt suitable risk management or risk mitigation measures, where required, without any undue delay.

Country risks

Our comprehensive approach to risk management also includes measuring and monitoring country risk exposure. When defining country risk, in addition to the risk of sovereign default or default of state entities, Aareal Bank also considers the risk that a counterparty could become unable to meet its payment obligations as a result of government action, despite being willing and able to pay, due to restrictions being imposed on making payments to creditors (transfer risk). Country risk exposure is managed using a cross-divisional process. The respective country limits are determined on the basis of a country risk assessment by the Bank's senior management. The Risk Controlling division is responsible for the continuous monitoring of country limits and limit utilisation, and for periodical reporting.

Interest rate risk in the banking book

Definition

Interest rate risk in the banking book (IRRBB) is defined as the risk exposure of instruments held in the banking book which are sensitive to changes in interest rates, caused by yield curve shifts.

Specifically, for Aareal Bank this includes:

- risks arising from maturity transformation in the event of yield curve shifts (so-called gap risk), which, in turn, are broken down into:
  - risks from cash flows which are sensitive to interest rates, relative to the general yield curve (interest rate risk or repricing risk);
  - risks arising from the valuation of future cash flows, relative to the general yield curve (yield curve risk);
- risks from cash flows which are sensitive to interest rates, in terms of spreads to the general yield curve (basis risk);
- risks from explicit and implied options (option risk);
- risks arising from changing valuation of pension liabilities (pension risk);
- risks from fluctuations in the value of fund assets (fund risk); and
- risks from changes in Aareal Bank's specific funding spreads (funding risk).

Risk measurement and monitoring

Risk Controlling informs the members of the Management Board responsible for Treasury and risk monitoring about the risk position and the exposure to interest rate risk in the banking book on a daily basis.

The VaR concept has been broadly accepted as the predominant method for measuring economic interest rate risk in the banking book. VaR quantifies risk as the maximum loss that will occur within a certain period of time, and given a defined probability.

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 a 250-day historical data pool maintained within the Bank. The loss potential is determined applying a 99.9 % confidence interval under the economic perspective.

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 and deposits at notice which are factored into calculations for a period of up to five years, using the average residual amount of deposits observed in the past. Loans are taken into account using their fixed-interest period (for fixed-rate exposures), or using their expected maturity (variable-rate exposures). Aareal Bank Group's consolidated equity is not taken into account as a risk-mitigating item. This tends to overstate VaR, demonstrating our goal to pursue a conservative approach adopted in our risk measurement processes.

Market risks

Definition

Market risks are broadly defined as the threat of losses due to changes in market parameters; this refers to market risks which are not assigned to the IRRBB. In particular, this also encompasses any type of spread risk exposure of instruments held in the banking book which are sensitive to changes in interest rates, and which are neither included in IRRBB nor in counterparty credit risk. Specifically, for Aareal Bank this includes:

- risks resulting from fluctuations of spot foreign exchange (FX) rates (spot FX risk);
- risks resulting from fluctuations of forward foreign exchange rates (forward FX risk); and
- risks from the regulatory review of the trading book (Financial Risk in the Trading Book – FRTB).

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 CRR. Given that no such trades were concluded during the period under review, trading book risks played a negligible role.

Commodities are irrelevant for the Bank's business. Exchange rate risks are largely eliminated through hedges.

Additional elements of market risk are:

- valuation risks due to changes in credit spreads (credit spread risk);
- specific price risks from the bond portfolio, wherein the bonds are mainly sovereign bonds (sovereign risk); and
- risks from adjustments to the credit valuation of OTC derivatives (CVA risk).

To differentiate spread risks (credit spread risk and sovereign risk) in terms of their credit risk exposure, reported market risk is adjusted accordingly.

Risk measurement and monitoring

Risk Controlling informs the members of the Management Board responsible for Treasury and risk monitoring about the risk position and market risk exposure on a daily basis.

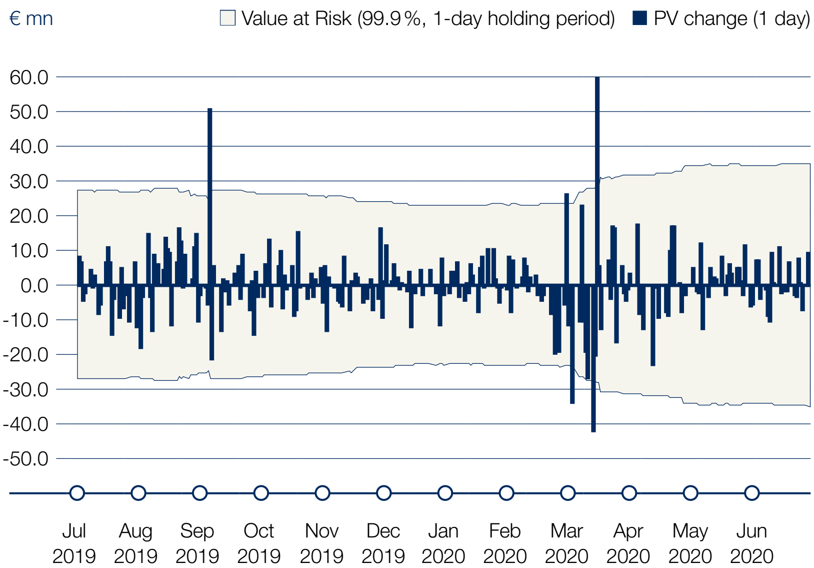
The VaR concept has been broadly accepted as the predominant method for measuring economic market risk. VaR quantifies risk as the maximum loss that will occur within a certain period of time, and given a defined probability.

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 a 250-day historical data pool maintained within the Bank. The loss potential is determined applying a 99.9 %[1] confidence interval;

Backtesting

The quality of forecasts made using statistical models is checked through a monthly backtesting

Present values and 1-day VaR during the course of 2019/2020



[1] Due to the Covid-19-induced exceptional situation on the international financial markets, a 99.5 % confidence interval was temporarily applied within internal risk assessment from May 2020 onwards.

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 interval of 99.9 %, only a small number of events are expected to break out of the VaR projection (≤ 1 for a 250-day period).

The backtesting exercise shown on the page before comprises all risk positions subject to daily changes from the "Market risks" category.

Two negative outliers were observed at Group level during the past 250 trading days, as a result of volatility induced by the coronavirus in March; this does not refute the long-term forecasting quality of the VaR model we use.

Operational risks

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

Aareal Bank's legal department deals with any litigation the Bank is involved in, as well as with any legal issues of fundamental importance.

An analysis on the basis of instruments used has not indicated any disproportionate operational risk exposure for the Bank, nor were any material risk concentrations evident.

Tools to control operational risk are supplemented by a system to manage and monitor outsourced activities and processes (outsourcing).

Investment risks

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

All relevant Group entities are subject to regular audits, including a review and assessment of their risk situation within the framework of risk measurement and monitoring.

Property risks

We define property risk as the threat of unexpected losses arising from changes in the value of property held by the Bank, or by fully-consolidated subsidiaries.

Due to the special character of property risk (involving marketing risks, for example), special methods and procedures are employed to deal with property risk. All relevant property holdings are subject to regular audits, including a review and assessment of their risk situation. The effects of the Covid-19 pandemic required an internal valuation review for some properties – taking our Covid-19 scenario into account – and the estimation of the impact on attainable operating income. This required an impairment to be recognised for a property held by the Bank.

Business and strategic risks

Business and strategic risk is defined as the risk of unexpected losses, usually brought about by a decline in profits due to income falling short of expectations, whereby the shortfall cannot be compensated for by cost reductions. Strategic risk may emerge from changes in the competitive or regulatory environment, or due to unsuitable positioning in the macro-economic environment.

In this context, we distinguish between investment risk and allocation risk, whereby allocation risk is already covered by various planning scenarios, and is thus incorporated in aggregate risk cover.

Liquidity risks

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

Report on Expected Developments and Opportunities

Macro-economic environment

The economic framework is determined by the further course of the Covid-19 pandemic and the associated speed of the measures taken to ease the lockdown, as well as the related recovery phase. This also applies with regard to the significant risks threatening the economy, which closely depend upon the further progress of the pandemic and containment measures taken in this respect. New Covid-19 infections in the US have increased again recently, constituting a threat to the further progress of economic recovery.

Even though other risks – hanging over the global economy, the financial markets and commercial property – have currently taken a back seat somewhat in the public debate, they cannot be ignored. These include price developments on the oil market, trends towards protectionism, doubts as to solidarity within the European project, Brexit (with negotiations between the EU and the UK on the end of the transition period still portraying an uncertain outcome), and other geopolitical risks. Resurgence of the European sovereign debt crisis, for example, due to higher debt levels resulting from the Covid-19 pandemic or because of doubts as to solidarity within the euro zone, also have to be considered a threat. Within this context, the UK's withdrawal from the EU represents a significant economic risk for both the country itself and the EU as a whole. Political uncertainty in Spain also needs to be mentioned in this context. A separation of the Autonomous Community of Catalunya from the Kingdom of Spain might have negative economic consequences, which are as yet difficult to assess. Spain and Italy pose another risk with their high number of Covid-19 infections. Although the EU's rescue package announced in July is aimed in particular at supporting these countries, there is still a risk that the measures will not be quite enough to stem the negative consequences.

A backlog of reforms and structural economic issues in certain countries across the euro zone, geopolitical risks (such as armed conflicts and terrorism) as well as the sharp rise in global debt constitute further uncertainty, risk, and burdening factors.

Relating to macro-economic development, these factors are also significant for the financial and capital markets, and could trigger further disruption on these markets if they were to materialise to a considerable extent. Volatility on these markets is thus set to remain noticeable going forward.

In the US, the Bank sees potential for increased political uncertainty as a result of the aforementioned risks and burdens. In addition, this year's presidential elections will exacerbate the risk in an environment characterised by the aforementioned stress factors.

There are several risks for commercial property resulting from the Covid-19 pandemic: Bans on contact, travel restrictions and business closures of a temporary nature to begin with are likely to have a marked negative impact on cash flows in the second half of the year too, particularly for hotel and retail properties. They are exposed to the risk of continuing constraints and the resulting followon risks, which might reduce cash flows over the longer term. Furthermore, the Bank cannot exclude that the pandemic's economic impact will have a negative effect upon property values.

The Bank expects competition in the commercial property financing markets to remain intense. We draw this conclusion from the fact that we expect lower transaction volumes compared to the previous year. While loan-to-value ratios for new business look set to remain virtually stable, changes in the market environment could put direct pressure on margins, or result in higher loan-to-value ratios.

Economy

Given the events surrounding the Covid-19 pandemic, we currently expect to see a significant drop in global economic output this year. The recovery will vary from country to country and continues to rely heavily on how quickly curfews and contact restrictions are lifted and in what form private consumption can bounce back. The risk lies, in particular, in a much longer lockdown period in the various countries and in the length of the economic recovery phase. Furthermore, rising new infections in many countries around the world pose a risk, as potential, albeit only regional lockdowns cannot be ruled out in response to a second wave with increased numbers of Covid-19 infections.

In the euro zone, too, real gross domestic product is expected to slump noticeably compared with the previous year. France, Italy and Spain are likely to be the countries most affected due to the severity and length of the pandemic and the related containment measures. It is fair to anticipate an economic recovery during the second half of the year, given that a relaxation of restrictions can be expected. However, since this recovery will not fully offset the preceding decline, the recovery can reasonably be expected to extend well beyond the year-end – a development which is likely to be observed in other EU countries as well.

The development of the UK economy will depend on whether an agreement will have been reached on future relations between the EU and the UK when the transition period ends at the close of the year. The UK has ruled out any extension of the transition period. The resulting uncertainty is likely to put additional pressure on the economy this year over and above the pandemic.

A deep recession is also expected for the US this year, with a slow economic recovery commencing from the start of the second half of the year. Given that new Covid-19 infections have increased again towards the middle of the year, we see an increased risk that economic recovery in the US might turn out to be weaker than expected.

Financial and capital markets, monetary policy and inflation

The economy, the financial and capital markets and the commercial property markets are exposed to significant uncertainty factors, risks and threats. In particular, this includes political and economic uncertainty triggered by the Covid-19 pandemic.

The risks and uncertainties referred to above are also significant for the financial and capital markets and could continue to create considerable disruption. Given the prevailing conditions, volatility is expected to be higher than it was in the previous year overall.

Due to the uncertainty, especially regarding the impact of the Covid-19 pandemic on the economy, we expect to see extremely expansionary monetary and fiscal policy measures and continued low interest rates in 2020. However, the persistent low interest rate environment might impair the effect of central banks' traditional policy.

Weakness in economic demand is likely to push inflation to very low levels – possibly towards deflationary trends.

Regulatory environment

The Covid-19 pandemic impacted on the regulatory environment as well. Various regulatory initiatives were deferred and temporary relief resolved for financial institutions. Nonetheless, the trend towards a tighter regulatory framework in the banking business is set to persist in the years ahead, too. For instance, the finalisation of the Basel III framework, adopted by the Basel Committee's Group of Governors and Heads of Supervision (GHOS), will bring about extensive changes to the approaches used for determining risk-weighted capital requirements (a concept known as "Basel IV"). In the course of the Covid-19 pandemic, the Basel Committee has deferred the date of application to 1 January 2023. A second consultation on implementing Basel IV at a European level, taking into account the experience gathered from the Covid-19 pandemic, is anticipated and likely to start at the end of 2020.

The EBA guidelines on granting and monitoring loans will place further demands on the banks' internal governance (incl. in risk culture and strategy) and on the credit processes (incl. documentation, credit rating review) as well as the monitoring framework (e.g. monitoring the credit terms).

The requirements are supplemented at a European level by another MaRisk amendment at national level, which is due to come into force in 2021.

Furthermore, supervisory authorities are increasingly focusing on the topic of sustainable finance – not least due to BaFin's Guidance Notice on Dealing with Sustainability Risks. The ECB has also released its draft Guide on climate-related and environmental risks for consultation.

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

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

Sector-specific and business developments

Structured Property Financing segment

Demand for commercial properties will vary in the second half of 2020, depending on the region and property type. This is an area in which developments surrounding the Covid-19 pandemic and the form of economic recovery will be decisive, especially given that some regions and types of property were more severely affected by the pandemic than others.

Moreover, other uncertainty factors and risks in the macro-economic environment are also relevant for commercial property markets.

It is expected that various factors will have an impact on how commercial property values develop this year. While historically low interest rates support property values, political uncertainty, economic downturns or a reluctance among investors to invest can have an adverse impact on property values. Whilst we expect market values of office and logistics properties to remain stable this year, market values of retail and hotel properties are likely to see a negative development in most markets – depending upon the economic impact of the Covid-19 pandemic. The cash flows of hotels and retail properties are particularly dependent upon potential new lockdown measures, and on the type of recovery. There is considerable uncertainty as to how long such restrictions will remain in place and how the subsequent recovery phase will develop, especially given the increase in new Covid-19 infections in many places in July.

Intense competition in commercial property finance – as seen in recent years – is likely to persist in numerous markets during the second half of the year. Loan-to-value ratios are expected to be more or less stable.

As a matter of principle, it is worth noting that estimation uncertainty – concerning the economy, markets, and the impact upon Aareal Bank – is currently much higher than usual, as the pandemic has provoked a situation unprecedented in recent history. Data and experience are therefore both lacking.

In the Structured Property Financing segment, we are endeavouring to originate new business during the 2020 financial year to an extent that Aareal Bank Group's property financing portfolio will range in size between € 26 billion and € 28 billion, subject to exchange rate fluctuations. To manage our portfolio and risk exposure, we also use syndications.

Consulting/Services Bank segment

The German housing and commercial property industries are expected to continue showing solid development in 2020, in spite of the Covid-19 pandemic. We expect property values to be very stable and rental income to remain largely steady. On average, rental income is likely to stagnate during the second half of the year, following a long phase of growth – also against the background of the Covid-19 pandemic. Further rent deferrals or defaults due to rising unemployment are also to be expected, especially among freelancers and the self-employed. At present, it is impossible to seriously forecast just how serious the impact is going to be – this will largely depend upon the further development of the Covid-19 pandemic.

Companies will continue to sustainably optimise and develop existing portfolios, driven especially by political and socio-political aspects, such as refurbishing buildings to make them suitable for the elderly, district development, or the significantly underdeveloped urban centres. The demands of climate protection targets for Germany, and the decisive pressure on the property industry to achieve them, is putting serious demands on resources.

We see good opportunities during the remainder of 2020 to acquire new clients and to intensify business relationships with our existing client base. This also applies to utilities and the waste disposal industry. In addition, in line with our strategic orientation, we continue to invest in the expansion of the "Housing Industry Ecosystem", the cross-sector development of interface products, and the expansion to adjacent ecosystems. The focus here is on, for example, the functional expansion of the Aareal Portal corporate client platform as regards the digitalisation of client communication and account processing.

In our view, the range of services that connect alternative online payment solutions to existing systems, thus helping to overcome process breaks (even across industry sectors), are particularly interesting. The Aareal Exchange & Payment Platform, which integrates alternative payment processes into existing accounting systems, has become available in 2020. We also see potential in technical solutions for automating billing processes as part of electromobility in the network of charging stations. A corresponding product was already tested in 2019 and is also expected to be market ready in 2020.

Besides these future technologies, we also see growth in established processes and procedures, such as incorporating the offers of plusForta GmbH, which was acquired in the previous financial year, into our existing range of deposit management offers.

Finally, we are focusing on our clients' workflows in order to be able to offer efficiency gains through alternative products, where we see opportunities to leverage our know-how to drive and implement appropriate developments. Within this context, we are currently testing a solution for mobile meter reading together with a cooperation partner.

Against this background, we are aiming for net commission income growth of around 15 % year-on-year (2019: € 23 million), expecting an average deposit volume from the housing industry of between € 10 billion and € 11 billion. The persistently low interest rate environment, which is relevant for the results from our deposit-taking business, will continue to burden segment results. However, the importance of this business goes way beyond the interest margin generated from the deposits, which is under pressure in the current market environment. This is because the deposits from the housing industry represent a strategically important additional source of funding for Aareal Bank.

Aareon segment

Aareon's business model is characterised by long-term client relationships, as well as recurring revenues. Nevertheless, the events associated with the global Covid-19 pandemic are also leaving their mark on current business development in 2020. Despite the negative impact on the consulting and licensing business associated with the crisis, sales revenue is expected to increase slightly overall in a year-on-year comparison. The acquisition of CalCon Group, in particular, will contribute to the segment's growth. In line with its long-term corporate strategy, Aareon will continue to forge ahead with its human resources policy by recruiting new staff as part of its growth strategy. We are assuming that the Covid-19 pandemic will significantly raise our clients' awareness of the importance of digitalisation. This should create further business potential in the long term. Aareon devotes great attention to the strategic focus of realising such potential, in terms of both organic and inorganic opportunities.

Aareon expects a slight drop in sales in the ERP business compared with 2019. Due to the restrictions on physical contact, our advisors have increasingly turned to working remotely. This was not, however, sufficient to completely offset the loss in consultancy volumes for projects executed with clients on location. Furthermore, clients postponed projects since they also had to adjust their workflows, and priorities shifted during the course of the crisis. The last few migration projects from GES to other ERP solutions are in the final phase. GES will be discontinued on 31 December 2020. In addition to the impact of the Covid-19 pandemic on Aareon's licensing business, the new cloud-based ERP product generation Tobias 365 in the Netherlands will reduce the amount of licence income that can be generated in the short term, but will lead to higher recurring revenues in the future. Overall, recurring revenues will be only marginally affected by the Covid-19 pandemic. Various customer projects from the previous year will be rolled out in 2020, thus generating higher revenues from maintenance and software as a service (SaaS). Overall, a shift from licence revenues to recurring revenues continues to be expected, due to the increased conclusion of SaaS contracts. Marked increases are expected in the commercial property market. Additional client acquisition is expected in the DACH region with the RELion products and in the Netherlands with REMS. Sales revenue in the energy utility market is expected to witness a marked slump temporarily, as this sector is particularly reliant on on-site consulting activities.

Despite the impact of the Covid-19 pandemic, Aareon still expects to achieve strong organic revenue growth for its digital solutions thanks to further market penetration. In addition, the acquisition of CalCon Group (closed as at 1 January 2020) will lead to a significant year-on-year increase in digital solutions revenue. Aareon will continue to make significant investments in digital solutions to accelerate organic growth at the planned level, and will make part of its strategic investments in the existing product portfolio. The CRM (customer relationship management) and WRM (workplace relationship management) products from the existing digital portfolios will contribute primarily to growth. There is still very strong demand among clients to digitalise their processes.

In line with the original forecast, sales revenues are expected to increase by a low double-digit percentage, to between € 272 million and € 276 million (2019: € 252 million), with adjusted EBITDA[1] also increasing to between € 68 million and € 71 million (2019: € 64 million). Current estimates suggest that effect of the Covid-19 pandemic on business activity will have an indirect or direct negative impact on earnings of around € 10 million. In addition, strategic investments will be shifted to the existing product portfolio.

[1] "Earnings before interest, taxes, depreciation and amortisation" excluding strategic investments and non-recurring effects

Business strategy

Aareal Bank Group's strategy focuses on sustainable business success. Following on from the "Aareal 2020" programme for the future, the medium-term strategic development process will continue under the motto of "Aareal Next Level". The general strategic orientation will continue – with large-volume, international commercial property financing on the one hand and consulting and services for the housing sector in Europe and related industries on the other. The individual business activities will be developed in a targeted manner, in order to sharpen their own independent profiles, accelerate the Group's growth overall and create value for the shareholders and other stakeholders.

The emphasis in the Structured Property Financing segment is to ensure the Bank's success of previous years and secure its existing position in an adverse environment. To do so, Aareal Bank makes systematic use of the flexibility gained in recent years regarding regions, asset classes, structures, and exit channels, as well as expanding the activities along the value creation chain. The Consulting/Services Bank and Aareon segments are expected to continue to grow in the years ahead. The objective is to gradually reduce the overlaps and cross-dependencies, while strengthening the independence of the individual brands and business models – whilst securing existing synergies at the same time.

On 19 May 2020, the Management Board of Aareal Bank AG resolved to enter into discussions with a select group of financial investors with a long-term horizon – within the framework of a structured process – on the sale of a significant minority stake in its subsidiary Aareon AG. The process is aimed at further enhancing Aareon's growth prospects and implementing its growth programme even more swiftly hand-in-hand with partner in an environment that is currently favourable for tech enterprises like Aareon.

Group targets

Aareal Bank Group had qualified its annual forecast published in the 2019 Report on Expected Developments and Opportunities that is part of the Group Management Report, noting that the impact of the Covid-19 pandemic cannot be reliably estimated and that it is thus impossible to anticipate the consequences for business and earnings development.

Besides the strategic measures and initiatives within the framework of "Aareal Next Level", Aareal Bank Group's focus for the further course of the 2020 financial year will remain on coping with the impact of the Covid-19 pandemic in the best way possible – together with its clients. In this context, it will be crucial whether the expected recovery of the real economy will materialise, and how quickly such a recovery will gain momentum. Despite a slight deterioration and with a more precise forecast compared to the first quarter, Aareal Bank Group maintains its "swoosh" scenario, assuming a continued normalisation of global economic activity, with a marked acceleration of the recovery during 2021 and 2022.

Based on this assumption and from today's point of view, Aareal Bank Group continues to be confident that it can achieve a substantially positive consolidated operating profit for the 2020 financial year, i.e. in the mid- to upper double-digit euro million range. Naturally, in the current environment, this forecast is subject to significant uncertainty, especially with regard to the assumed duration and intensity of the crisis, the pace of recovery and the associated effects on our clients, as well as prevailing unclear regulatory and accounting provisions, and the possibility that individual loan defaults cannot be reliably predicted. Further impacts from potential de-risking measures are also not included.

Consolidated Interim Financial Statements
Statement of Comprehensive Income
Income Statement

€ mn	Note	1 Jan-30 Jun 2020	1 Jan-30 Jun 2019
Interest income from financial instruments (ac and fvoci)		370	457
Interest income from financial instruments (fvpl)		22	19
Market-driven modification gains		0	0
Interest expenses for financial instruments (ac)		42	60
Interest expenses for financial instruments (fvpl)		104	147
Market-driven modification losses		1	0
Net interest income	1	**245**	**269**
Loss allowance excluding credit-driven net modification gain or loss		106	23
Credit-driven net modification gain or loss		0	5
Loss allowance	2	**106**	**28**
Commission income		137	134
Commission expenses		26	24
Net commission income	3	**111**	**110**
Net gain or loss on the derecognition of financial assets (ac)		11	15
Net gain or loss on the derecognition of financial liabilities (ac)		5	3
Net gain or loss on the derecognition of financial assets (fvoci)		–	9
Net derecognition gain or loss	4	**16**	**27**
Net gain or loss from financial instruments (fvpl)	5	-7	0
Net gain or loss from hedge accounting	6	2	-1
Net gain or loss from investments accounted for using the equity method		0	0
Administrative expenses	7	238	256
Net other operating income/expenses	8	-10	1
Operating profit		**13**	**122**
Income taxes		-3	41
Consolidated net income		**16**	**81**
Consolidated net income attributable to non-controlling interests		1	1
Consolidated net income attributable to shareholders of Aareal Bank AG		15	80
Earnings per share (EpS)			
Consolidated net income attributable to shareholders of Aareal Bank AG[1]		15	80
of which: allocated to ordinary shareholders		7	72
of which: allocated to AT1 investors		8	8
Earnings per ordinary share (€)[2]		0.11	1.20
Earnings per AT1 unit (€)[3]		0.08	0.08

[1] The allocation of earnings is based on the assumption that net interest payable on the AT1 bond is recognised on an accrual basis.
[2] Earnings per ordinary share are determined by dividing the earnings allocated to ordinary shareholders of Aareal Bank AG by the weighted average of ordinary shares outstanding during the financial year (59,857,221 shares). Basic earnings per ordinary share correspond to diluted earnings per ordinary share.
[3] Earnings per AT1 unit (based on 100,000,000 AT1 units with a notional amount of € 3 each) are determined by dividing the earnings attributable to AT1 investors by the weighted average of AT1 units outstanding during the financial year. Earnings per AT1 unit (basic) correspond to (diluted) earnings per AT1 unit.

Statement of Comprehensive Income

Reconciliation from Consolidated Net Income to Total Comprehensive Income

€ mn	1 Jan – 30 Jun 2020	1 Jan – 30 Jun 2019
Consolidated net income	**16**	**81**
Items that will not be reclassified subsequently to profit or loss		
Changes in the reserve from remeasurements of defined benefit plans	**-9**	**-36**
Remeasurements	-13	-53
Taxes	4	17
Changes in the reserve from the measurement of equity instruments (fvoci)	**0**	**0**
Gains and losses from equity instruments (fvoci)	0	0
Transfers to retained earnings	–	–
Taxes	0	0
Items that are reclassified subsequently to profit or loss		
Changes in the reserve from the measurement of debt instruments (fvoci)	**-5**	**-7**
Gains and losses from debt instruments (fvoci)	-8	0
Reclassifications to the income statement	–	-10
Taxes	3	3
Changes in the reserve from foreign currency basis spreads	**4**	**3**
Gains and losses from foreign currency basis spreads	6	4
Reclassifications to the income statement	–	–
Taxes	-2	-1
Changes in currency translation reserves	**-3**	**-1**
Gains and losses from translating foreign operations' financial statements	-2	-1
Reclassifications to the income statement	–	–
Taxes	-1	0
Other comprehensive income	**-13**	**-41**
Total comprehensive income	**3**	**40**
Total comprehensive income attributable to non-controlling interests	1	1
Total comprehensive income attributable to shareholders of Aareal Bank AG	2	39

Statement of Financial Position

€ mn	Note	30 Jun 2020	31 Dec 2019
Assets			
Financial assets (ac)	9	**37,967**	**33,972**
Cash funds		4,353	1,494
Loan receivables		25,799	25,783
Money market and capital market receivables		7,728	6,618
Receivables from other transactions		87	77
Loss allowance (ac)	10	-483	-386
Financial assets (fvoci)	11	**3,691**	**3,420**
Money market and capital market receivables		3,686	3,415
Equity instruments		5	5
Financial assets (fvpl)	12	**2,958**	**2,979**
Loan receivables		812	1,050
Money market and capital market receivables		91	135
Positive market value of designated hedging derivatives		1,462	1,380
Positive market value of other derivatives		593	414
Non-current assets held for sale	13	7	–
Investments accounted for using the equity method		8	8
Intangible assets	14	200	175
Property and equipment	15	296	311
Income tax assets		54	30
Deferred tax assets		176	168
Other assets	16	448	460
Total		**45,322**	**41,137**
Equity and liabilities			
Financial liabilities (ac)	17	**39,479**	**35,332**
Money market and capital market liabilities		28,155	24,526
Deposits from the housing industry		10,332	9,744
Liabilities from other transactions		52	94
Subordinated liabilities		940	968
Financial liabilities (fvpl)	18	**2,237**	**2,165**
Negative market value of designated hedging derivatives		1,533	1,341
Negative market value of other derivatives		704	824
Provisions	19	553	581
Income tax liabilities		35	44
Deferred tax liabilities		32	19
Other liabilities	20	139	135
Equity	21	**2,847**	**2,861**
Subscribed capital		180	180
Capital reserves		721	721
Retained earnings		1,811	1,812
AT1 bond		300	300
Other reserves		-166	-154
Non-controlling interests		1	2
Total		**45,322**	**41,137**

Statement of Changes in Equity

€ mn	Equity as at 1 Jan 2020	Total comprehensive income for the period	Payments to non-controlling interests	Dividends	AT1 coupon	Other changes	Equity as at 30 Jun 2020
Subscribed capital	**180**						**180**
Capital reserves	**721**						**721**
Retained earnings	**1,812**	15			-16		**1,811**
AT1 bond	**300**						**300**
Other reserves	**-154**	**-13**				**1**	**-166**
Reserve from remeasurements of defined benefit plans	-141	-9				1	-149
Reserve from the measurement of equity instruments (fvoci)	-4	0					-4
Reserve from the measurement of debt instruments (fvoci)	7	-5					2
Reserve from changes in the value of foreign currency basis spreads	-15	4					-11
Currency translation reserves	-1	-3					-4
Total	**2,859**	**2**			**-16**	**1**	**2,846**
Non-controlling interests	**2**	1	-2				**1**
Equity	**2,861**	**3**	**-2**		**-16**	**1**	**2,847**

€ mn	Equity as at 1 Jan 2019	Total comprehensive income for the period	Payments to non-controlling interests	Dividends	AT1 coupon	Other changes	Equity as at 30 Jun 2020
Subscribed capital	**180**						**180**
Capital reserves	**721**						**721**
Retained earnings	**1,793**	80		-126	-16		**1,731**
AT1 bond	**300**						**300**
Other reserves	**-72**	**-41**					**-113**
Reserve from remeasurements of defined benefit plans	-98	-36					-134
Reserve from the measurement of equity instruments (fvoci)	0						0
Reserve from the measurement of debt instruments (fvoci)	39	-7					32
Reserve from changes in the value of foreign currency basis spreads	-9	3					-6
Currency translation reserves	-4	-1					-5
Total	**2,922**	**39**		**-126**	**-16**		**2,819**
Non-controlling interests	**2**	1	-1				**2**
Equity	**2,924**	**40**	**-1**	**-126**	**-16**		**2,821**

Statement of Cash Flows (condensed)

€ mn	2020	2019
Cash and cash equivalents as at 1 January	**1,494**	**1,265**
Cash flow from operating activities	2,909	1,877
Cash flow from investing activities	-22	8
Cash flow from financing activities	-28	-211
Total cash flow	**2,859**	**1,674**
Cash and cash equivalents as at 30 June	**4,353**	**2,939**

Notes (condensed)

Basis of Accounting

Legal framework

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

This half-yearly financial report for the period ended 30 June 2020 was prepared pursuant to the provisions of section 115 of the German Securities Trading Act (Wertpapierhandelsgesetz – "WpHG") in conjunction with section 117 no. 2 of the WpHG and was approved for publication by the Management Board on 5 August 2020. It comprises the present condensed consolidated interim financial statements, as well as an interim group management report.

Aareal Bank AG prepares its condensed consolidated interim financial statements in accordance with International Financial Reporting Standards (IFRSs) applicable within the European Union (EU) as at the reporting date, in connection with the provisions pursuant to section 315e (1) of the German Commercial Code (Handelsgesetzbuch – "HGB"). In particular, the consolidated interim financial statements comply with the requirements for interim financial reporting set out in IAS 34. The reporting currency is the euro (€).

Reporting entity structure

Subsidiaries of Aareal Bank AG are included in the consolidated financial statements by way of full consolidation. Companies over which Aareal Bank AG may exercise a significant influence ("associates") are included in the consolidated financial statements, using the equity method. The present interim report is based on the same consolidation methods as were applied in the consolidated financial statements 2019.

With the exception of the addition of CalCon Group, a provider of digital solutions for structural condition assessment, requirements assessment, and maintenance planning, there were no other material changes to the reporting entity structure.

Accounting policies

Unless specifically indicated otherwise, the accounting policies applied in preparation of the consolidated financial statements 2019 were also applied in preparation of these condensed consolidated interim financial statements, including the calculation of comparative figures.

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

- **IAS 1 Definition of Material**
  The amendments were issued to refine the definition of the term "material" and to harmonise the various definitions in the Conceptual Framework and in the standards.

- **IFRS 3 Definition of a Business**
  The objective of the amendments is to resolve cases of doubt that arise when a company determines whether it has acquired a business or a group of assets. The problems result from the fact that the accounting policies for goodwill, the acquisition costs and deferred taxes in case of the acquisition of a business differ from those applicable to the purchase of a group of assets.

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

The amendments to the first part of the Interest Rate Benchmark Reform as regards the hedge accounting requirements were applied by Aareal Bank Group already in the 2019 financial year.

Notes to the Statement of Comprehensive Income

(1) Net interest income

€ mn	1 Jan - 30 Jun 2020	1 Jan - 30 Jun 2019
Interest income from financial assets (ac and fvoci)	359	451
Loan receivables	359	443
Money market and capital market receivables	0	8
Interest income from financial liabilities (ac)	11	6
Money market and capital market liabilities	4	2
Deposits from the housing industry	7	4
Interest income from financial instruments (fvpl)	22	19
Loan receivables	10	11
Money market and capital market receivables	3	3
Other derivatives	9	5
Market-driven modification gains	0	0
Total interest and similar income	**392**	**476**
Interest expenses from financial liabilities (ac)	35	53
Money market and capital market liabilities	24	40
Deposits from the housing industry	0	1
Liabilities from other transactions	0	0
Subordinated liabilities	11	12
Interest expenses from financial assets (ac)	7	7
Cash funds	5	6
Money market and capital market receivables	2	1
Interest expenses for financial instruments (fvpl)	104	147
Other derivatives	104	147
Market-driven modification losses	1	0
Total interest and similar expenses	**147**	**207**
Total	**245**	**269**

Net interest income of € 245 million was down on the previous year (€ 269 million), mainly due to a year-on-year decline in the loan and securities portfolios. This was attributable to the previous year's accelerated de-risking involving defaulted loans, a larger exposure to a single borrower and securities in Italy, as well as to lower new business, on account of Covid-19.

(2) Loss allowance

€ mn	1 Jan - 30 Jun 2020	1 Jan - 30 Jun 2019
Additions	124	96
Reversals	18	71
Recoveries on loans and advances previously written off	0	2
Loss allowance – other items	–	0
Credit-driven net modification gain or loss	0	5
Total	**106**	**28**

Loss allowance of € 106 million (H1 2019: € 28 million) was recognised, largely due to the adverse economic effects related to the Covid-19 pandemic. For this purpose, we have taken the economic forecasts of our "swoosh" scenario into account, which further deteriorated slightly (or were specified in more detail) since the first quarter of 2020. The scenario assumes a continued normalisation of global economic activity commencing from mid-2020, with a marked acceleration of the recovery during 2021 and 2022. Whilst economic recovery will progress at a slower pace than the decline observed, the economy will almost completely return to the starting level by the end of 2022. Essentially, our internal "swoosh" scenario is based on the baseline scenario published by Oxford Economics in June 2020, which is generally in line with the ECB forecast also published in June 2020. The ECB's projections – which are focused on the euro zone – can only be used as an indication or a benchmark for our internationally oriented portfolio. Besides the expected development of the macro-economic environment – as outlined above – the scenario is based on the assumption of interest rates remaining low over the long-term, which had (or should have) a stabilising or positive impact on asset prices in the past, as well as on our expectations for the coming years.

In addition to one newly-defaulted loan during the first quarter and assumptions of extended realisation periods for defaulted financings, the impact of the Covid-19 pandemic had a specific impact upon determining loss allowance in the second quarter too. The general approach to determining loss allowance has not changed (refer to the chapter on Loss allowance within the Accounting policies section of the consolidated financial statements 2019, and to Note 22 of the consolidated interim financial statements for the first half of 2020). The specific features are outlined below:

For non-defaulted loans (Stage 1 and 2), loss allowance for numerous financings directly affected (mainly concerning hotels or retail properties) was determined by updating individual ratings, together with an associated increase in PD if appropriate. When considering the impact of Covid-19 effects on ratings, we have taken the recommendations made by the IASB, and by relevant regulatory authorities such as the EBA, the ECB and ESMA, into consideration. Concerning the scenario analyses to be taken into account when determining individual LGDs, we applied an updated scenario mix, in line with the customary process. This probability-weighted scenario mix reflects the uncertainties as to how the Covid-19 pandemic will develop further and supplements our baseline scenario (swoosh) with the addition of divergent developments over an observation period of three years. Three out of a total of five scenarios reflect less favourable economic development than the baseline scenario.

In order to assess further potential loan losses in the future, which the Bank believes are not adequately reflected in forward-looking information in all individual cases, owing to the current situation, the Bank decided to implement a management overlay. The purpose of this is to also take into account the considerable uncertainties the Covid-19 pandemic could have on developments, and its impact on borrowers, as well as regulatory requirements. The Bank has simulated expected changes to the cash flows of financed properties and the resulting development of property values over a period of three years, in line with our "swoosh" scenario, for the entire portfolio, forecasting their impact upon the measurement parameters PD and LGD. Any additional loss allowance arising from this was taken into consideration in the form of a management overlay. We refer to Note 22 of the consolidated interim financial statements for the first half of 2020 for the underlying macro-economic factors. Based on simulations, the management overlay also accounts for a potential transfer to Stage 2: if the simulation indicates a rating deterioration beyond the threshold for a significant increase in credit risk, the exposure is allocated to Stage 2. Any excess of LTV beyond 90 % was assumed as an additional qualitative criterion for a stage transfer. Overall, the deterioration in economic forecasts will lead to an expected increase of around 50 % in the probability of default, and to a net change of around 60 % in the loss allowance in Stage 1 and Stage 2, relative to the level of loss allowance as at the 2019 year-end.

Where defaulted financings (Stage 3) were concerned, due to the impact of Covid-19, it was not always possible to obtain new appraisals where there were indications for a fluctuation in value. Specifically, retail properties were closed well into the second quarter – with hotels being closed beyond this period in some cases. A review of the value of these properties was conducted internally by the Bank. The outcome of this review was included in the valuation scenarios and taken into account in the calculation of loan losses in the form of an additional management overlay. We applied this approach analogously to defaulted property loans whose measurement losses are reflected in net gain or loss from financial instruments (fvpl), due to failure to meet the SPPI criterion.

Furthermore, in spite of the adverse circumstances caused by the lockdown in Italy, we managed to successfully continue our accelerated de-risking exercise, selling two defaulted loan exposures totalling € 141 million in July 2020 in this connection. The related charge of € 9 million was already absorbed in loss allowance for the second quarter.

Please also refer to our explanations in Note (10).

(3) Net commission income

€ mn	1 Jan – 30 Jun 2020	1 Jan – 30 Jun 2019
Commission income from		
ERP products (incl. add-on products)	87	91
Digital solutions	30	23
Banking business and other activities	20	20
Total commission income	**137**	**134**
Commission expenses for		
Purchased services	23	21
Banking business and other activities	3	3
Total commission expenses	**26**	**24**
Total	**111**	**110**

Net commission income amounted to € 111 million (H1 2019: € 110 million).

(4) Net derecognition gain or loss

€ mn	1 Jan - 30 Jun 2020	1 Jan - 30 Jun 2019
Net gain or loss on the derecognition of financial assets (ac)		
Loan receivables	11	14
Money market and capital market receivables	–	1
Net gain or loss on the derecognition of financial liabilities (ac)		
Money market and capital market liabilities	5	3
Net gain or loss on the derecognition of financial assets (fvoci)		
Money market and capital market receivables	–	9
Total	**16**	**27**

The net derecognition gain of € 16 million (H1 2019: € 27 million) was attributable to market-driven effects from early loan repayments, and to repurchases in the Treasury business, as part of market support, whilst the higher figure for the previous year reflected structural adjustments to our securities portfolio following the acquisition of former Düsseldorfer Hypothekenbank AG (Düsselhyp).

(5) Net gain or loss from financial instruments (fvpl)

€ mn	1 Jan - 30 Jun 2020	1 Jan - 30 Jun 2019
Net gain or loss from loan receivables	-12	-6
Net gain or loss from money market and capital market receivables	-5	7
Net gain or loss from other derivatives	9	-1
Currency translation	1	0
Total	**-7**	**0**

The net gain or loss from financial instruments (fvpl) primarily resulted from credit-risk induced measurement losses of defaulted property loans. Please refer to Notes 2 and 22 for calculation details regarding the determination of loss allowance.

(6) Net gain or loss from hedge accounting

€ mn	1 Jan - 30 Jun 2020	1 Jan - 30 Jun 2019
Ineffective portion of fair value hedges	2	-1
Ineffective portion of net investment hedges	0	0
Total	**2**	**-1**

(7) Administrative expenses

€ mn	1 Jan-30 Jun 2020	1 Jan-30 Jun 2019
Staff expenses	137	143
Wages and salaries	107	113
Social security contributions	18	18
Pensions	12	12
Other administrative expenses	80	94
Depreciation, amortisation and impairment of property and equipment and intangible assets	21	19
Total	**238**	**256**

Administrative expenses declined to € 238 million (H1 2019: € 256 million). The previous year's figure still included running costs and integration expenses incurred in conjunction with the integration of Düsselhyp. Cost savings in connection with the Covid-19 crisis also had a mitigating effect.

(8) Net other operating income/expenses

€ mn	1 Jan-30 Jun 2020	1 Jan-30 Jun 2019
Income from properties	5	23
Income from the reversal of provisions	0	1
Income from goods and services	0	0
Other operating income	19	9
Total other operating income	**24**	**33**
Expenses for properties	26	20
Expenses for other taxes	3	2
Miscellaneous other operating expenses	5	10
Total other operating expenses	**34**	**32**
Total	**-10**	**1**

Income from properties declined, mainly due to the shutdown of our hotel operations. The previous year's figure also included gains realised on disposal. Expenses for properties were increased by an impairment on a property held by the Bank, which was based on an internal valuation review, taking our Covid-19 scenario into account.

Notes to the Statement of Financial Position

(9) Financial assets (ac)

€ mn	30 Jun 2020	31 Dec 2019
Cash funds (ac)	**4,353**	**1,494**
Cash on hand	0	0
Balances with central banks	4,353	1,494
Loan receivables (ac)	**25,799**	**25,783**
Property loans	25,361	25,333
Public-sector loans	379	398
Other loan receivables	59	52
Money market and capital market receivables (ac)	**7,728**	**6,618**
Money market receivables	2,766	1,363
Promissory note loans	1,789	1,823
Bonds	3,173	3,432
Receivables from other transactions (ac)	**87**	**77**
Trade receivables	38	37
Other financial receivables	49	40
Total	**37,967**	**33,972**

(10) Loss allowance (ac)

30 June 2020

€ mn	Stage 1	Stage 2	Stage 3	Receivables from other transactions (ac)	Total loss allowance (ac)
Balance as at 1 January	**22**	**16**	**345**	**3**	**386**
Additions	20	17	82	2	**121**
Utilisation	–	–	7	–	**7**
Reversals	6	7	4	0	**17**
Transfer to Stage 1	0	0	–	–	**–**
Transfer to Stage 2	-3	3	–	–	**–**
Transfer to Stage 3	–	-1	1	–	**–**
Interest rate effect	–	–	3	–	**3**
Currency adjustments	0	0	-3	0	**-3**
Balance as at 30 June	**33**	**28**	**417**	**5**	**483**

The loss allowance for financial assets measured at amortised cost refers to loan receivables, money and capital market receivables as well as receivables from other transactions (largely trade receivables) that are measured at amortised cost.

Please refer to Notes 2 and 22 for calculation details.

30 June 2019

€ mn	Stage 1	Stage 2	Stage 3	Receivables from other transactions (ac)	Total loss allowance (ac)
Balance as at 1 January	**34**	**22**	**519**	**2**	**577**
Additions	10	5	79	1	**95**
Utilisation	–	–	26	1	**27**
Reversals	12	13	42	0	**67**
Transfer to Stage 1	0	0	–	–	**–**
Transfer to Stage 2	0	0	–	–	**–**
Transfer to Stage 3	–	0	0	–	**–**
Interest rate effect	–	–	18	–	**18**
Currency adjustments	0	0	0	0	**0**
Balance as at 30 June	**32**	**14**	**548**	**2**	**596**

(11) Financial assets (fvoci)

€ mn	30 Jun 2020	31 Dec 2019
Money market and capital market receivables (fvoci)	**3,686**	**3,415**
Bonds	3,686	3,415
Equity instruments (fvoci)	**5**	**5**
Equities and other non-fixed income securities	0	0
Other investments	5	5
Total	**3,691**	**3,420**

(12) Financial assets (fvpl)

€ mn	30 Jun 2020	31 Dec 2019
Loan receivables (fvpl)	**812**	**1,050**
Property loans	809	1,050
Other loan receivables	3	–
Money market and capital market receivables (fvpl)	**91**	**135**
Promissory note loans	87	94
Bonds	0	38
Fund units	4	3

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€ mn	30 Jun 2020	31 Dec 2019
Positive market value of designated hedging derivatives (fvpl)	**1,462**	**1,380**
Positive market value of fair value hedges	1,456	1,374
Positive market value of net investment hedges	6	6
Positive market value of other derivatives (fvpl)	**593**	**414**
Positive market value of economic hedging derivatives	373	238
Positive market value of other derivatives	220	176
Total	**2,958**	**2,979**

(13) Non-current assets held for sale

As at the reporting date, the criteria for classification as "held for sale" were fulfilled for the operating property of the Rome branch in the Structured Property Financing segment with a carrying amount of € 7 million, which is held by a subsidiary. Its sale is envisaged for the second half of 2020.

(14) Intangible assets

€ mn	30 Jun 2020	31 Dec 2019
Goodwill	102	89
Proprietary software	45	37
Other intangible assets	53	49
Total	**200**	**175**

The increase in goodwill is attributable to the acquisition of CalCon Group.

(15) Property and equipment

€ mn	30 Jun 2020	31 Dec 2019
Land and buildings and construction in progress	265	277
Office furniture and equipment	31	34
Total	**296**	**311**

The effects of the Covid-19 pandemic required an internal valuation review for our hotel operations – taking our Covid-19 scenario into account – and the estimation of the impact on attainable operating income. No impairments were required in addition to scheduled depreciation.

(16) Other assets

€ mn	30 Jun 2020	31 Dec 2019
Properties	337	337
Contract assets	25	25
Miscellaneous	86	98
Total	**448**	**460**

The effects of the Covid-19 pandemic required an internal valuation review for the properties held by the Bank – taking our Covid-19 scenario into account – and the estimation of the impact on attainable operating income. Impairment losses of € 13 million were recognised. In addition, costs for value-enhancing measures were capitalised.

(17) Financial liabilities (ac)

€ mn	30 Jun 2020	31 Dec 2019
Money market and capital market liabilities (ac)	**28,155**	**24,526**
Money market liabilities	8,358	3,566
Promissory note loans	4,443	4,797
Mortgage Pfandbriefe	10,141	10,820
Public-sector Pfandbriefe	2,246	2,585
Other debt securities	2,967	2,758
Other financial liabilities	0	0
Deposits from the housing industry (ac)	**10,332**	**9,744**
Payable on demand	8,350	7,694
Term deposits	1,982	2,050
Liabilities from other transactions (ac)	**52**	**94**
Trade payables	9	20
Other liabilities	43	74
Subordinated liabilities (ac)	**940**	**968**
Total	**39,479**	**35,332**

Money-market liabilities increased due to entering into targeted longer-term refinancing operations (TLTROs).

(18) Financial liabilities (fvpl)

€ mn	30 Jun 2020	31 Dec 2019
Negative market value of designated hedging derivatives (fvpl)	**1,533**	**1,341**
Negative market value of fair value hedges	1,519	1,327
Negative market value of net investment hedges	14	14
Negative market value of other derivatives (fvpl)	**704**	**824**
Negative market value of economic hedging derivatives	263	422
Negative market value of miscellaneous other derivatives	441	402
Total	**2,237**	**2,165**

(19) Provisions

€ mn	30 Jun 2020	31 Dec 2019
Provisions for pensions and similar obligations	445	428
Provisions for unrecognised lending business	4	2
Other provisions and contingent liabilities	104	151
Total	**553**	**581**

Changes in the discount rate applicable to pensions require a revaluation of the amount of obligations. This is recognised directly in other comprehensive income, under changes in the reserve from defined benefit plans.

(20) Other liabilities

€ mn	30 Jun 2020	31 Dec 2019
Lease liabilities	82	84
Deferred income	3	1
Liabilities from other taxes	31	35
Contract liabilities	20	15
Miscellaneous	3	0
Total	**139**	**135**

(21) Equity

€ mn	30 Jun 2020	31 Dec 2019
Subscribed capital	180	180
Capital reserves	721	721
Retained earnings	1,811	1,812
AT1 bond	300	300
Other reserves		
Reserve from remeasurements of defined benefit plans	-149	-141
Reserve from the measurement of equity instruments (fvoci)	-4	-4
Reserve from the measurement of debt instruments (fvoci)	2	7
Reserve from foreign currency basis spreads	-11	-15
Currency translation reserves	-4	-1
Non-controlling interests	1	2
Total	**2,847**	**2,861**

The item "Reserve from the measurement of debt instruments (fvoci)" includes loss allowance of € 0 million (H1 2019: € 0 million).

Treasury shares

No treasury shares were held during the period under review.

Distributions

The Annual General Meeting of Aareal Bank AG held on 27 May 2020 resolved that Aareal Bank AG's net retained profit of € 119,714,442.00 for the financial year 2019, as reported under the German Commercial Code (HGB), be transferred in full to other retained earnings.

Previously, following a request issued by the European Central Bank, dated 27 March 2020, to refrain from paying out any dividends at least until 1 October 2020 due to the Covid-19 pandemic, having conducted a detailed review – and diverging from the proposal for the appropriation of profits as published in the financial statements 2019 – the Management Board and the Supervisory Board resolved to propose to the Annual General Meeting that no dividends be distributed for the 2019 financial year, as an exceptional measure to strengthen the Bank's capital base, and that net retained profit be transferred in full to other retained earnings. On 28 July 2020, the ECB extended its request until 1 January 2021. The Management Board and the Supervisory Board will carefully monitor further developments, and will re-assess the situation in due course.

In addition, on 30 April 2020, the Management Board resolved on a distribution in relation to the AT1 instruments, in accordance with the terms and conditions of the notes.

Within Aareal Bank Group's consolidated statement of financial position, a distribution on the AT1 bond reduces the retained earnings item within consolidated equity.

Notes to Financial Instruments

A detailed description of the system in place at Aareal Bank Group to measure, limit, and manage risks throughout Aareal Bank Group is presented in the Risk Report as part of the Interim Group Management Report. The disclosures on the description and the extent of the risks arising from financial instruments in accordance with IFRS 7 are included (in part) in the Risk Report.

(22) Loss allowance

Loss allowances are based on the internal staging and expected credit loss (ECL/EL) model of Aareal Bank. For this purpose, financial instruments measured at amortised cost and at fair value through other comprehensive income as well as loan commitments and financial guarantees are allocated to various stages at both initial recognition and subsequent measurement. The related loss allowances are recognised in the amount of the twelve-month or the lifetime expected credit loss.

Stage 1: All financial instruments without impairment trigger are allocated to this stage at initial recognition. If the credit risk is not significantly increased, the financial instrument has to remain in Stage 1 for subsequent measurement. Loss allowances are recognised in the amount of the losses expected for the following twelve months and interest income is calculated on the basis of the gross carrying amount, applying the effective interest method. Loss allowances have to be recognised on a present value basis.

Stage 2: All financial instruments where credit risk has increased significantly since initial recognition are allocated to this stage. Loss allowances are recognised in the amount of the losses expected for the entire remaining term of the instrument and interest income is calculated on the basis of the gross carrying amount, applying the effective interest method. Loss allowances have to be recognised on a present value basis. The significant increase in credit risk for the allocation to Stage 2 is determined using the so-called expected downgrade bank-internal staging model and taking into consideration quantitative and qualitative criteria such as the credit rating of the customer, the intensity of customer handling and payment defaults. If the significant increase in credit risk no longer applies, the financial instrument is re-transferred to Stage 1.

Stage 3: This stage includes all financial instruments where there is objective evidence of impairment (impairment trigger or credit impaired). Loss allowances are recognised in the amount of the losses of the lifetime expected credit loss, and interest income is calculated on the basis of the net carrying amount (i. e. gross carrying amount less loss allowance) using the effective interest method. The lifetime expected credit loss in Stage 3 is determined as the difference between the gross carrying amount and the present value of expected future cash flows (discounted using the original effective interest). If the impairment triggers no longer apply, the financial instrument is re-transferred to Stage 1 or 2.

POCI (purchased or originated credit impaired): This category includes all financial instruments that were subject to an impairment trigger at initial recognition. The loss allowance is recorded in the amount of the lifetime expected credit loss.

The expected credit loss is generally determined by Aareal Bank using a model-based procedure where, depending on the stage, one- or multi-year parameters are used. The calculation of the expected loss in Stage 1 and of lifetime expected credit loss in Stage 2 is based on the one-year or lifetime probability of default (PD), respectively, the loss given default (LGD), the expected exposure at default (EAD), a discount factor (DF) and the expected contractual term. Current and expected country-specific economic conditions such as the GDP, long-term interest rates and unemployment rate are included in the LGD by means of a scenario-weighted market value forecast. A period of not more than twelve months is assessed for Stage 1, while the expected contractual term of the financial instrument has to be taken into account for Stages 2 and 3 (and, in addition, the expected term for loan repayment in Stage 3). The expected loss in Stage 3 is usually determined on the basis of individually estimated cash flows (ECF procedure) in several probability-weighted scenarios. The amount of the loss allowance is determined as being the difference between the carrying amount of the asset and the present value of the expected future cash flows, discounted using the original effective interest rate applicable at initial recognition (taking into account cash flows from realisation of collateral provided). Collateral is largely provided in the form of land charges or mortgages; these are measured at fair value which is generally based on either the income capitalisation approach or the discounted cash flow method. Impairment triggers are strong indications for a decline of the borrower's credit quality, arrears as well as further indications that not all interest and principal payments can be made as contractually agreed.

This general loss allowance approach was also followed in the first half of 2020. Some special factors had to be taken into consideration due to the Covid-19 pandemic:

- While ratings were updated for a number of financings affected, reliable information was not available for all of the financings. The ratings are subject to the issue of providing a realistic estimate of the expected losses without overstating short-term effects, such as those from the lockdown. Accordingly, any measures implemented as a result of Covid-19 do not automatically result in a significant credit deterioration or in a default; instead, each individual case is reviewed separately.

- Due to Covid-19, only a very limited number of new appraisals could be obtained where there were indications for a fluctuation in value. Specifically, retail properties were closed well into the second quarter – with hotels being closed beyond this period in some cases.

- Our clients and sponsors have provided a significant portion of the required liquidity from their own resources. In addition, funds obtained from government assistance were used and a few clients reduced their exposures. Furthermore, Aareal Bank supported its customers by granting deferrals on repayments, and liquidity facilities.

- At present, we pay particular attention to the economic forecasts. In the context of this ongoing review, we also rely on projections published by the ECB, apart from those issued by our usual data providers. Yet estimation uncertainties are currently much higher than usual, as the pandemic has provoked a situation unprecedented in recent history. Data and experience are therefore both lacking.

Aareal Bank has taken into account these special factors through adjustments regarding processes and valuation methods (so-called management overlay). We implement these measures on the basis of the recommendations made by the IASB and by relevant regulatory authorities such as the EBA, the ECB and ESMA.

Our "swoosh" scenario was based on the following macro-economic factors:

	2020	2021	2022
€ mn			
Exchange rate			
US dollar per euro	1.11	1.13	1.14
%			
Gross domestic product (year-on-year change)			
Eurozone	-7.99	6.25	3.23
Germany	-6.10	5.24	3.17
Italy	-9.33	5.73	2.79
France	-10.64	7.77	3.50
US	-6.14	6.33	3.79
UK	-10.83	10.19	3.51
Interest rate (year-on-year change)			
US 10-year government bonds	0.91	1.18	1.54
Eurozone long-term government bond yield	0.28	0.67	1.01
Unemployment rate (year-on-year change)			
Eurozone	8.98	8.84	8.07
Germany	5.64	5.43	5.20
Italy	10.54	11.60	10.60
France	9.68	9.52	8.66
US	9.33	7.60	5.54
UK	7.47	5.67	4.23

(23) Determination of fair value

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

Fair value hierarchy

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

Measurement methods

The property and public-sector loans included in loan receivables are measured using the discounted cash flow method for the purpose of the determination of fair value. Discounting of future cash flows of a transaction is based on transaction-specific risk-adjusted interest rates. These are derived on the basis of a virtually risk-free market interest rate for each currency depending on the relevant term, taking into account add-ons for risks specific to the counterparty as well as credit costs. In the case of loans subject to fixed interest rates, the contractually agreed payments are used as future cash flows. The future cash flows for floating-rate loans are derived using the future forward interest rates, taking into account the relevant spread for customer-specific terms and conditions.

Debt securities and promissory note loans for which no current market price is available are measured through an analysis of future payments using the fully-capitalised earnings value approach, where the inputs are based on observable market data. These approaches include the discounted cash flow (DCF) method which is used to determine the present value of contractual cash flows until the expected end of the term. The present value is determined based on the benchmark curve applicable for the relevant market, taking into account mark-ups based on credit quality and liquidity. The valuation model used for options included in the transaction is the commonly used Black-Scholes model or appropriate numerical procedures.

In the case of unquoted financial investments in equity instruments, the costs of acquisition may also be the best estimate of fair value.

The fair value of OTC derivatives is determined on the basis of sector-specific standardised measurement models, such as the present value method or option pricing models. These techniques are based on inputs of active markets, such as interest rates, yield curves and credit spreads. The fair value of foreign exchange forwards is generally based on current forward exchange rates quoted on active markets. Since the derivatives are part of highly effective collateral agreements (Credit Support Annex to the ISDA Master Agreement and Collateral Annex to the German Master Agreement on Financial Derivatives Transactions) which are each subject to a master collateralisation agreement, measurement adjustments to reflect any potential counterparty credit risk or own credit risk (CVA and DVA) are not required for reasons of materiality. The Bank uses the overnight interest rate swap curve (OIS curve) for the measurement of derivatives secured by cash collateral.

Amortised cost is an adequate estimate of fair value for cash funds, other loan receivables as well as short-term money market receivables and liabilities.

(24) Fair value hierarchy in accordance with IFRS 13

The carrying amounts of financial instruments held by Aareal Bank Group which are reported at fair value in the statement of financial position are presented in the following table according to the three-tier fair value hierarchy pursuant to IFRS 13.72 et seq. The presentation is made for each class of financial instrument:

30 June 2020

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Financial assets (fvoci)	**3,691**	**3,686**	**0**	**5**
Money market and capital market receivables	3,686	3,686	–	–
Equity instruments	5	–	0	5
Financial assets (fvpl)	**2,958**	**0**	**2,142**	**816**
Loan receivables	812	–	–	812
Money market and capital market receivables	91	0	87	4
Positive market value of designated hedging derivatives	1,462	–	1,462	–
Positive market value of other derivatives	593	–	593	–
Financial liabilities (fvpl)	**2,237**	**–**	**2,237**	**–**
Negative market value of designated hedging derivatives	1,533	–	1,533	–
Negative market value of other derivatives	704	–	704	–

31 December 2019

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Financial assets (fvoci)	**3,420**	**3,415**	**3**	**2**
Money market and capital market receivables	3,415	3,415	–	–
Equity instruments	5	–	3	2
Financial assets (fvpl)	**2,979**	**0**	**1,926**	**1,053**
Loan receivables	1,050	–	–	1,050
Money market and capital market receivables	135	0	132	3
Positive market value of designated hedging derivatives	1,380	–	1,380	–
Positive market value of other derivatives	414	–	414	–
Financial liabilities (fvpl)	**2,165**	**0**	**2,165**	**–**
Negative market value of designated hedging derivatives	1,341	–	1,341	–
Negative market value of other derivatives	824	0	824	–

In the first six months of 2020, there were no material transfers between the hierarchy levels for the various financial instruments.

The fair values of loan receivables recognised at fair value in the statement of financial position that are assigned to Level 3 of the fair value hierarchy developed as follows during the period under review:

Loan receivables (fvpl)

€ mn	2020	2019
Fair value as at 1 January	**1,050**	**711**
Change in measurement	**-13**	**-7**
Portfolio changes		
Additions	111	442
Derecognition	336	425
Deferred interest	0	0
Fair value as at 30 June	**812**	**721**

Financial instruments held in the Bank's portfolio contributed € -13 million to the net gain or loss from financial instruments fvpl (H1 2019: € -6 million).

Regarding loan receivables (fvpl), the add-ons for risks specific to the counterparty represent the material input parameter not observable in the market. Regarding the non-defaulted loans, an increase/decrease by 1 % would lead to a decrease/increase of the fair value by approximately € 20 million (H1 2019: approximately € 16 million).

(25) Comparison of carrying amounts and fair values of the financial instruments

The fair values of financial instruments are compared with their carrying amounts (including loss allowance) in the following table. The presentation is made for each class of financial instrument:

€ mn	30 Jun 2020 Carrying amount	30 Jun 2020 Fair Value	31 Dec 2019 Carrying amount	31 Dec 2019 Fair Value
Financial assets (ac)	**37,484**	**37,783**	**33,586**	**33,899**
Cash funds	4,353	4,353	1,494	1,494
Loan receivables	25,325	25,750	25,403	25,850
Money market and capital market receivables	7,725	7,601	6,615	6,481
Receivables from other transactions	81	79	74	74
Financial assets (fvoci)	**3,691**	**3,691**	**3,420**	**3,420**
Money market and capital market receivables	3,686	3,686	3,415	3,415
Equity instruments	5	5	5	5

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€ mn	30 Jun 2020 Carrying amount	30 Jun 2020 Fair Value	31 Dec 2019 Carrying amount	31 Dec 2019 Fair Value
Financial assets (fvpl)	**2,958**	**2,958**	**2,979**	**2,979**
Loan receivables	812	812	1,050	1,050
Money market and capital market receivables	91	91	135	135
Positive market value of designated hedging derivatives	1,462	1,462	1,380	1,380
Positive market value of other derivatives	593	593	414	414
Financial liabilities (ac)	**39,479**	**39,450**	**35,332**	**35,477**
Money market and capital market liabilities	28,155	28,123	24,526	24,610
Deposits from the housing industry	10,332	10,332	9,744	9,744
Liabilities from other transactions	52	46	94	94
Subordinated liabilities	940	949	968	1,029
Financial liabilities (fvpl)	**2,237**	**2,237**	**2,165**	**2,165**
Negative market value of designated hedging derivatives	1,533	1,533	1,341	1,341
Negative market value of other derivatives	704	704	824	824

Segment Reporting

(26) Segment results

As explained in the Group Management Report 2019, Aareal Bank's management system was revised in the course of the "Aareal Next Level" strategic development at the turn of the year. The previous Consulting/Services segment was split into the Consulting/Services Bank and Aareon segments, in order to sharpen the independent profiles of the individual business activities and to enhance transparency. The previous year's figures were adjusted accordingly.

Whilst the structure of the existing Structured Property Financing segment remained unchanged in principle, two changes were necessary as part of the further developed management system. A review of our liquidity model conducted during the fourth quarter of 2019 showed that a higher share of deposits from the housing industry is available to the Bank for an extended period of time, as a replacement for unsecured placements on the capital markets. This resulted in lower unsecured funding requirements (and to a corresponding relief on income), as well as a change in intra-segment charges. A similar effect applies to the interest rate on residual deposits; this rate was also raised as part of modelling changes. In the current (as well as in the expected) interest rate environment, backing this residual interest rate using fixed-income assets gives rise to interest income as well as typing up RWAs; these effects have been allocated to the Consulting/Services Bank segment from the effective date of this change on 1 January 2020. For management purposes, the calculation of allocated equity was changed for all segments, applying the regulatory calculation method. Reported equity on the statement of financial position differs from this. Other reserves are now also included when calculating allocated equity at Group level. RoE before taxes is thus also changed accordingly. The previous year's figures were adjusted accordingly.

	Structured Property Financing		Consulting/Services Bank		Aareon		Consolidation/ Reconciliation		Aareal Bank Group	
€ mn	1 Jan–30 Jun 2020	1 Jan–30 Jun 2019	1 Jan–30 Jun 2020	1 Jan–30 Jun 2019	1 Jan–30 Jun 2020	1 Jan–30 Jun 2019	1 Jan–30 Jun 2020	1 Jan–30 Jun 2019	1 Jan–30 Jun 2020	1 Jan–30 Jun 2019
Net interest income	226	276	20	-6	-1	-1	0	0	245	269
Loss allowance	106	28			0	0			106	28
Net commission income	3	4	12	10	102	101	-6	-5	111	110
Net derecognition gain or loss	16	27							16	27
Net gain or loss from financial instruments (fvpl)	-7	0	0		0				-7	0
Net gain or loss from hedge accounting	2	-1							2	-1
Net gain or loss from investments accounted for using the equity method					0	0			0	0
Administrative expenses	117	140	35	37	92	84	-6	-5	238	256
Net other operating income/expenses	-11	1	0	-1	1	1	0	0	-10	1
Operating profit	**6**	**139**	**-3**	**-34**	**10**	**17**	**0**	**0**	**13**	**122**
Income taxes	-5	47	-1	-11	3	5			-3	41
Consolidated net income	**11**	**92**	**-2**	**-23**	**7**	**12**	**0**	**0**	**16**	**81**

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€ mn	Structured Property Financing 1 Jan-30 Jun 2020	Structured Property Financing 1 Jan-30 Jun 2019	Consulting/Services Bank 1 Jan-30 Jun 2020	Consulting/Services Bank 1 Jan-30 Jun 2019	Aareon 1 Jan-30 Jun 2020	Aareon 1 Jan-30 Jun 2019	Consolidation/ Reconciliation 1 Jan-30 Jun 2020	Consolidation/ Reconciliation 1 Jan-30 Jun 2019	Aareal Bank Group 1 Jan-30 Jun 2020	Aareal Bank Group 1 Jan-30 Jun 2019
Consolidated net income attributable to non-controlling interests	0	0	0	0	1	1			1	1
Consolidated net income attributable to shareholders of Aareal Bank AG	11	92	-2	-23	6	11	0	0	15	80
Allocated equity[1]	1,809	1,878	194	194	42	42	466	389	2,511	2,503
RoE before taxes (%)[2] [3]	-0.7	13.6	-2.8	-34.6	43.4	73.3			0.0	8.8
Employees (average)	**779**	**813**	**377**	**391**	**1,718**	**1,588**			**2,874**	**2,792**
Segment assets	**34,213**	**32,172**	**10,740**	**10,744**	**369**	**348**			**45,322**	**43,264**

[1] For management purposes, the calculation of allocated equity was changed for all segments, applying the regulatory calculation method. Reported equity on the statement of financial position differs from this. Aareon's total equity as disclosed in the statement of financial position amounts to € 192 million. Other reserves are now also included when calculating allocated equity at Group level. RoE before taxes is thus also changed accordingly. The previous year's figures were adjusted accordingly.

[2] On an annualised basis

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

Commission income from contracts with customers is allocated to the segments as follows:

€ mn	Structured Property Financing 1 Jan-30 Jun 2020	Structured Property Financing 1 Jan-30 Jun 2019	Consulting/Services Bank 1 Jan-30 Jun 2020	Consulting/Services Bank 1 Jan-30 Jun 2019	Aareon 1 Jan-30 Jun 2020	Aareon 1 Jan-30 Jun 2019	Consolidation/ Reconciliation 1 Jan-30 Jun 2020	Consolidation/ Reconciliation 1 Jan-30 Jun 2019	Aareal Bank Group 1 Jan-30 Jun 2020	Aareal Bank Group 1 Jan-30 Jun 2019
ERP products (incl. add-on products)					96	99	-9	-8	87	91
Digital solutions					30	23			30	23
Banking business and other activities	5	6	15	14					20	20
Total	**5**	**6**	**15**	**14**	**126**	**122**	**-9**	**-8**	**137**	**134**

Other Notes

(27) Contingent liabilities and loan commitments

€ mn	30 Jun 2020	31 Dec 2019
Contingent liabilities	162	157
Loan commitments	1,300	1,205
of which: irrevocable	966	881

(28) Employees

The number of Aareal Bank Group employees is shown below:

	30 Jun 2020[1]	Average 1 Jan - 30 Jun 2020[2]	31 Dec 2019[1]	Average 1 Jan - 31 Dec 2019[2]
Salaried employees	2,740	2,711	2,640	2,641
Executives	163	163	148	150
Total	**2,903**	**2,874**	**2,788**	**2,791**
of which: Part-time employees	574	552	556	564

[1] This number does not include 58 employees of the hotel business (31 December 2019: 45 employees).
[2] This number does not include 55 employees of the hotel business (1 January to 31 December 2019: 180 employees).

(29) Related party disclosures in accordance with IAS 24

In the first six months of the 2020 financial year, there were no material transactions with related parties that would have to be reported here.

(30) Events after the interim reporting period

In spite of the adverse circumstances caused by the lockdown in Italy, Aareal Bank managed to successfully continue its accelerated de-risking exercise, selling two defaulted Italian loan exposures totalling € 141 million in July 2020 in this connection. The related charge of € 9 million was already absorbed in loss allowance for the second quarter. In addition, Aareal Bank acquired a property with a carrying amount of € 28 million from a defaulted credit exposure for its own property holdings in July 2020.

No other material events occurred after the interim reporting period which would have to be reported here.

Executive bodies of Aareal Bank AG

Supervisory Board

Marija Korsch [1) 2) 3) 4) 5)]
Chairman of the Supervisory Board
Former partner of Bankhaus Metzler seel.
Sohn & Co. Holding AG

Richard Peters [1) 2) 3)]
Deputy Chairman of the Supervisory Board
President and Chairman of the Management Board of Versorgungsanstalt des Bundes und der Länder

Klaus Novatius [1) 2) 6)]
Deputy Chairman of the Supervisory Board
Aareal Bank AG

Jana Brendel [4) 5)]
Chief Technology Officer DACH
Nets Group
(since 27 May 2020)

Christof von Dryander [1) 2) 3)]
Senior Counsel, Cleary Gottlieb
Steen & Hamilton LLP
(since 27 May 2020)

Thomas Hawel [5) 6)]
Aareon Deutschland GmbH

Petra Heinemann-Specht [3) 4) 6)]
Aareal Bank AG

Jan Lehmann [5) 6)]
Aareon Deutschland GmbH
(since 27 May 2020)

Sylvia Seignette [4)]
Chairman of the Risk Committee
Former CEO for Germany and Austria,
Crédit Agricole CIB (formerly Calyon)

Elisabeth Stheeman [4) 5)]
External Member of the Financial Policy Committee and of the Financial Market Infrastructure Board, Bank of England, Prudential Regulation Authority

Hans-Dietrich Voigtländer [2) 3) 5)]
Chairman of the Technology and Innovation Committee
Associate Partner at BDG Innovation + Transformation GmbH & Co. KG

Prof. Hermann Wagner [1) 3) 4)]
Chairman of the Audit Committee
German Chartered Accountant, tax consultant

Members retired at the Annual General Meeting on 27 May 2020:
Prof. Stephan Schüller
Dr Hans-Werner Rhein
Beate Wollmann

Management Board

Hermann Josef Merkens
Chairman of the Management Board

Marc Hess
Member of the Management Board

Dagmar Knopek
Member of the Management Board

Christiane Kunisch-Wolff
Member of the Management Board

Thomas Ortmanns
Member of the Management Board

Christof Winkelmann
Member of the Management Board

[1)] Member of the Executive and Nomination Committee; [2)] Member of the Remuneration Control Committee; [3)] Member of the Audit Committee;
[4)] Member of the Risk Committee; [5)] Member of the Technology and Innovation Committee; [6)] Elected by employees

Responsibility Statement

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

Wiesbaden, 5 August 2020

The Management Bopard

Hermann J. Merkens	Marc Hess	Dagmar Knopek
Christiane Kunisch-Wolff	Thomas Ortmanns	Christof Winkelmann

Review Report

To Aareal Bank AG, Wiesbaden

We have reviewed the condensed consolidated interim financial statements – comprising the statement of financial position, statement of comprehensive income, condensed statement of cash flows, statement of changes in equity and selected explanatory notes – and the interim group management report of Aareal Bank AG, Wiesbaden, for the period from 1 January 2020 to 30 June 2020 which are part of the half-year financial report pursuant to § (Article) 115 WpHG ("Wertpapierhandelsgesetz": German Securities Trading Act). The preparation of the condensed consolidated interim financial statements in accordance with the IFRS applicable to interim financial reporting as adopted by the EU and of the interim group management report in accordance with the provisions of the German Securities Trading Act applicable to interim group management reports is the responsibility of the parent Company's Board of Managing Directors. Our responsibility is to issue a review report on the condensed consolidated interim financial statements and on the interim group management report based on our review.

We conducted our review of the condensed consolidated interim financial statements and the interim group management report in accordance with German generally accepted standards for the review of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW) and additionally observed the International Standard on Review Engagements "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" (ISRE 2410). Those standards require that we plan and perform the review so that we can preclude through critical evaluation, with moderate assurance, that the condensed consolidated interim financial statements have not been prepared, in all material respects, in accordance with the IFRS applicable to interim financial reporting as adopted by the EU and that the interim group management report has not been prepared, in all material respects, in accordance with the provisions of the German Securities Trading Act applicable to interim group management reports. A review is limited primarily to inquiries of company personnel and analytical procedures and therefore does not provide the assurance attainable in a financial statement audit. Since, in accordance with our engagement, we have not performed a financial statement audit, we cannot express an audit opinion.

Based on our review, no matters have come to our attention that cause us to presume that the condensed consolidated interim financial statements have not been prepared, in all material respects, in accordance with the IFRS applicable to interim financial reporting as adopted by the EU nor that the interim group management report has not been prepared, in all material respects, in accordance with the provisions of the German Securities Trading Act applicable to interim group management reports.

Frankfurt/Main, 7 August 2020

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

Ralf Schmitz	**Christian F. Rabeling**
Wirtschaftsprüfer	**Wirtschaftsprüfer**
(German Public Auditor)	**(German Public Auditor)**

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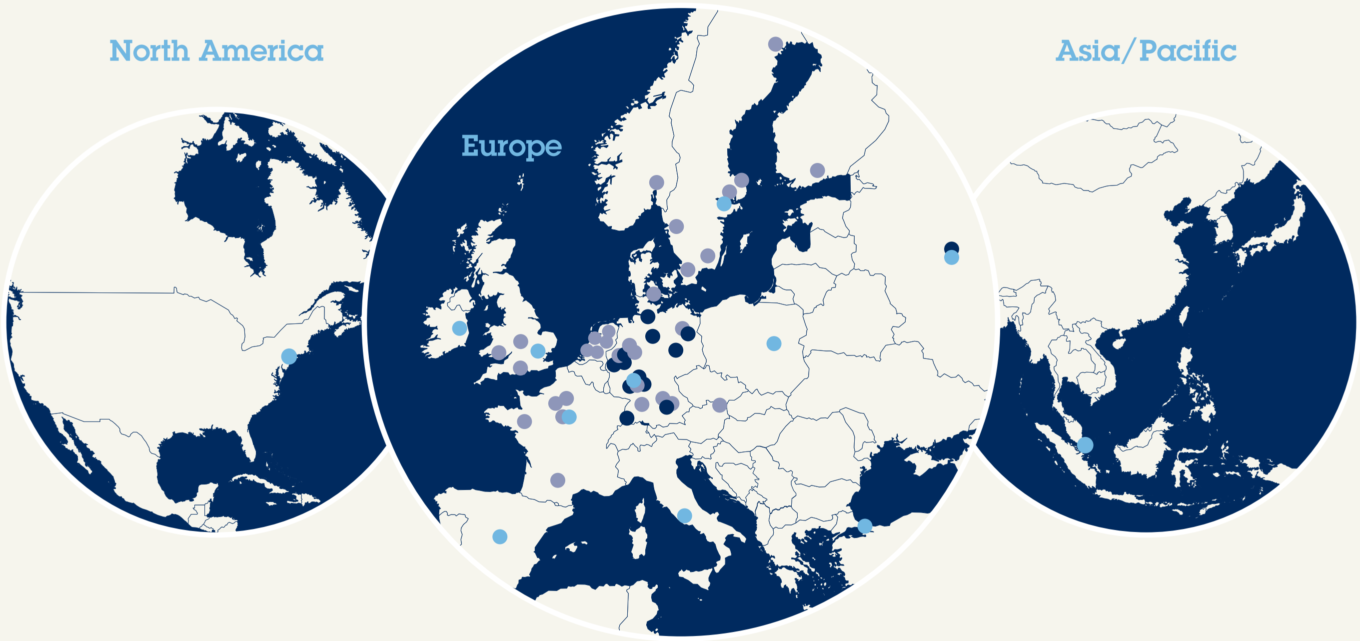
Financial Calendar

12 November 2020	Publication of results as at 30 September 2020
26 May 2021	Annual General Meeting – Kurhaus, Wiesbaden

Locations/Imprint



Structured Property Financing
Consulting/Services Bank
Aareon

Aareal Bank, Real Estate Structured Finance: Dublin, Istanbul, London, Madrid, Moscow, New York, Paris, Rome, Singapore, Stockholm, Warsaw, Wiesbaden | **Aareal Estate AG:** Wiesbaden

Aareal Bank, Consulting/Services Bank: Berlin, Essen, Wiesbaden | **Aareal First Financial Solutions AG:** Mainz | **Deutsche Bau- und Grundstücks-AG:** Berlin, Bonn, Düsseldorf, Frankfurt/Main, Freiburg, Hamburg, Hanover, Leipzig, Moscow, Munich | **plusForta GmbH:** Berlin, Düsseldorf

Aareon: Amsterdam, Augsburg, Berlin, Bochum, Coventry, Dortmund, Emmen, Enschede, Gorinchem, Grathem, Hamburg, Hattingen, Helsinki, Hückelhoven, Karlskrona, Kiel, Lund, Mainz, Meudon-la-Forêt, Mölndal, Munich, Nantes, Norrtälje, Orléans, Oslo, Paris, Piteå, Southampton, Stockholm, Stuttgart, Swansea, Toulouse, Utrecht, Vienna

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Aareal Bank Group

08/2020

Aareal

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