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

Consolidated Financial Statements

Contents II

169 Notes to the Statement of Financial Position

192 Notes to Financial Instruments

208 Segment Reporting

213 Other Notes

231 Responsibility Statement

232 Independent Auditors' Report

Consolidated Financial Statements
Statement of Comprehensive Income

Income Statement

	Note	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017[1]
€ mn			
Interest income from financial instruments (ac and fvoci)		847	835
Interest income from financial instruments (fvpl)		38	8
Market-driven modification gains		2	n/a
Interest expenses for financial instruments (ac)		113	110
Interest expenses for financial instruments (fvpl)		236	149
Market-driven modification losses		3	n/a
Net interest income	28	**535**	**584**
Loss allowance excluding credit-driven net modification gain or loss		72	82
Credit-driven net modification gain or loss		0	n/a
Loss allowance	29	**72**	**82**
Commission income		259	243
Commission expenses		44	37
Net commission income	30	**215**	**206**
Net gain or loss on the derecognition of financial assets (ac)		24	50
Net gain or loss on the derecognition of financial liabilities (ac)		0	0
Net gain or loss on the derecognition of financial assets (fvoci)		–	0
Net derecognition gain or loss	31	**24**	**50**
Net gain or loss from financial instruments (fvpl)	32	-2	14
Net gain or loss from hedge accounting	33	-2	-7
Net gain or loss from investments accounted for using the equity method	34	0	–
Administrative expenses	35	462	511
Net other operating income/expenses	36	25	74
Negative goodwill from acquisitions	37	55	–
Operating profit		**316**	**328**
Income taxes	38	90	115
Consolidated net income		**226**	**213**
Consolidated net income attributable to non-controlling interests		2	6
Consolidated net income attributable to shareholders of Aareal Bank AG		224	207
Earnings per share (EpS)			
Consolidated net income attributable to shareholders of Aareal Bank AG[2]		224	207
of which: allocated to ordinary shareholders		208	191
of which: allocated to AT1 investors		16	16
Earnings per ordinary share (in €)[3]		3.48	3.20
Earnings per AT1 unit (in €)[4]		0.16	0.16

[1] Comparative amounts reclassified according to the new classification format

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

[3] 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.

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

Statement of Comprehensive Income

Reconciliation from Consolidated Net Income to Total Comprehensive Income

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017[1)]
Consolidated net income	**226**	**213**
Items that will not be reclassified subsequently to profit or loss		
Changes in the reserve from remeasurements of defined benefit plans	**-7**	**9**
Remeasurements	-10	13
Taxes	3	-4
Changes in the reserve from the measurement of equity instruments (fvoci)	**0**	**–**
Gains and losses from equity instruments (fvoci)	0	–
Transfers to retained earnings	–	–
Taxes	0	–
Items that are reclassified subsequently to profit or loss		
Changes in the reserve from the measurement of debt instruments (fvoci)	**-14**	**-5**
Gains and losses from debt instruments (fvoci)	-20	-7
Reclassifications to the income statement	–	0
Taxes	6	2
Changes in hedging reserves	**–**	**-18**
Profit/loss from derivatives used to hedge future cash flows	–	-27
Reclassifications to the income statement	–	0
Taxes	–	9
Changes in the reserve from foreign currency basis spreads	**-12**	**n/a**
Gains and losses from foreign currency basis spreads	-17	n/a
Reclassifications to the income statement	–	n/a
Taxes	5	n/a
Changes in currency translation reserves	**5**	**-15**
Gains and losses from translating foreign operations' financial statements	1	-15
Reclassifications to the income statement	–	–
Taxes	4	–
Other comprehensive income	**-28**	**-29**
Total comprehensive income	**198**	**184**
Total comprehensive income attributable to non-controlling interests	2	6
Total comprehensive income attributable to shareholders of Aareal Bank AG	196	178

[1)] Comparative amounts reclassified according to the new classification format

Statement of Financial Position

€ mn	Note	31 Dec 2018	31 Dec 2017[1]	31 Dec 2016[1]
Assets				
Financial assets (ac)	39	**34,702**	**33,696**	**38,421**
Cash funds	8	1,265	2,081	1,786
Loan receivables	9	26,795	26,316	29,767
Money market and capital market receivables	10	6,578	5,225	6,800
Receivables from other transactions	12	64	74	68
Loss allowance (ac)	40	-577	-540	-554
Financial assets (fvoci)	41	**4,450**	**5,424**	**5,949**
Money market and capital market receivables	10	4,443	5,422	5,947
Equity instruments	11	7	2	2
Financial assets (fvpl)	42	**3,183**	**2,449**	**2,983**
Loan receivables	9	711	196	–
Money market and capital market receivables	10	538	–	–
Positive market value of designated hedging derivatives	13	1,277	1,926	2,481
Positive market value of other derivatives	14	657	327	502
Investments accounted for using the equity method	15, 43	7	7	0
Intangible assets	16, 44	158	153	126
Property and equipment	17, 45	260	253	252
Income tax assets	46	30	52	68
Deferred tax assets	18, 47	141	99	134
Other assets	19, 48	333	315	329
Total		**42,687**	**41,908**	**47,708**
Equity and liabilities				
Financial liabilities (ac)	49	**37,215**	**36,630**	**40,587**
Money market and capital market liabilities	20	26,371	26,109	29,935
Deposits from the housing industry	21	9,679	9,164	9,191
Liabilities from other transactions	22	121	92	95
Subordinated capital	23	1,044	1,265	1,366
Financial liabilities (fvpl)	50	**1,934**	**1,703**	**3,181**
Negative market value of designated hedging derivatives	13	1,461	1,479	2,529
Negative market value of other derivatives	14	473	224	652
Provisions	24, 51	519	570	680
Income tax liabilities	52	40	29	71
Deferred tax liabilities	18, 53	18	19	28
Other liabilities	25, 54	33	33	32
Equity	26, 55	**2,928**	**2,924**	**3,129**
Subscribed capital		180	180	180
Capital reserves		721	721	721
Retained earnings		1,797	1,798	1,734
AT1 bond		300	300	300
Other reserves		-72	-77	-48
Non-controlling interests		2	2	242
Total		**42,687**	**41,908**	**47,708**

[1] Comparative amounts reclassified according to the new classification format; recognised amounts of the previous period as at 1 January 2017 correspond to the recognised amounts as at 31 December 2016

Statement of Changes in Equity

€ mn	Equity as at 1 Jan 2018[1]	Adjustment due to first-time application of IFRS 9	Adjusted equity as at 1 Jan 2018	Total comprehensive income for the period	Payments to non-controlling interests	Dividends	AT1 coupon	Other changes	Equity as at 31 Dec 2018
Subscribed capital	**180**		**180**						**180**
Capital reserves	**721**		**721**						**721**
Retained earnings	**1,798**	-60	**1,738**	224		-150	-16	1	**1,797**
AT1 bond	**300**		**300**						**300**
Other reserves	**-77**	**33**	**-44**	**-28**					**-72**
Reserve from remeasurements of defined benefit plans	-91		-91	-7					-98
Reserve from the measurement of equity instruments (fvoci)	0		0	0					0
Reserve from the measurement of debt instruments (fvoci)	24	29	53	-14					39
Hedging reserve	-1	1							
Reserve from changes in the value of foreign currency basis spreads		3	3	-12					-9
Currency translation reserves	-9		-9	5					-4
Total	**2,922**	**-27**	**2,895**	**196**		**-150**	**-16**	**1**	**2,926**
Non-controlling interests	**2**		**2**	2	-2				**2**
Equity	**2,924**	**-27**	**2,897**	**198**	**-2**	**-150**	**-16**	**1**	**2,928**

€ mn	Equity as at 1 Jan 2017[1]	Total comprehensive income for the period	Payments to non-controlling interests	Dividends	AT1 coupon	Other changes	Equity as at 31 Dec 2017[1]
Subscribed capital	**180**						**180**
Capital reserves	**721**						**721**
Retained earnings	**1,734**	207		-120	-16	-7	**1,798**
AT1 bond	**300**						**300**
Other reserves	**-48**	**-29**					**-77**
Reserve from remeasurements of defined benefit plans	-100	9					-91
Reserve from the measurement of equity instruments (fvoci)	0						0
Reserve from the measurement of debt instruments (fvoci)	29	-5					24
Hedging reserves	17	-18					-1
Reserve from changes in the value of foreign currency basis spreads							
Currency translation reserves	6	-15					-9
Total	**2,887**	**178**		**-120**	**-16**	**-7**	**2,922**
Non-controlling interests	**242**	6	-6			-240	**2**
Equity	**3,129**	**184**	**-6**	**-120**	**-16**	**-247**	**2,924**

[1] Comparative amounts reclassified according to the new classification format

Statement of Cash Flows

€ mn	Cash flow 1 Jan-31 Dec 2018	Cash flow 1 Jan-31 Dec 2017[1]
Consolidated net income	**226**	**213**
Additions to and reversals of loss allowances	76	118
Amortisation, depreciation, impairment and write-ups of non-current assets	16	27
Other non-cash changes	164	-1,070
Gains/losses on the disposal of non-current assets	-55	-7
Other adjustments	-548	130
Subtotal	**-121**	**-589**
Changes in financial assets (ac) (excluding cash funds)	42	3,756
Changes in financial assets (fvoci)	245	577
Changes in financial assets (fvpl)	259	373
Changes in other assets	-50	-2
Changes in financial assets (ac) (excluding subordinated capital)	-1,060	-2,977
Changes in financial liabilities (fvpl)	-90	-259
Changes in provisions	-58	-101
Changes in other liabilities	10	-6
Income taxes paid	-22	-107
Interest received	868	346
Dividends received	0	–
Interest paid	-317	-182
Cash flow from operating activities	**-294**	**829**
Proceeds from the disposal of equity instruments and investments accounted for using the equity method	0	0
Payments for the acquisition of equity instruments and investments accounted for using the equity method	-6	-7
Proceeds from the disposal of property and equipment and intangible assets	2	13
Payments for the acquisition of property and equipment and intangible assets	-31	-43
Effect of changes in reporting entity structure	-44	-21
Cash flow from investing activities	**-79**	**-58**
Dividends paid and AT1 coupon payments	-165	-135
Changes in subordinated capital[2]	-276	-87
Changes due to other funding activities	-2	-254
Cash flow from financing activities	**-443**	**-476**
Cash and cash equivalents as at 1 January	**2,081**	**1,786**
Cash flow from operating activities	-294	829
Cash flow from investing activities	-79	-58
Cash flow from financing activities	-443	-476
Cash and cash equivalents as at 31 December	**1,265**	**2,081**

[1] Within the scope of the changeover to IFRS 9 and the business model allocation, cash flows from securities were re-allocated from investment activities to operating activities.
[2] The changes in subordinated capital in the amount of € -221 million (2017: € -101 million) consists of € -215 million (2017: € -116 million) related to cash flow relevant payments of principal and interest as well as an amount of € -6 million (2017: € 15 million) non-cash changes in fair value and changes of accrued interest.

Notes
Basis of Accounting

Aareal Bank AG is a public limited company incorporated under German law, with its registered office in Wiesbaden, Germany. It is the parent company of an international property finance and services group, and registered under no. HRB 13 184 in the Commercial Register at the Wiesbaden local court (Amtsgericht Wiesbaden).

As a listed public limited company, Aareal Bank AG has prepared its consolidated financial statements for the financial year ended on 31 December 2018 in accordance with International Financial Reporting Standards (IFRSs) applicable within the European Union (EU) as at the reporting date, in connection with the provisions pursuant to section 315e of the German Commercial Code (Handelsgesetzbuch – "HGB"). The reporting currency is the euro (€).

The Management Board approved the consolidated financial statements for publication on 5 March 2019; they will be published in the German Federal Gazette.

Accounting policies

(1) Accounting standards

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

We generally apply accounting policies – and the presentation of financial statements – consistently, in order to ensure the comparability of financial statements over time. The classification format was adjusted within the framework of the first-time application of IFRS 9.

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

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

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

Interest income and expenses are recognised using the effective interest method. In the case of impaired receivables, interest revenue is recognised based on the net carrying amount. Interest from derivatives designated for hedge accounting and economic hedging relationships is included in net interest income. Interest from derivative hedging instruments is shown under interest from financial instruments (ac and fvoci). Based on the IFRIC decision ”Presentation of interest revenue for particular financial instruments“, we report interest from economic hedging relationships under interest from financial instruments (fvpl). The previous year‘s figures were adjusted accordingly. We provide specific information on negative interest from financial assets or positive interest from financial liabilities in the Notes, under net interest income. These assets and liabilities are deposits as well as money market and securities repurchase transactions.

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

Commission income and expenses include revenue from the provision of goods or services in the ordinary course of business. This mainly refers to IT consulting projects, trainings, licence and maintenance agreement and hosting or outsourcing services.

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

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

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

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

(2) Changes in accounting policies

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

- **IFRS 9 Financial Instruments**
  IFRS 9 Financial Instruments introduces new rules for the accounting of financial instruments, and generally replaced IAS 39 Financial Instruments: Recognition and Measurement as at 1 January 2018. We present the changes in the chapter "First-time application of IFRS 9 Financial Instruments" in this section.

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

- **IFRS 15 Revenue from Contracts with Customers**
  IFRS 15 governs the recognition of revenue from contracts with customers based on a uniform model. The standard supersedes the current revenue recognition provisions set out in IAS 11 and IAS 18 as well as the related interpretations. IFRS 15 has to be applied by all companies that enter into contracts with customers for the delivery of goods or the provision of services unless these contracts are within the scope of other standards. Accordingly, amongst other things, financial instruments and other contractual rights or obligations within the scope of IFRS 9 are excluded from the scope of IFRS 15. The core principle of IFRS 15 for revenue recognition is that an entity has to recognise revenue when the performance obligations assumed are satisfied, i.e. when control over the goods and services has been transferred. Revenue has to be recognised in an amount that reflects the consideration that the entity expects to receive in exchange for those goods or services. IFRS 15 introduces a 5-step model based on which the amount and the timing of revenue recognition are determined. In addition, the standard requires additional disclosures, including, amongst other things, a disaggregation of total revenue, performance obligations, a reconciliation of opening and closing balances of contractual net assets and liabilities as well as significant judgements and estimates. Aareal Bank Group has reviewed the effects of the new standard on the consolidated financial statements by analysing the relevant standard contracts on the basis of the 5-step model. Within the Group, these changes mainly affect Aareon. Aareon has adjusted its processes. Within the scope of this adjustment, we have changed the breakdown of net commission income to reflect the product view which is relevant for management purposes. Com-

mission income from advisory and other services is broken down into ERP products, digital solutions, and add-on products. Commission expenses from advisory and other services have been renamed as purchased services. Net commission income from trustee and administered loans, securities business, and other lending and money market transactions as well as net other commission income have been summarised as net commission income from banking business and other activities. Moreover, commission income is also shown in segment reporting. The modified retrospective approach did not have any material consequences for Aareal Bank Group.

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

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

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

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

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

Except for IFRS 9, the revised standards did not have any material consequences for the consolidated financial statements of Aareal Bank Group.

Until 31 December 2018, the following financial reporting standards (IASs/IFRSs) and interpretations (SICs and IFRICs) had been published by the International Accounting Standards Board (IASB) and adopted by the EU Commission:

New International Financial Reporting Standards/Interpretations		Issued	Endorsed	Effective Date
IFRS 16	Leases	January 2016	October 2017	Financial years beginning on or after 1 January 2019
IFRS 17	Insurance Contracts	May 2017		Financial years beginning on or after 1 January 2022
IFRIC 23	Uncertainty over Income Tax Treatments	June 2017	October 2018	Financial years beginning on or after 1 January 2019

Revised International Financial Reporting Standards		Issued	Endorsed	Effective Date
IAS 1	Definition of Material	October 2018		Financial years beginning on or after 1 January 2020
IFRS 3	Definition of a Business	October 2018		Financial years beginning on or after 1 January 2020
IAS 19	Plan Amendment, Curtailment or Settlement	February 2018		Financial years beginning on or after 1 January 2019
IAS 28	Long-term Interests in Associates and Joint Ventures	October 2017	February 2019	Financial years beginning on or after 1 January 2019
IFRS 9	Prepayment Features with Negative Compensation	October 2017	March 2018	Financial years beginning on or after 1 January 2019
	Annual Improvements Cycle 2015-2017	December 2017		Financial years beginning on or after 1 January 2019

- **IFRS 16: Leases**
  The new financial reporting standard IFRS 16, regarding lease accounting, will replace IAS 17 as well as the related interpretations IFRIC 4, SIC 15 and SIC 7. IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise (in the statement of financial position) any leases and the related contractual rights and obligations with a term of more than twelve months, unless the underlying asset is of low value. The lessee recognises a right-of-use asset (representing its right to use the underlying leased asset) and also a lease liability (representing its obligation to make lease payments). Similar to the previous rules set out in IAS 17, the lessor continues to classify its leases as finance or operating leases. The criteria for classification under IFRS 16 equal those of IAS 17. In addition, IFRS 16 sets outs a number of further rules for presentation, disclosures in the Notes and sale-and-lease-back transactions. Overall, we do not expect any material impact on the consolidated financial statements. The adoption of IFRS 16 is based on the modified retrospective approach, i.e. the expected transition effect from the retrospective application (€ -6 million) is recorded in equity, in retained earnings. We anticipate the amount of right-of-use assets and the corresponding lease liabilities to be € 71 million. The practical relief provided for by the IFRS 16 as regards short-term lease agreements and low-value leased assets are made use of.

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

- **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 the problems 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.

- **IAS 19 Plan Amendment Curtailment or Settlement**
  As a result of the amendments, entities will be required in future to re-determine the current service cost and the net interest for the remainder of the financial year in case of an amendment, curtailment or settlement of a defined benefit plan using current actuarial assumptions used to remeasure the net defined benefit liability (asset).

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

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

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

Aareal Bank Group did not opt for early application of these standards in 2018, which are required to be applied in future financial years.

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

First-time application of IFRS 9 Financial Instruments

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

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

- ”Financial assets measured at amortised cost (ac) using the effective interest method”;
- ”Financial assets at fair value through other comprehensive income (fvoci)”; and
- ”Financial assets at fair value through profit or loss (fvpl)”.

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

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

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

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

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

Specific allowances for credit losses pursuant to IAS 39 were recognised where estimated future cash flows fall below the carrying amount of a loan receivable. This methodology was developed further into a probability-weighted multi-scenario analysis. The transition effect amounted to € -22 million (after taxes) for Stage 3.

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

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

Due to the introduction of IFRS 9 and in order to increase the transparency of the financial statements, the classification format was adjusted. The comparative figures were reclassified, but are still based on the IAS 39 rules. The following table shows a reconciliation of the financial instruments by measurement categories under IAS 39 to IFRS 9 (before taxes).

€ mn	IAS 39 31 Dec 2017	IAS 39 reclassified 31 Dec 2017	Reclassi-fication	Revaluation OCI	Revaluation Retained earnings	IFRS 9 1 Jan 2018
Financial assets (ac)						
Cash funds (ac)		**2,081**				**2,081**
from cash funds (lar)	2,081					
Loan receivables (ac)		**26,316**				**25,885**
from loans and advances to banks (lar)	5					
from loans and advances to customers (lar)	26,311				27	
less loan receivables (fvpl)			-458			
Money market and capital market receivables (ac)		**5,225**				**6,087**
from loans and advances to banks (lar)	774					
from loans and advances to customers (lar)	1,338					
from non-trading assets (lar, htm)	3,113			63		
plus money market and capital market receivables (fvoci)			1,594	-41		
less money market and capital market receivables (fvoci)			-505			
less money market and capital market receivables (fvpl)			-249			
Receivables from other transactions (ac)		**74**	2			**76**
from other (financial) assets (lar)	74					
Financial assets (fvoci)						
Money market and capital market receivables (fvoci)		**5,422**				**4,343**
from non-trading assets (afs)	5,422					
plus money market and capital market receivables (ac)			505	10		
less money market and capital market receivables (ac)			-1,594			
Equity instruments (fvoci)		**2**				**2**
from non-trading assets (afs)	2					
Financial assets (fvpl)						
Loan receivables (fvpl)		**196**				**604**
from loans and advances to customers (hft)	196					
plus (net) loan receivables (ac)			408			
Money market and capital market receivables (fvpl)		**–**			2	**251**
plus money market and capital market receivables (ac)			249			
Positive market value of designated hedging derivatives (fvpl)		**1,926**				**1,387**
from positive market value of derivative hedging instruments (hft)	1,926					
less positive market value of other derivatives (fvpl)			-539			
Positive market value of other derivatives (fvpl)		**327**				**866**
from trading assets (hft)	327					
plus positive market value of designated hedging derivatives (fvpl)			539	-1	1	
Total		**41,569**	**-48**	**31**	**30**	**41,582**

€ mn	IAS 39 31 Dec 2017	IAS 39 reclassified 31 Dec 2017	Reclassi-fication	Revaluation OCI	Revaluation Retained earnings	IFRS 9 1 Jan 2018
Financial liabilities (ac)						
Money market and capital market liabilities (ac)		**26,109**				**26,109**
from liabilities to banks (lac)	1,914					
from liabilities to customers (lac)	16,601					
from certificated liabilities (lac)	7,594					
Deposits from the housing industry (ac)		**9,164**				**9,164**
from liabilities to customers (lac)	9,164					
Liabilities from other transactions (ac)		**92**				**92**
from other (financial) liabilities (lac)	92					
Subordinated capital (ac)		**1,265**				**1,265**
Subordinated capital (lac)	1,265					
Financial liabilities (fvpl)						
Negative market value of designated hedging derivatives (fvpl)		**1,479**				**1,318**
from negative market value of derivative hedging instruments (hft)	1,479					
less negative market value of other derivatives (fvpl)			-161	1	-1	
Negative market value of other derivatives (fvpl)		**224**				**385**
from trading liabilities (hft)	224			6	-6	
plus negative market value of other derivatives (fvpl)			161			
Total		**38,333**	**–**	**7**	**-7**	**38,333**

€ mn	IAS 39 31 Dec 2017	IAS 39 reclassified 31 Dec 2017	Reclassi-fication	Revaluation OCI	Revaluation Retained earnings	IFRS 9 1 Jan 2018
Loss allowance on financial assets (ac)						
Loan receivables (ac)		**-540**				**-571**
from loans and advances to customers (lar)	-540				-81	
less loan receivables (fvpl)			50			
Money market and capital market receivables (ac)		**–**				**-20**
from non-trading assets (lar, htm)	–				-15	
plus money market and capital market receivables (fvoci)					-5	
Receivables from other transactions (ac)		**–**				**-2**
from other (financial) assets (lar)	–		-2			
Provisions for unrecognised lending business		**-4**				**-6**
from provisions in the lending business for unrecognised items	-4				-2	
Loss allowance in reserves from debt instruments (fvoci)						
Money market and capital market receivables (fvoci)		**–**				**0**
from non-trading assets (afs)	–				0	
Total	**-544**	**-544**	**48**	**–**	**-103**	**-599**

The total transition effect of € -27 million (after taxes) recognised under equity comprises the revaluation effects disclosed in other comprehensive income and retained earnings of € -42 million, less tax effects of € 15 million.

Within the scope of the first-time application, non-trading assets (afs) (money market and capital market receivables (fcovi)) in the amount of € 1,594 million were allocated to the "hold" business model and since then have been measured at amortised cost. Debt securities held on the reporting date were carried at € 1,461 million, reflecting their fair value. Therefore, there was no material difference required to be reported in the revaluation surplus in accordance with IAS 39.

(3) Consolidation

Consolidation principles

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

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

Any non-controlling interests resulting from full consolidation are shown in the statement of financial position, as a separate item of equity.

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

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

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

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

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

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

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

Reporting entity structure

As at 31 December 2018, the reporting entity structure comprised 67 companies (2017: 73), including Aareal Bank AG as well as 59 (2017: 65) subsidiaries, two joint arrangements (2017: two) as well as five associates (2017: five).

Aareal Bank Group successfully closed the acquisition of all shares of Düsseldorfer Hypothekenbank AG (Düsselhyp), announced on 10 September 2018. The acquisition was completed with effect from 31 December 2018 (the closing date). Düsselhyp is therefore now a legally independent subsidiary of Aareal Bank Group. The purchase price paid amounted to € 149 million. Aareal Bank will not pursue any further strategic objectives with this acquisition. Aareal Bank will consistently pursue this orderly run-down. The acquisition resulted in a negative goodwill of € 55 million, which was recognised in income. Administrative expenses for the 2019 financial year will presumably be burdened by the transaction, in a very low double-digit million amount. These costs have reduced the purchase price and increased negative goodwill accordingly. As part of the integration of Düsselhyp into Aareal Bank Group, a control and profit transfer agreement was concluded.

In accordance with IFRS 3, all identifiable assets and liabilities of the acquired entity have to be measured at their fair value at the time of acquisition (closing). These fair values also represent the amounts recognised upon initial consolidation. The difference between the purchase price and the higher net balance of assets and liabilities acquired and measured at fair value is recognised as negative goodwill in the income statement, and directly increases the equity of Aareal Bank Group. This income currently amounts to € 55 million and is reported in the statement of comprehensive income in a separate item. It primarily results from the utilisation of a favourable market environment for such transactions. Apart from favourable price-to-book valuations and attractive asset and liability spreads, limited investor interest in the European corporate property banking sector contributed to this favourable environment.

The determination of the fair value for the assets acquired and liabilities assumed, which is required for the purchase price allocation in accordance with IFRS 3, is subject to judgements, in particular with regard to cash flows and discount rates. The purchase price allocation has been completed.

The following overview shows the purchase price allocation in accordance with IFRS 3 as at the acquisition date:

€ mn	Fair value as at 31 December 2018
Financial assets (ac)	**1,663**
Cash funds	105
Loan receivables	312
Money market and capital market receivables	1,244
Receivables from other transactions	2
Financial assets (fvoci)	**412**
Money market and capital market receivables	412
Financial assets (fvpl)	**398**
Money market and capital market receivables	308
Positive market value of designated hedging derivatives	76
Positive market value of other derivatives	14
Intangible assets	0
Property and equipment	0
Income tax assets	0
Net deferred tax assets	45
Other assets	1
Total assets acquired	**2,519**
Financial liabilities (ac)	**1,975**
Money market and capital market liabilities	1,972
Liabilities from other transactions	3
Financial liabilities (fvpl)	**324**
Negative market value of designated hedging derivatives	214
Negative market value of other derivatives	110
Provisions	16
Other liabilities	0
Total liabilities assumed	**2,315**
Total net assets acquired	**204**
Purchase price	149
Negative goodwill	**55**

The nominal amount of loan receivables ac is € 299 million; it does not include any impaired loans. Within the scope of the acquisition of Düsselhyp, Aareal Bank also assumed credit and legal risks. The risks were taken into account within the context of the purchase price allocation.

The business combination resulted in costs of € 2 million.

There were no other material changes to the scope of consolidation during the period under review.

Note 87 "List of Shareholdings" includes an overview of the Group companies.

(4) Currency translation

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

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

Currency translation adjustments on monetary assets and liabilities must be recognised in income. Depending on the relevant measurement category, currency translation adjustments on non-monetary items are either recognised directly in equity (in the currency translation reserves), or recognised in the income statement (in net gain or loss from transactions measured at fair value).

Financial statements of consolidated subsidiaries, which are presented in a currency other than the euro, are translated at the ECB reference rate prevailing at the reporting date (statement of financial position) or at average rates (income statement). Translation differences are recognised in equity, in the currency translation reserves.

(5) Revenue recognition

Revenue recognition is assessed on the basis of the five-step model in accordance with IFRS 15. Aareal Bank Group recognised revenue in the banking business as well as in the area of Consulting/Services. Revenue recognition in the banking business mainly refers to the provision of loans, the administration of syndicated loans or the provision of payment systems for the property and energy industries. Aareal Bank Group recognises revenue in the same period in which the services are provided. When contracts comprise various performance obligations, each of the performance obligations are priced separately. Mostly, fixed fees are agreed. Commissions from the lending and other banking business mainly arise over time. The customer obtains control over the service while Aareal Bank is providing the service. The agreed transaction price is invoiced to the customer on a pro-rata basis as at the end of an agreed period (normally monthly or quarterly). The Bank recognises the invoiced amount as revenue when it is entitled to a consideration in an amount that directly corresponds to the value of the services already provided.

Invoiced amounts are payable immediately in the agreed amounts. Since the service has already been provided at the time the invoice is issued, an unconditional right to consideration arises, and a receivable due from the customer is recorded.

In the Consulting/Services unit, Aareal Bank Group earns revenue mainly from the country-specific ERP business in the property industry, from the marketing of digital solutions and other additional products and services such as insurance management, IT outsourcing, solutions for the energy industry and integrated payment systems. In this context, services are provided within the framework of licence agreements, maintenance agreements, consulting and training projects as well as hosting from the exclusive Aareon Cloud.

Licence revenue is deemed to be realised when there is an agreement signed by both parties without a right of rescission, the product has been delivered in its entirety (e.g. via licence keys), the licence fee is fixed, and payment is probable. Thus, the customer obtains control over the right-of-use asset transferred. The payment is made primarily after the licence agreement has been concluded or after successful implementation of the software with a credit term of several days. Revenue is accrued as a contract asset until the implementation is completed. After that, the amount is recognised as a trade receivable.

The recognition of maintenance as well as hosting and outsourcing services is made on a pro-rata basis over the contractual service period. Hosting solutions are billed monthly and recorded as sales revenue. A large portion of the customers pays its maintenance and hosting fees in advance for a specified period (not more than one year). The advance payments that refer to performance conditions that have not yet been satisfied are accrued as contract liabilities and released on a pro-rata basis as the services are provided in future. The customer obtains the benefits from the service and uses the service at the same time as it is provided.

Consulting and training services are recognised in income when the service has been provided. In addition, the Group provides implementation services as part of projects. This involves the generation or enhancement of assets for the customers over which they obtain control. Revenue recognition as well as the recognition of the contract asset is based on the progress towards complete satisfaction which is normally measured using input methods. The progress of the projects is determined by comparing the contract costs incurred with the expected contract costs for the project. Customers make advance payments in relation to the long-term services provided by Aareon. These are offset against the related contract assets, or reported under contract liabilities if the advance payment received exceeds the contract asset. Provisions are recognised for anticipated losses from such services in the period in which they are caused, to the extent that there is no assets item.

Standardised contracts are concluded within Aareal Bank Group for the vast majority of contracts with customers. This does not involve costs of obtaining a contract. In addition, there are no material amounts of variable consideration for the various services. The customers are not granted significant financing components.

(6) Determination of fair value

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

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 as well as of OTC hedging derivatives is determined on the basis of sector-specific standardised measurement models, such as the present value method or option pricing models. These techniques are based on inputs 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. Adjustments for specific counterparty risks (CVA and DVA) are not taken into account for the determination of the present value of derivatives at Aareal Bank, as they are deemed immaterial. Since the derivatives are part of highly effective collateral agreements (Credit Support Annex to the ISDA Master Agreement and Collateral Annex to the German Master Agreement on Financial Derivatives Transactions) which are each subject to a master collateralisation agreement, measurement adjustments to reflect any potential counterparty credit risk or own credit risk are not required. The Bank uses the overnight interest rate swap curve (OIS curve) for the measurement of derivatives secured by cash collateral. In the year under review, callable derivatives were switched to this measurement method. The impact of this change in estimates, which was applied prospectively, on income was immaterial.

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.

(7) Recognition and measurement of financial instruments

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

Recognition

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

Financial instruments have to be derecognised when the contractual rights to the cash flows from the financial asset expire or an entity transfers the financial asset, including substantially all its risks and rewards. The modification of the contractual terms may also result in the derecognition of a financial instrument and the recognition of a new financial instrument.

If only a portion of risks and rewards is transferred and a portion of control is retained, the financial asset is recognised only to the extent of its continuing involvement. The extent of the continuing involvement corresponds to the extent to which the Company is exposed to changes in the value of the financial asset. A financial liability is derecognised when it is extinguished, i.e. when the obligation specified in the contract is discharged.

Modification

As a matter of principle, a modification is defined as any change made to existing terms of a loan agreement or a contractual adjustment during the loan or contract term. This applies regardless of the reasons for the modification (credit-driven or market-driven). Contractual adjustments may either lead to the derecognition of the ”old” and the recognition of a ”new” asset when such adjustments are substantial to the extent that they, in essence, constitute a new asset (hereinafter referred to as ”substantial modification”) or to the recalculation of the carrying amount and the recognition of a net modification gain or loss, when such adjustments constitute an adjustment of an existing asset (hereinafter referred to as ”non-substantial modification”).

The contractual adjustments subject to modifications may generally be caused by the borrower's credit quality and solvency (credit-driven modifications) or the granting of more favourable terms and conditions in an existing contract or the adjustment of the framework for financings as a result of changes in the customer's financing needs (market-driven modifications).

Both substantial and non-substantial modifications have an impact on profit or loss.

The amount of net modification gains or losses arising from non-substantial modifications is determined by the difference of the gross carrying amounts before and after the modification. Net modification gains or losses arising from market-driven modifications are recognised in net interest income, while credit-driven modifications are reported in the loss allowance. Subsequently, the changes in the carrying amount of the receivable is amortised over the remaining term of the receivable and recorded in net interest income.

In the case of a substantial modification, the old asset has to be derecognised, and a new asset has to be recognised. The difference of the gross carrying amounts before and after the modification is reported as net derecognition gain or loss in the case of market-driven modifications. In the case of credit-driven modifications, a loss allowance is recorded prior to derecognition in an amount that covers the entire difference between the old carrying amount and the fair value determined at the time of initial recognition.

Measurement

Upon initial recognition, financial instruments are measured at fair value plus any transaction costs.

Subsequent measurement of financial assets is based on the classification of the financial instrument. Depending on the classification, financial assets are measured at amortised cost, at fair value through other comprehensive income or at fair value through profit or loss. Investments in equity instruments are measured at fair value through profit or loss, unless an irrevocable election is made at initial recognition to present subsequent changes in fair value in other comprehensive income. Within Aareal Bank Group, this election is exercised as a rule due to the investment characteristics of the equity instruments.

Financial liabilities are measured at amortised cost.

In addition, financial assets and liabilities may be designated as at fair value through profit or loss if certain prerequisites are met. Aareal Bank Group does not make use of this option.

Classification

The classification, i. e. the determination of the measurement category of a financial asset is to be assessed on the basis of two criteria. The objective criterion refers to the contractual design as to whether the payments solely represent payments of interest and principal on the principal amount outstanding (SPPI = solely payments of principal and interest). Relevant criteria were defined that are reviewed at initial recognition. For example, this may be financings with a primary investment risk or contractually agreed payments that depend on the borrower's economic performance. The subjective classification criterion refers to the business model, i. e. the aim that a company pursues for a group of assets.

Subsequent measurement has to be based on amortised cost (ac) when the financial instrument is held in order to collect contractual cash flows (business model ”Hold”) and additionally the contractual cash flows represent solely payments of principal and interest, i.e. are SPPI compliant. This classification category is used for a large portion of the lending and securities business.

Subsequent measurement at fair value, with changes in fair value being recognised initially directly in equity and subsequently reclassified to profit or loss (so-called recycling) (fair value through other comprehensive income (fvoci)) has to be made when financial instruments are SPPI compliant and are held either to collect contractual cash flows or to be sold (business model ”Hold & Sell”).

Subsequent measurement at fair value, with changes in fair value being recognised through profit or loss (fvpl), has to be made if the financial instrument is not SPPI compliant or cannot be allocated to one of the two business models mentioned above. The latter is the case for example when there is the purpose of selling such financial instruments in the near term due to syndication covenants.

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 or if the absolute credit risk can be classified as low, 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. A description of the credit risk methods and systems in place at Aareal Bank AG is presented in the Risk Report as part of the Group Management Report.

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), the expected contractual term and the current and expected country-specific economic environment such as the GDP, long-term interest and unemployment rate. 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.

The loss allowance for debt instruments measured at amortised cost are reported in the item "Loss allowance (ac)", for debt instruments measured at fair value through other comprehensive income in the item "Reserve from the measurement of debt instruments (fvoci)" and for loan commitments and financial guarantees under provisions. Debt instruments reported under POCI are accounted for on a net basis, i.e. without any loss allowance. Changes in loss allowance are reflected by increasing or decreasing the carrying amount through other loss allowance.

If the receivables are not recoverable, the corresponding loss allowance is utilised and the receivable is derecognised. Direct write-offs are not made.

The loss allowance for receivables from other transactions is determined using a simplified procedure in the amount of the lifetime expected credit losses.

Hedging relationships

The risk management strategy set out in the Risk Report of the Group Management Report is the basis for the recognition of hedging relationships. At Aareal Bank Group, risks from value fluctuations or from changed cash flows are hedged in the case of transactions not measured at fair value through profit or loss. In this context, the risks from hedged items are intended to be offset by entering into hedging derivatives where the fair value changes or the changes in the cash flows have the opposite direction compared to those of the hedged item. Average prices of the hedges are not relevant for risk management. Hedging relationships are not recorded for transactions that are measured at fair value through profit or loss. The results from economic hedging relationships are offset in net gain or loss from transactions measured at fair value.

Hedge accounting in accordance with IFRS 9 distinguishes various forms of hedging relationships.

Fair value hedges are used to hedge hedged items against fair value changes resulting from changes in interest rates or from changes in interest and exchange rates that are determined accordingly as hedged risk. At Aareal Bank Group, property loans, securities and promissory note loans are typically hedged using interest rate swaps and cross-currency swaps. The derivatives used for hedging are accounted for at fair value through profit or loss. The offsetting fair value changes of the hedged item resulting from the hedged risk are also recognised through profit or loss. The proportion of the fair value changes of the hedged item not attributable to the hedged risk is accounted for in line with the classification of the hedged item. A fully effective hedging relationship results in offsetting measurement results. The hedging relationship may result in adjustments in the carrying amount of the underlying transaction. Such adjustments will only be recognised in income at the end of the transaction term.

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

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

The effectiveness of hedging relationships is reviewed by way of a forward-looking sensitivity analysis regarding the hedged risks. Factors which may lead to ineffectiveness include the term of transactions or payment dates, or diverging market conventions for underlying transactions and related hedges which affect the relevant measurement parameters (e.g. discounting using an OIS rate). Currency basis spreads are accounted for as hedging costs, with fair value changes of this element recognised in other comprehensive income. In the event of any changes to hedging relationships occurring in the course of risk management, the hedge ratio of existing hedges and/or hedged items is adjusted accordingly.

(8) Cash funds

Cash funds include cash on hand and balances with central banks. Cash funds are exclusively allocated to the measurement category "ac".

(9) Loan receivables

The item ”Loan receivables” comprises property loans, public-sector loans and other loan receivables, including deferred interest. Loan receivables can be allocated to all measurement categories. At present, they are allocated to the ac and fvpl measurement categories. The portion of loan commitments not disbursed is reported as contingent liabilities.

(10) Money market and capital market receivables

Money market and capital market receivables consist of money market receivables, promissory note loans and debt securities, including deferred interest. Money market and capital market receivables may generally be allocated to all measurement categories.

(11) Equity instruments

This item includes unconsolidated equity instruments. They are allocated to the measurement category ”fvoci”.

(12) Receivables from other transactions

The item ”Receivables from other transactions” comprises trade receivables and other financial receivables. Receivables from other transactions are exclusively allocated to the measurement category ”ac”.

(13) Positive market value of designated hedging derivatives / Negative market value of designated hedging derivatives

The items ”Positive market value of designated hedging derivatives” and ”Negative market value of designated hedging derivatives” include derivatives with positive or negative market values from fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation, including deferred interest. Derivatives are exclusively allocated to the measurement category ”fvpl”. The basis for the recognition of hedging relationships is described in the chapter ”Recognition and measurement of financial instruments” in this section. Effects from the measurement of these derivatives are reported in the item ”Net gain or loss from hedge accounting”, together with the effects from the measurement of the transactions.

(14) Positive market values of other derivatives / Negative market value of other derivatives

Derivative financial instruments that are not part of recognised hedging relationships are reported in Aareal Bank Group under positive or negative market values of other derivatives. They are mainly used to hedge economic market price risks. Derivatives are exclusively allocated to the measurement category ”fvpl”. Results from the measurement and the termination of the derivatives are reported in the item ”Net gain or loss from financial assets (fvpl)”. Interest received or paid in connection with these derivatives is also recorded generally in the item ”Net gain or loss from financial assets (fvpl)”. Interest received or paid for derivatives entered into for hedging purposes which, however, do not meet the hedge accounting criteria, is reported in net interest income. Effects from the measurement of these derivatives are reported in the item "Net gain or loss from financial assets (fvpl)", together with the effects from the measurement of the transactions.

(15) Investments accounted for using the equity method

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

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

The equity method applied to the major associates was based on the most recent available financial statements prepared under local GAAP.

(16) Intangible assets

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

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

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

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

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

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

(17) Property and equipment

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

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

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

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

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

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

The costs to purchase property and equipment in the amount of up to € 250.00 (low-value assets) are expensed as they are incurred.

Any items of property and equipment with a cost of more than € 250.00 net, but not exceeding € 1,000.00, can be combined in a collective account for the year, which is then depreciated on a straight-line basis over a period of five years.

(18) Deferred tax assets / deferred tax liabilities

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

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

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

(19) Other assets

The item "Other assets" includes, amongst other things, properties and contract assets. Properties reported under other assets are intended for short-term disposal, though the IFRS 5 criteria are not met. They are measured at the lower of cost or net realisable value, in accordance with IAS 2, and therefore are subject to estimation uncertainties.

(20) Money market and capital market liabilities

The item "Money market and capital market liabilities" comprises money market liabilities, mortgage Pfandbriefe, registered public sector Pfandbriefe, promissory note loans and other debt securities, including deferred interest. Money market and capital market activities are allocated to the measurement category "ac".

(21) Deposits from the housing industry

The item "Deposits from the housing industry" includes deposits payable on demand and term deposits, including deferred interest. Deposits from the housing industry are allocated to the measurement category "ac".

(22) Liabilities from other transactions

The item "Liabilities from other transactions" comprises trade payables and other financial liabilities. Liabilities from other transactions are exclusively allocated to the measurement category "ac".

(23) Subordinated capital

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

Subordinated capital is allocated to the measurement category "ac".

(24) Provisions

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

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

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

Provisions for pensions and similar obligations

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

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

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

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

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

Share-based payment

Aareal Bank Group maintains share-based payment plans subject to cash settlement in accordance with IFRS 2. We refer to our comments in Note (77) to the consolidated financial statements, which include a detailed description of the plans and their scope as well as information on the valuation model applied and the effects of share-based payments on the Group's financial position and performance.

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

(25) Other liabilities

Other liabilities include, among other items, contract liabilities, deferred income and liabilities from other taxes.

(26) Equity

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

(27) Financial guarantee contracts

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

Notes to the Statement of Comprehensive Income

(28) Net interest income

€ mn	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017[1]
Interest income from financial assets (ac)	838	828
Loan receivables	820	810
Money market and capital market receivables	18	18
Interest income from financial liabilities (ac)	9	7
Money market and capital market liabilities	5	4
Deposits from the housing industry	4	3
Interest income from financial assets (fvoci)	0	0
Money market and capital market receivables	0	0
Current dividend income	0	0
Interest income from financial instruments (fvpl)	38	8
Loan receivables	22	1
Money market and capital market receivables	7	–
Other derivatives	9	7
Market-driven modification gains	2	n/a
Total interest and similar income	**887**	**843**
Interest expenses from financial liabilities (ac)	104	98
Money market and capital market liabilities	77	69
Deposits from the housing industry	2	0
Liabilities from other transactions	0	1
Subordinated capital	25	28
Interest expenses from financial assets (ac)	9	12
Cash funds	8	10
Money market and capital market receivables	1	2
Interest expenses for financial instruments (fvpl)	236	149
Other derivatives	236	149
Market-driven modification losses	3	n/a
Total interest and similar expenses	**352**	**259**
Total	**535**	**584**

[1] Comparative amounts reclassified according to the new classification format

Net interest income totalled € 535 million, an expected reduction from the previous year (2017: € 584 million), which was largely due to the portfolio decline seen in the previous year, reflecting – amongst other factors – the scheduled reduction of the former WestImmo and Corealcredit portfolios.

(29) Loss allowance

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017[1]
Additions	137	131
Reversals	61	53
Direct write-offs	–	43
Recoveries on loans and advances previously written off	4	39
Loss allowance – other items	0	n/a
Credit-driven net modification gain or loss	0	n/a
Total	**72**	**82**

[1] Comparative amounts reclassified according to the new classification format

Loss allowance amounted to € 72 million (2017: € 82 million) and was thus in line with our expectations. Please also refer to our explanations in Note (59).

(30) Net commission income

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017[1]
Commission income from		
ERP products	167	160
Digital solutions	42	37
Additional products	11	11
Banking business and other activities	39	35
Total commission income	**259**	**243**
Commission expenses for		
Purchased services	40	32
Banking business and other activities	4	5
Total commission expenses	**44**	**37**
Total	**215**	**206**

[1] Comparative amounts reclassified according to the new classification format

Net commission income increased to € 215 million (2017: € 206 million), as expected, which was mainly due to higher commission income at Aareon. Commission income from ERP products, digital solutions and additional products includes € 26 million of licence revenue (2017: € 20 million) that are recognised at a point in time. In the reporting period, revenue of € 2 million was recorded attributable to performance obligations of earlier periods.

The net amount of commission income and commission expenses from financial assets and financial liabilities not measured at fair value amounts to € 11 million (2017: € 8 million).

(31) Net derecognition gain or loss

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017[1]
Net gain or loss on the derecognition of financial assets (ac)		
Loan receivables	24	50
Net gain or loss on the derecognition of financial liabilities (ac)		
Money market and capital market liabilities	0	0
Net gain or loss on the derecognition of financial assets (fvoci)		
Money market and capital market receivables	–	0
Total	**24**	**50**

[1] Comparative amounts reclassified according to the new classification format

The € 24 million net gain on derecognition (2017: € 50 million) – a market-driven figure which is usually volatile – mainly resulted from gains on derecognition of loan receivables and declined due to lower effects from early repayments.

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

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017[1]
Net gain or loss from loan receivables	-6	–
Net gain or loss from money market and capital market receivables	-2	0
Net gain or loss from other derivatives	8	7
Currency translation	-2	7
Total	**-2**	**14**

[1] Comparative amounts reclassified according to the new classification format

(33) Net gain or loss from hedge accounting

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017
Ineffective portion of fair value hedges	-2	-2
Ineffective portion of cash flow hedges	–	-5
Ineffective portion of net investment hedges	0	0
Total	**-2**	**-7**

(34) Net gain or loss from investments accounted for using the equity method

In the past financial year, there were € 0 million from investments accounted for using the equity method (2017: € –); this was also in line with the pro-rata results from joint ventures and associates.

(35) Administrative expenses

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017
Staff expenses	261	313
Wages and salaries	206	257
Social security contributions	33	33
Pensions	22	23
Other administrative expenses	177	176
Depreciation, amortisation and impairment of property and equipment and intangible assets	24	22
Total	**462**	**511**

At € 462 million (2017: € 511 million), administrative expenses were reduced, reflecting the impact of transformation costs and running costs.

Staff expenses include contributions to defined contribution plans in the amount of € 14 million (2017: € 14 million).

Other administrative expenses include administrative costs for research and development not eligible for capitalisation in the amount of € 7 million (2017: € 5 million).

This item also includes the total fees charged by the auditor of the consolidated financial statements in the financial year 2018, which consists of the following sub-items:

€ 000's	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017
Auditing fees	4,616	5,271
Other assurance services	218	411
Tax advisory services	7	7
Other services	308	587
Total	**5,149**	**6,276**

Other assurance services include the review in accordance with the German Securities Trading Act (WpHG), deposit protection, the bank levy, software confirmations, comfort letters and the Combined Separate Non-financial Report. Tax advisory services relate to general tax advice rendered. Other services include, in particular, due diligence services and regulatory advice.

(36) Net other operating income/expenses

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017
Income from properties	57	62
Income from the reversal of provisions	5	83
Income from goods and services	1	0
Miscellaneous other operating income	31	23
Total other operating income	**94**	**168**
Expenses for properties	57	54
Expenses for other taxes	4	5
Miscellaneous other operating expenses	8	35
Total other operating expenses	**69**	**94**
Total	**25**	**74**

Income from properties comprises a reversal of an impairment loss of € 13 million, reflecting changed expectations of income, in relation to the owner-operated hotel that is allocated to the Structured Property Financing segment. This reversal referred to an impairment loss recognised in 2016. Expenses for properties include a loss on disposal in the amount of € 10 million that arose on the sale of a commercial property in the US.

The comparative figure for the previous year's period included € 50 million in net reversals of provisions in connection with the final agreement on contractual issues with a third party, which were still pending when Aareal Bank Group acquired former Corealcredit, and the release of tax assessment notes. This was offset by corresponding income tax expense of € 26 million.

(37) Negative goodwill from acquisitions

Further information is included in the section "Consolidation".

(38) Income taxes

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017
Current income taxes	55	82
Deferred taxes	35	33
Total	**90**	**115**

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

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017
Operating profit (before income taxes)	316	328
Expected tax rate	31.7 %	31.7 %
Calculated income taxes	**100**	**104**
Reconciliation to reported income taxes		
Different foreign tax burden	10	9
Tax attributable to tax-exempt income	-25	-24
Tax attributable to non-deductible expenses	5	10
Taxes for previous years	–	17
Other tax effects	–	-1
Reported income taxes	**90**	**115**
Effective tax rate	29 %	35 %

The expected tax rate of 31.7 % (2017: 31.7 %), including a trade tax rate of assessment of 453 %, comprises trade taxes (15.9 %), corporation taxes (15 %) and the solidarity surcharge (0.825 %; 5.5 % of corporation tax).

Notes to the Statement of Financial Position

(39) Financial assets (ac)

€ mn	31 Dec 2018	31 Dec 2017[1]
Cash funds (ac)	**1,265**	**2,081**
Cash on hand	0	0
Balances with central banks	1,265	2,081
Loan receivables (ac)	**26,795**	**26,316**
Property loans	26,309	25,701
Public-sector loans	448	537
Other loan receivables	38	78
Money market and capital market receivables (ac)	**6,578**	**5,225**
Money market receivables	1,000	713
Promissory note loans	1,751	1,399
Bonds	3,827	3,113
Receivables from other transactions (ac)	**64**	**74**
Trade receivables	35	37
Other financial receivables	29	37
Total	**34,702**	**33,696**

[1] Comparative amounts reclassified according to the new classification format

(40) Loss allowance (ac)

31 December 2018

€ mn	Stage 1	Stage 2	Stage 3	Receivables from other transactions (ac)	Total loss allowance (ac)
Balance as at 1 January	**32**	**42**	**517**	**2**	**593**
Additions	18	6	110	0	**134**
Utilisation	–	–	100	1	**101**
Reversals	16	14	26	1	**57**
Transfer to Stage 1	1	-1	0	–	**–**
Transfer to Stage 2	-1	1	0	–	**–**
Transfer to Stage 3	0	-12	12	–	**–**
Interest rate effect	–	–	5	–	**5**
Currency adjustments	0	0	1	0	**1**
Transfers	–	–	–	2	**2**
Balance as at 31 December	**34**	**22**	**519**	**2**	**577**

The loss allowances 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.

A detailed breakdown of loss allowance by classes of financial assets is disclosed in Note (59) in the chapter "Notes related to financial instruments".

31 December 2017 [1)]

€ mn	Specific valuation allowance	Portfolio impairment allowance	Total loss allowance for recognised items	Provisions in the lending business for unrecog-nised items	Total loss allowance for provisions in the lending business
Loss allowance as at 1 January	**435**	**119**	**554**	**5**	**559**
Additions	131	–	**131**	–	**131**
Utilisations	57	–	**57**	0	**57**
Reversals	15	37	**52**	1	**53**
Unwinding	30	–	**30**	–	**30**
Changes in the basis of consolidation	–	–	**–**	–	**–**
Currency adjustments	-5	-1	**-6**	0	**-6**
Balance as at 31 December	**459**	**81**	**540**	**4**	**544**

1) Comparative values determined in accordance with IAS 39

(41) Financial assets (fvoci)

€ mn	31 Dec 2018	31 Dec 2017 [1)]
Money market and capital market receivables (fvoci)	**4,443**	**5,422**
Bonds	4,443	5,422
Equity instruments (fvoci)	**7**	**2**
Equities and other non-fixed income securities	0	–
Other investments	7	2
Total	**4,450**	**5,424**

1) Comparative amounts reclassified according to the new classification format

(42) Financial assets (fvpl)

€ mn	31 Dec 2018	31 Dec 2017[1]
Loan receivables (fvpl)	**711**	**196**
Property loans	711	196
Money market and capital market receivables (fvpl)	**538**	**–**
Promissory note loans	90	–
Bonds	448	–
Positive market value of designated hedging derivatives (fvpl)	**1,277**	**1,926**
Positive market value of fair value hedges	1,277	1,915
Positive market value of cash flow hedges	–	8
Positive market value of net investment hedges	–	3
Positive market value of other derivatives (fvpl)	**657**	**327**
Positive market value of economic hedging derivatives	466	80
Positive market value of miscellaneous other derivatives	191	247
Total	**3,183**	**2,449**

[1] Comparative amounts reclassified according to the new classification format

(43) Investments accounted for using the equity method

Aareal Bank holds interests in five associates (2017: five) and one joint arrangement (2017: one) that are accounted for using the equity method. The sum total of the carrying amounts of the equity investments amounted to € 7 million (31 December 2017: € 7 million). The joint venture had a carrying amount of € 0 million (2017: € 0 million), meaning that pro-rata losses of € 2 million did not need to be recognised.

(44) Intangible assets

€ mn	31 Dec 2018	31 Dec 2017
Goodwill	85	85
Proprietary software	32	24
Other intangible assets	41	44
Total	**158**	**153**

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

€ mn	31 Dec 2018 Goodwill	31 Dec 2017 Goodwill
Business divisions		
Germany	35	35
International Business	50	50
Total	**85**	**85**

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

The present values of future cash flows were determined consistently throughout the Aareon sub-group on the basis of a risk-adequate discount factor of 6.2 % before taxes. The discount factor is calculated based on a risk-free basic interest rate of 1.0 % plus a company-specific risk premium of 6.5 %, multiplied with a beta factor of 0.8. Due to the uncertainty surrounding the planning beyond the four-year horizon, we assume a 2 % growth rate, which reflects expected inflation developments and our cautious view of the market environment. The recoverable amounts show a significant excess compared to the carrying amounts: even if the above-mentioned material assumptions were to change significantly (such as a 1.0 % increase in the risk-adequate discount factor, a 5.0 % decline in the EBIT included in the cash-flow projections, or a decrease in the growth rate to 1 %), this would not result in a specific impairment loss. There was no need to recognise impairment losses in the year under review.

Intangible assets developed as follows:

€ mn	2018 Goodwill	2018 Proprietary software	2018 Other intangible assets	2018 Total	2017 Goodwill	2017 Proprietary software	2017 Other intangible assets	2017 Total
Cost								
Balance as at 1 January	**138**	**93**	**124**	**355**	**133**	**87**	**78**	**298**
Additions	0	13	5	**18**	10	5	11	**26**
Transfers	–	0	1	**1**	-4	0	26	**22**
Disposals	–	–	26	**26**	0	–	7	**7**
Changes in the basis of consolidation	–	–	0	**0**	–	1	16	**17**
Currency translation differences	0	0	-1	**-1**	-1	0	0	**-1**
Balance as at 31 December	**138**	**106**	**103**	**347**	**138**	**93**	**124**	**355**
Amortisation and impairment losses								
Balance as at 1 January	**53**	**69**	**80**	**202**	**57**	**65**	**50**	**172**
Amortisation and impairment losses	–	4	8	**12**	–	4	7	**11**
of which: impairment losses	–	–	–	**–**	–	–	–	**–**
Write-ups	–	–	–	**–**	–	–	–	**–**
Transfers	–	–	–	**–**	-4	–	26	**22**
Disposals	–	–	26	**26**	–	–	3	**3**
Changes in the basis of consolidation	–	–	–	**–**	–	–	–	**–**
Currency translation differences	–	1	0	**1**	–	0	0	**0**
Balance as at 31 December	**53**	**74**	**62**	**189**	**53**	**69**	**80**	**202**
Carrying amount as at 1 January	**85**	**24**	**44**	**153**	**76**	**22**	**28**	**126**
Carrying amount as at 31 December	**85**	**32**	**41**	**158**	**85**	**24**	**44**	**153**

(45) Property and equipment

€ mn	31 Dec 2018	31 Dec 2017
Land and buildings and construction in progress	230	221
Office furniture and equipment	30	32
Total	**260**	**253**

Property and equipment developed as follows:

	2018			2017		
€ mn	Land and buildings and construction in progress	Office furniture and equipment	Total	Land and buildings and construction in progress	Office furniture and equipment	Total
Cost						
Balance as at 1 January	**299**	**86**	**385**	**288**	**81**	**369**
Additions	6	7	**13**	19	8	**27**
Transfers	–	0	**0**	1	9	**10**
Disposals	2	19	**21**	9	12	**21**
Changes in the basis of consolidation	–	0	**0**	–	0	**0**
Currency translation differences	0	0	**0**	0	0	**0**
Balance as at 31 December	**303**	**74**	**377**	**299**	**86**	**385**
Depreciation and impairment losses						
Balance as at 1 January	**78**	**54**	**132**	**68**	**49**	**117**
Depreciation and impairment losses	9	8	**17**	9	7	**16**
of which: impairment losses	–	–	**–**	–	0	**0**
Write-ups	13	–	**13**	–	0	**0**
Transfers	–	–	**–**	1	9	**10**
Disposals	1	18	**19**	0	11	**11**
Changes in the basis of consolidation	–	–	**–**	–	–	**–**
Currency translation differences	0	0	**0**	0	0	**0**
Balance as at 31 December	**73**	**44**	**117**	**78**	**54**	**132**
Carrying amount as at 1 January	**221**	**32**	**253**	**220**	**32**	**252**
Carrying amount as at 31 December	**230**	**30**	**260**	**221**	**32**	**253**

(46) Income tax assets

Income tax assets in a total amount of € 30 million as at 31 December 2018 (2017: € 52 million) include € 1 million (2017: € 2 million) expected to be realised after a period of more than twelve months.

(47) Net deferred tax assets

When recognising deferred taxes, claims and liabilities arising vis-à-vis the same tax authority, which may be netted and paid in one amount, were offset in the amount of € 572 million (2017: € 546 million).

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

€ mn	31 Dec 2018	31 Dec 2017[1)]
Financial assets (ac)	34	–
Financial assets (fvpl)	1	–
Intangible assets	–	0
Property and equipment	0	0
Other assets	0	0
Financial liabilities (ac)	455	482
Financial liabilities (fvpl)	123	47
Provisions	90	85
Other liabilities	0	26
Tax loss carryforwards	10	5
Net deferred tax assets	**713**	**645**

[1)] Comparative amounts reclassified according to the new classification format

Of the deferred taxes on loss carryforwards, an amount of € 3 million (2017: € 1 million) is attributable to foreign permanent establishments. The existing loss carryforwards may be carried forward for an unlimited period. Deferred taxes on losses carried forward were recognised to the extent that they are expected to be realised within the next five years.

The deferred tax assets not recognised or not subject to valuation adjustments amount to € 62 million (2017: € 43 million).

Deferred tax assets in the amount of € 32 million (2017: € 25 million) were reported under other reserves.

(48) Other assets

€ mn	31 Dec 2018	31 Dec 2017[1)]
Properties	209	203
Contract assets	24	19
Miscellaneous	100	93
Total	**333**	**315**

[1)] Comparative amounts reclassified according to the new classification format

The portion of the unsatisfied performance obligation from IT consulting projects in the amount of € 10 million is expected to be realised in the amount of € 9 million in 2019 as well as € 1 million in 2020 and thereafter. We do not disclose the portion of unsatisfied performance obligations from other contracts since the consideration from the customer equals the services provided.

(49) Financial liabilities (ac)

€ mn	31 Dec 2018	31 Dec 2017[1]
Money market and capital market liabilities (ac)	**26,371**	**26,109**
Money market liabilities	4,600	4,821
Promissory note loans	5,200	5,421
Mortgage Pfandbriefe	10,934	11,036
Public-sector Pfandbriefe	2,989	2,578
Other debt securities	2,648	2,230
Other financial liabilities	0	23
Deposits from the housing industry (ac)	**9,679**	**9,164**
Payable on demand	7,719	7,314
Term deposits	1,960	1,850
Liabilities from other transactions (ac)	**121**	**92**
Trade payables	24	18
Other liabilities	97	74
Subordinated capital (ac)	**1,044**	**1,265**
Subordinated liabilities	1,044	1,060
Profit-participation certificates	–	12
Silent participations	–	193
Total	**37,215**	**36,630**

[1] Comparative amounts reclassified according to the new classification format

(50) Financial liabilities (fvpl)

€ mn	31 Dec 2018	31 Dec 2017[1]
Negative market value of designated hedging derivatives (fvpl)	**1,461**	**1,479**
Negative market value of fair value hedges	1,443	1,464
Negative market value of cash flow hedges	–	15
Negative market value of net investment hedges	18	–
Negative market value of other derivatives (fvpl)	**473**	**224**
Negative market value of economic hedging derivatives	322	34
Negative market value of miscellaneous other derivatives	151	190
Total	**1,934**	**1,703**

[1] Comparative amounts reclassified according to the new classification format

(51) Provisions

€ mn	31 Dec 2018	31 Dec 2017[1]
Provisions for pensions and similar obligations	362	351
Provisions for unrecognised lending business	5	4
Other provisions and contingent liabilities	152	215
Total	**519**	**570**

[1] Comparative amounts reclassified according to the new classification format

A detailed breakdown of the provisions for unrecognised lending business by classes of financial assets is disclosed in Note (59) in the chapter "Notes related to financial instruments".

Provisions for pensions and similar obligations

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

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

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

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

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

Consolidated Financial Statements
Transparency

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

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

Brief description of the material pension plans

DePfa Bank Betriebsvereinbarung dated 14 December 1999 (BV 97)

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

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

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

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

Management Board

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

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

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

DePfa Bank Dienstvereinbarung dated 30 December 1955 (DePfa 55)
DePfa 55 is a pay-related benefit commitment for new entrants before 31 December 1988. It provides for benefit payments after completing the 65th year of age after a waiting period of five service years and benefits paid in case of occupational incapacity (disability) as well as benefits for surviving dependants, each in form of a monthly annuity.

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

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

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

BauBoden agreement dated 1 July 1968 (BauBoden 68)
This agreement applies to employees after completing their 18th year of age who were employed by the Bank on 1 January 1967 or joined the Bank not later than on 31 December 1983. The following benefits are granted after a waiting period of ten service years: old-age pension after completing the 65th year of age, early old-age pension, (total) occupational incapacity pension as well as widow(er)'s pension.

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

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

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

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

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

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

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

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

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

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

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

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

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

The pension benefits of the statutory pension insurance and the BVV Versicherungsverein des Bankgewerbes a. G., which are based on mandatory contributions, are taken into account in the pension determined as described. To that extent, the benefit obligation directly depends on the development of the level of pensions from the statutory pension insurance on the one hand and from the BVV on the other.

As a result of the German Pension Reform Act of 1992 and the associated cuts in statutory pension insurance, the pension scheme was restructured in 1995. The main pillar of the new structure is the limitation of the Bank's deficiency guarantee for the declining level of statutory pensions due to deduction factors applied at early retirement (Rentenzugangsfaktor) and the lower adjustment of the pension value. Accordingly, the Bank continues to assume the deficiency guarantee on a pro-rata basis for the periods of service until the restructuring on 31 December 1995 in relation to the deduction factors applied at early retirement and for the reduced level of the current pension value (net adjustment factor). The reduction in the level of statutory pensions that occurred during the service periods from the restructuring date until retirement is taken into account at the expense of the beneficiary.

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

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

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

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

The monthly benefits for employees who commenced service prior to 1 October 1978 amount to 5% of pensionable remuneration (most recent monthly salary based on collective or individual agreements) after ten service years and increase by 0.5% of pensionable remuneration for each service year, up to 14% of pensionable remuneration after 15 service years. The monthly benefit entitlement increases by 0.3% of pensionable remuneration for any additional service years, up to a maximum of 20%. The BVV benefits are taken into account in such entitlement to the extent that these are based on employer contributions.

The benefits for employees who commenced service after 30 September 1978 amount to 0.15% of pensionable remuneration up to the contribution ceiling as well as 1.5% of pensionable remuneration above the contribution ceiling for each year of service between the 25th and 65th year of age. The maximum number of recognisable service years is 35.

The old-age pension under the Rheinboden pension schemes is paid after completing the 65th year of age or upon commencement of old-age pension under the statutory pension insurance scheme (full pension). In case of early retirement, the benefits are subject to deductions of 0.3% per month of early retirement prior to the age of 65 as a partial compensation for the additional costs associated with early retirement. The surviving dependant's benefits amount to 60% of the employee's pension entitlement for widow(er)s as well as 15 % for half-orphans and 20 % for orphans, however, in aggregate not exceeding the amount of the employee's pension entitlement.

Supplementary individual contractual arrangements were agreed with individual pensioners and leavers with vested benefits for the purpose of the transition from the old to the new Rheinboden pension scheme and the application of the BVV benefits.

In addition, individual contractual commitments apply to former management board members and general managers – currently pensioners and one leaver with vested benefits.

The adjustment of current pensions on the basis of the Rheinboden commitments is performed on the basis of the inflation allowance set out in section 16 of the German Occupational Pensions Act (BetrAVG), with the exception of a small group of approximately ten pensioners where adjustment is made pursuant to the collective agreement for banks.

WestImmo – Pension fund rules dated 1 October 1995

The pension fund rules dated 1 October 1995 represent a defined contribution scheme. The following benefits are paid after a waiting period of five year of service: old-age pension, early old-age pension, (total) occupational incapacity pension as well as widow(er)'s and orphan's pension.

The amount of the old-age pension, the early old-age pension and the (total) occupational incapacity pension is calculated based on the sum of the pension components earned during the pensionable service period. If the pensionable service period exceeds 40 years, the monthly pension is calculated based on the sum of the highest 40 pension components earned during the pensionable service period. The amount of one pension component is derived from multiplying the reference contribution (since 2014: € 260), the personal earnings relation (relation between pensionable income and contribution ceiling of the German statutory pension insurance; earnings components above the contribution ceiling are weighted with a factor of 3.75) and the annuitisation factor in the relevant age pursuant to the annuitisation table. The amount of the early old-age pension is reduced by 0.5 % for each month in which annuity is paid prior to completing the 65th year of age. The widow(er)'s pension entitlement amounts to 60 %.

If necessary, the determination of the amount of pension obligations is based on the following actuarial assumptions applied consistently throughout the Group:

	31 Dec 2018	31 Dec 2017
Calculation method	Projected unit credit method	Projected unit credit method
Calculation basis	Actuarial tables issued by K. Heubeck in 2018	Actuarial tables issued by K. Heubeck in 2005
Actuarial assumptions (in %)		
Interest rate used for valuation	1.80	1.84
Development of salaries	2.00	2.00
Pension increase	1.57	1.59
Rate of inflation	1.75	1.75
Staff turnover rate	3.00	3.00

As at year-end, the calculation principles were changed to the 2018 G actuarial tables. The actuarial loss resulting from the remeasurement is reported under changes in demographic assumptions.

Development of net pension liabilities:

€ mn	Present value of pension obligations	Fair value of plan assets	Net pension liability
Balance as at 1 January 2018	**431**	**-80**	**351**
Pension expense	**18**	**-2**	**16**
Current service cost	10	-	10
Net interest cost	8	-2	6
Payments	**-8**	**-7**	**-15**
Pension benefits paid	-12	1	-11
Employer's contributions	–	-4	-4
Contributions made by beneficiaries of defined benefit plans	4	-4	–
Remeasurements	**7**	**3**	**10**
due to experience adjustments	-1	–	-1
due to changes in financial assumptions	2	–	2
due to changes in demographic assumptions	6	–	6
Difference between actual return and return calculated using an internal rate of interest (plan assets)	–	3	3
Changes in basis of consolidation	**–**	**–**	**–**
Balance as at 31 December 2018	**448**	**-86**	**362**

€ mn	Present value of pension obligations	Fair value of plan assets	Net pension liability
Balance as at 1 January 2017	**432**	**-73**	**359**
Pension expense	**19**	**-1**	**18**
Current service cost	11	–	11
Net interest cost	8	-1	7
Payments	**-9**	**-5**	**-14**
Pension benefits paid	-12	0	-12
Employer's contributions	–	-2	-2
Contributions made by beneficiaries of defined benefit plans	3	-3	-
Remeasurements	**-12**	**-1**	**-13**
due to experience adjustments	-7	–	-7
due to changes in financial assumptions	-5	–	-5
due to changes in demographic assumptions	–	–	–
Difference between actual return and return calculated using an internal rate of interest (plan assets)	–	-1	-1
Changes in basis of consolidation	**1**	**–**	**1**
Balance as at 31 December 2017	**431**	**-80**	**351**

The weighted duration of pension liabilities is 18.1 years as at 31 December 2018 (2017: 18.7 years).

Expected maturities of the defined benefit obligation (DBO):

€ mn	31 Dec 2018	31 Dec 2017
Up to 1 year	13	13
Between 1 year and 5 years	57	55
More than 5 years and up to 10 years	80	78
Total	**150**	**146**

Contributions in the amount of € 11 million (2018: € 10 million) are expected to be paid in the financial year 2019.

Sensitivity of the defined benefit obligation (DBO) compared to the central actuarial assumptions

Based on the qualitative plan description, the valuation parameters significant for calculating the amount of the obligation were derived and corresponding calculations were made as regards sensitivity.
The sensitivity analysis takes into account, in each case, the change of an assumption, while the other assumptions remain unchanged compared to the original calculation, i.e. any potential correlation effects between the individual assumptions are not taken into consideration.

		Defined benefit obligation 2018	Change	Defined benefit obligation 2017	Change
		€ mn	%	€ mn	%
Present value of obligations		**448**		**431**	
Interest rate used for valuation	Increase by 1.0 percentage points	375	-16	362	-16
	Decrease by 1.0 percentage points	542	21	523	21
Development of salaries	Increase by 0.5 percentage points	457	2	440	2
	Decrease by 0.5 percentage points	439	-2	422	-2
Pension increase	Increase by 0.25 percentage points	456	2	439	2
	Decrease by 0.25 percentage points	440	-2	423	-2
Life expectancy	Increase by 1 year	470	5	452	5
	Decrease by 1 year	425	-5	410	-5

Plan assets can be broken down as follows:

€ mn	31 Dec 2018	31 Dec 2017
Cash	0	0
Equities	–	–
Investment funds	58	53
Bonds	–	–
Reinsurance	28	27
Total	**86**	**80**

Apart from the usual actuarial risks, the risks associated with defined benefit obligations primarily relate to financial risks in connection with plan assets. Amongst others, these may include counterparty credit risks and market price risks. These risks are taken into account in the risk management of Aareal Bank Group. The measurement of investment funds has to be allocated to Level 2 of the fair value hierarchy.

Other provisions

Other provisions developed as follows:

€ mn	Provisions for staff expenses and non-staff operating costs	Provisions for legal and tax risks	Miscellaneous other provisions	Total
Carrying amount as at 1 Jan 2018	**187**	**13**	**15**	**215**
Additions	55	0	3	**58**
Utilisation	61	1	1	**63**
Reversals	35	2	6	**43**
Interest	0	0	0	**0**
Reclassifications	-31	0	-1	**-32**
Changes in basis of consolidation	12	0	4	**16**
Currency translation differences	1	0	0	**1**
Carrying amount as at 31 Dec 2018	**128**	**10**	**14**	**152**

€ mn	Provisions for staff expenses and non-staff operating costs	Provisions for legal and tax risks	Miscellaneous other provisions	Total
Carrying amount as at 1 Jan 2017	**187**	**103**	**26**	**316**
Additions	89	1	7	**97**
Utilisation	71	2	8	**81**
Reversals	16	89	10	**115**
Interest	0	–	0	**0**
Reclassifications	0	–	0	**0**
Changes in basis of consolidation	–	–	0	**–**
Currency translation differences	-2	–	0	**-2**
Carrying amount as at 31 Dec 2017	**187**	**13**	**15**	**215**

Other provisions of € 152 million include € 37 million expected to be realised after a period exceeding twelve months.

Provisions for staff expenses and non-staff operating costs refer to personnel provisions in the amount of € 105 million (2017: € 140 million) and provisions for non-staff operating costs in the amount of € 23 million (2017: € 47 million). Personnel provisions consist of, among other things, provisions for bonuses, partial retirement, severance pay and existing working hours accounts; they include € 32 million in provisions for severance pay and for partial retirement. Provisions for non-staff operating expenses mainly include provisions for professional and legal advice.

(52) Income tax liabilities

Income tax liabilities in a total amount of € 40 million as at 31 December 2018 (2017: € 29 million) include € 6 million (2017: € 7 million) expected to be realised after a period of more than twelve months.

(53) Deferred tax liabilities

When recognising deferred taxes, claims and liabilities arising vis-à-vis the same tax authority, which may be netted and paid in one amount, were offset in the amount of € 572 million (2017: € 546 million).

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

€ mn	31 Dec 2018	31 Dec 2017[1]
Financial assets (ac)	383	135
Financial assets (fvoci)	130	302
Financial assets (fvpl)	52	98
Intangible assets	11	12
Property and equipment	6	6
Other assets	8	12
Provisions	0	0
Other liabilities	–	0
Deferred tax liabilities	**590**	**565**

[1] Comparative amounts reclassified according to the new classification format

(54) Other liabilities

€ mn	31 Dec 2018	31 Dec 2017[1]
Deferred income	1	16
Liabilities from other taxes	17	17
Contract liabilities	14	–
Other	1	0
Total	**33**	**33**

[1] Comparative amounts reclassified according to the new classification format

An amount of € 14 million of the contract liabilities was recorded in profit or loss in the current reporting period.

(55) Total shareholders' equity

€ mn	31 Dec 2018	31 Dec 2017[1]
Subscribed capital	180	180
Capital reserves	721	721
Retained earnings	1,797	1,798
AT1 bond	300	300
Other reserves		
Reserve from remeasurements of defined benefit plans	-98	-91
Reserve from the measurement of equity instruments (fvoci)	0	0
Reserve from the measurement of debt instruments (fvoci)	39	24
Hedging reserves	–	-1
Reserve from foreign currency basis spreads	-9	–
Currency translation reserves	-4	-9
Non-controlling interests	2	2
Total	**2,928**	**2,924**

[1] Comparative amounts reclassified according to the new classification format

The item "Reserve from the measurement of debt instruments (fvoci)" includes loss allowance of € 0 million (2017: n/a).

Subscribed capital

Aareal Bank AG's subscribed capital amounted to € 180 million as at the reporting date (2017: € 180 million). It is divided into 59,857,221 notional fully-paid no-par value shares ("unit shares") with a notional value of € 3 per share. The shares are bearer shares. Each share carries one vote. There are no pre-emptive rights or constraints with respect to dividend payouts.

Treasury shares

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

Furthermore, the Management Board was authorised by means of a resolution of the General Meeting held on 20 May 2015, pursuant to section 71 (1) no. 8 of the AktG, to purchase own shares up to a volume of 10 % of the share capital for purposes other than trading in treasury shares. This authorisation expires on 19 May 2020. Shares may be acquired via the stock exchange or by means of a public offer to buy directed at all shareholders, and at purchase prices stipulated in the authorisation and based on the prevailing market price of the Company's shares. This authorisation may be exercised, in full or in part, on one or more occasions.

The shares acquired in accordance with this or an earlier authorisation may be sold, subject to Supervisory Board approval, outside the stock exchange and without an offer directed at all shareholders, subject to the exclusion of shareholders' pre-emptive rights, when the shares sold do not exceed 10 % of the share capital and the issue price is not significantly below the prevailing stock exchange price or in the event of a sale against contributions in kind, or when the shares sold are used to service rights from convertible bonds or bonds with warrants. This also applies to shares issued by subsidiaries. The treasury shares may also be given to the holders of conversion or option rights in lieu of new shares from a contingent capital increase. The shares can also be withdrawn, without such a withdrawal or its implementation requiring a further resolution by the General Meeting.

The Management Board was also authorised to effect the acquisition of treasury shares by using put or call options. Any acquisition of shares using derivatives is limited to 5 % of share capital. In addition, any acquisition of shares shall count towards the 10 % threshold for the authorisation for the acquisition of treasury shares. Where treasury shares are acquired using equity derivatives, the shareholders' right to enter into any option transactions with the Company is excluded in analogous application of section 186 (3) sentence 4 of the AktG

Authorised capital

Aareal Bank has authorised capital pursuant to the resolution by the Annual General Meeting held on 31 May 2017. The Annual General Meeting authorised the Management Board to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 89,785,830 (Authorised Capital 2017) by issuance of new bearer shares for contribution in cash or in kind, subject to the approval of the Supervisory Board; this authority will expire on 30 May 2022. In the event of a capital increase against cash contributions, the shareholders shall be granted a subscription right, unless the Management Board exercises its authority to exclude shareholder's pre-emptive subscription rights. The Management Board may exclude shareholders' subscription rights, subject to approval by the Supervisory Board and the conditions set out below:

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

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

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

d) for an amount of up to € 4,000,000, to offer employees (of the Company or its affiliated companies) shares for subscription;

e) in the event of a capital increase against contributions in kind for the purpose of acquiring companies, divisions of companies or interests in companies or other assets.

The above authorisation for the exclusion of shareholders' subscription rights in the case of capital increases against contributions in cash or in kind is limited to a total of 20 % of the share capital; this limit may be exceeded neither at the time said authorisation comes into effect, nor at the time it is exercised. The above-mentioned 20 % threshold shall furthermore include treasury shares which are sold to the exclusion of shareholders' subscription rights during the validity of this authorisation as well as such shares which are issued to service debt securities, provided that the debt securities were issued to the exclusion of shareholders' subscription rights during the validity of this authorisation due to the authorisation under agenda item 6 of the Annual General Meeting on 21 May 2014. When a new authorisation for the exclusion of shareholders' subscription rights is resolved after the reduction and said new authorisation comes into effect, the upper limit, reduced in accordance with the above-mentioned requirements, shall be increased again to the amount permitted by the new authorisation, with a maximum total of 20 % of the share capital in accordance with the above-mentioned requirements.

The authorised capital has not been utilised.

Conditional capital

Based on a resolution passed by the General Meeting on 21 May 2014, the Management Board was authorised to issue, on one or more occasions until 20 May 2019, profit-participation rights with a limited or unlimited term for contribution in cash or in kind in a total nominal amount of € 1,000,000,000. If the profit-participation rights are not issued against contribution in kind, they may be linked to a conversion right for the holder or creditor. Conversion rights may only be issued for the Company's no-par value bearer shares with a proportionate share in the Company's share capital of € 89,785,830. The issue of profit-participation rights may also be effected by domestic or foreign companies in which the Company either directly or indirectly holds a majority interest. In this case, the Company, subject to Supervisory Board approval, may guarantee such issues as well as issue shares on its own to fulfil the conversion rights. Subject to the approval of the Supervisory Board, the Management Board may exclude shareholders' pre-emptive rights in relation to the profit-participation rights in certain cases.

The purpose of the authorisation passed by the Annual General Meeting on 21 May 2014 is to create Tier 1 capital that is eligible for regulatory purposes; it also provides for the issue of profit-participation rights with conversion obligations. It is in accordance with the various structuring alternatives for Additional Tier 1 capital instruments, pursuant to the Capital Requirements Regulation. For instance, a conversion obligation may be provided for if the Bank falls short of certain capital ratios (to be defined in the terms of convertible profit-participation certificates) or other financial indicators; conversion is required, in the opinion of the Company's Management Board and Supervisory Board, to safeguard the Company's continued existence; or if conversion is instructed by a supervisory authority within the scope of its powers.

Accordingly, the share capital is subject to a conditional capital increase not exceeding € 89,785,830 by issuance of up to 29,928,610 new no-par value bearer shares ("Conditional Capital 2014"). The conditional capital increase shall be implemented only insofar as (i) the holders or creditors of conversion rights from convertible profit-participation rights issued by the Company (or by an enterprise in which the Company either directly or indirectly holds a majority interest) until 20 May 2019 on the basis of the

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

The new shares will be issued at the conversion price to be set as defined in the resolution passed by the General Meeting on 21 May 2014.

To date, the Conditional Capital has not yet been utilised.

Capital reserves

The capital reserves contain premiums received upon the issuance of shares. Costs incurred within the framework of a capital increase reduce capital reserves.

Retained earnings

Retained earnings are comprised of statutory reserves (pursuant to section 150 of the AktG) of € 5 million (2017: € 5 million) and of other retained earnings of € 1,792 million (2017: € 1,793 million).

Additional Tier 1 bond (AT1 bond)

On 13 November 2014, the Management Board issued notes in an aggregate nominal amount of € 300 million with a denomination of € 200,000 and an initial interest rate of 7.625 %, based on the authorisation granted by the Annual General Meeting on 21 May 2014.

The notes bear interest of 7.625 % p. a. from the interest commencement date to 30 April 2020. The rate of interest for any interest period commencing on or after 30 April 2020 shall be equal to the reference rate (one-year EUR swap rate) determined on the relevant interest determination date plus a margin of 7.18 % p. a.

The notes constitute unsecured and subordinated obligations of the issuer.

Upon the occurrence of a trigger event, the redemption amount and the principal amount of each note shall be reduced by the amount of the relevant write-down. The write-down shall be effected pro rata with all other Additional Tier 1 instruments within the meaning of the CRR, the terms of which provide for a write-down upon the occurrence of the trigger event. A trigger event occurs if the Common Equity Tier 1 capital ratio, pursuant to Article 92 (1) (a) CRR or a successor provision, and determined on a consolidated basis, falls below 7.0 %. After a write-down has been effected, the principal amount and the redemption amount of each note, unless previously redeemed or repurchased and cancelled, may be written up in each of the financial years of the issuer subsequent to such write-down until the full initial principal amount has been reached.

The notes may be redeemed, in whole but not in part, at any time at the option of the issuer, subject to the prior consent of the competent supervisory authority, upon not less than 30 and not more than 60 days' prior notice of redemption at their redemption amount (taking into account a potential write-down) together with interest accrued until the redemption date (to the extent that interest payment is not cancelled or ruled out in accordance with the terms and conditions of the notes), when the tax or regulatory reasons set out in the terms and conditions of the notes apply. The issuer may also redeem the notes, in whole but not in part, at any time, subject to the prior consent of the competent supervisory authority, upon not less than 30 days' notice of redemption with effect as at 30 April 2020 for the first time and, thereafter, with effect as at each interest payment date at their redemption amount together with interest (if any) accrued to the redemption date.

Distributions

The Management Board of Aareal Bank AG proposes to the Annual General Meeting that the net retained profit of € 125,700,164.10 for the financial year 2018, as reported under the German Commercial Code (HGB), be used to distribute a dividend of € 2.10 per notional no-par value share. The dividend paid in 2018 amounted to € 2.50 per notional no-par value share.

In addition, on 30 April 2019, the Management Board will resolve on a distribution in relation to the AT1 instruments, pursuant to the terms and conditions of the notes.

Notes to Financial Instruments

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

(56) Net gains/losses of financial instruments by category

The following overview shows the net gains or net losses from financial instruments in accordance with the classification and measurement categories of financial assets and liabilities (from which the results are generated):

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017[1]
Net gain or loss from financial assets (ac)	-49	-33
Net gain or loss from financial liabilities (ac)	0	0
Net gain or loss from financial assets (fvoci) recognised in other comprehensive income	-20	-7
Net gain or loss from financial assets (fvoci) transferred to the income statement	–	0
Net gain or loss from equity instruments (fvoci)	0	0
Net gain or loss from financial instruments (fvpl)	-2	14
Net gain or loss from financial guarantee contracts and loan commitments	1	1

[1] Comparative amounts reclassified according to the new classification format

The net results include measurement gains and losses, realised gains/losses on disposal, subsequent recoveries on loans and advances previously written off in relation to all financial instruments of the respective measurement category. The net gain or loss from financial instruments (fvpl) also includes the net gain or loss from currency translation.

The hedge result from hedged items is aggregated with the hedge result from derivative hedging instruments in one line item and amounted to € -2 million (2017: € -7 million) in the year under review. Moreover, the change in the reserve from foreign-currency basis spreads amounted to € -17 million. In the previous year, the hedging reserve changed by € -27 million.

(57) 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 (p. 193) according to the three-tier fair value hierarchy pursuant to IFRS 13.72 et seq. The presentation is made for each class of financial instrument:

31 December 2018

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Financial assets (fvoci)	**4,450**	**4,443**	**1**	**6**
Money market and capital market receivables	4,443	4,443	–	–
Equity instruments	7	–	1	6
Financial assets (fvpl)	**3,183**	**308**	**2,164**	**711**
Loan receivables	711	–	–	711
Money market and capital market receivables	538	308	230	–
Equity instruments	0	0	–	–
Positive market value of designated hedging derivatives	1,277	–	1,277	–
Positive market value of other derivatives	657	–	657	–
Financial liabilities (fvpl)	**1,934**	**–**	**1,934**	**–**
Negative market value of designated hedging derivatives	1,461	–	1,461	–
Negative market value of other derivatives	473	–	473	–

31 December 2017 [1)]

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Financial assets (fvoci)	**5,424**	**5,422**	**–**	**2**
Money market and capital market receivables	5,422	5,422	–	–
Equity instruments	2	–	–	2
Financial assets (fvpl)	**2,449**	**–**	**2,253**	**196**
Loan receivables	196	–	–	196
Money market and capital market receivables	–	–	–	–
Positive market value of designated hedging derivatives	1,926	–	1,926	–
Positive market value of other derivatives	327	–	327	–
Financial liabilities (fvpl)	**1,703**	**–**	**1,703**	**–**
Negative market value of designated hedging derivatives	1,479	–	1,479	–
Negative market value of other derivatives	224	–	224	–

[1)] Comparative amounts reclassified according to the new classification format

In the financial year 2018, there were no material transfers between the hierarchy levels for the various financial instruments.

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

€ mn	Loan receivables (fvpl)
Fair value as at 1 January 2018 [1]	**604**
Change in measurement	**-2**
Portfolio changes	
Additions	690
Derecognition	582
Deferred interest	1
Fair value as at 31 December 2018	**711**

[1] Fair value in accordance with IAS 39, as at 31 December 2017: € 196 million (recognised in 2017)

Financial instruments held in the Bank's portfolio contributed € -1 million to the net gain or loss from financial instruments (fvpl) (2017: € 0 million).

Regarding loan receivables (ac), 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 € 12 million (2017: approximately € 2 million).

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

31 December 2018

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Financial assets (ac)	**34,556**	**3,165**	**4,495**	**26,896**
Cash funds	1,265	–	1,265	–
Loan receivables	26,858	–	3	26,855
Money market and capital market receivables	6,372	3,165	3,207	–
Receivables from other transactions	61	–	20	41
Financial liabilities (ac)	**37,168**	**2,327**	**25,003**	**9,838**
Money market and capital market liabilities	26,278	2,006	24,234	38
Deposits from the housing industry	9,679	–	–	9,679
Liabilities from other transactions	121	–	0	121
Subordinated capital	1,090	321	769	–

31 December 2017 [1]

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Financial assets (ac)	**33,679**	**2,304**	**4,994**	**26,381**
Cash funds	2,081	–	2,081	–
Loan receivables	26,308	–	3	26,305
Money market and capital market receivables	5,218	2,304	2,910	4
Receivables from other transactions	72	–	–	72
Financial liabilities (ac)	**36,961**	**853**	**26,593**	**9,515**
Money market and capital market liabilities	26,349	513	25,778	58
Deposits from the housing industry	9,164	–	–	9,164
Liabilities from other transactions	90	–	–	90
Subordinated capital	1,358	340	815	203

[1] Comparative amounts reclassified according to the new classification format

(58) 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	31 Dec 2018 Carrying amount	31 Dec 2018 Fair value	31 Dec 2017 Carrying amount[1]	31 Dec 2017 Fair value[1]
Financial assets (ac)	**34,125**	**34,556**	**33,156**	**33,679**
Cash funds	1,265	1,265	2,081	2,081
Loan receivables	26,232	26,858	25,776	26,308
Money market and capital market receivables	6,567	6,372	5,225	5,218
Receivables from other transactions	61	61	74	72
Financial assets (fvoci)	**4,450**	**4,450**	**5,424**	**5,424**
Money market and capital market receivables	4,443	4,443	5,422	5,422
Equity instruments	7	7	2	2
Financial assets (fvpl)	**3,183**	**3,183**	**2,449**	**2,449**
Loan receivables	711	711	196	196
Money market and capital market receivables	538	538	–	–
Equity instruments	0	0	–	–
Positive market value of designated hedging derivatives	1,277	1,277	1,926	1,926
Positive market value of other derivatives	657	657	327	327

>

[1] Comparative amounts reclassified according to the new classification format

€ mn	31 Dec 2018 Carrying amount	31 Dec 2018 Fair value	31 Dec 2017 Carrying amount[1]	31 Dec 2017 Fair value[1]
Financial liabilities (ac)	**37,215**	**37,168**	**36,630**	**36,961**
Money market and capital market liabilities	26,371	26,278	26,109	26,349
Deposits from the housing industry	9,679	9,679	9,164	9,164
Liabilities from other transactions	121	121	92	90
Subordinated capital	1,044	1,090	1,265	1,358
Financial liabilities (fvpl)	**1,934**	**1,934**	**1,703**	**1,703**
Negative market value of designated hedging derivatives	1,461	1,461	1,479	1,479
Negative market value of other derivatives	473	473	224	224

[1] Comparative amounts reclassified according to the new classification format

(59) Disclosures on credit risk

For information on risk management practice and input factors, please refer to the chapter "Credit default risk" in the Risk Report.

The following overviews present the loss allowance and the provisions for credit risks per stage and separately by product groups.

Loss allowance (ac)

€ mn	Balance as at 1 January	Additions	Utilisation	Reversals	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	Interest effect	Currency adjustment	Transfers	Balance as at 31 December
Stage 1	**32**	**18**	**–**	**16**	**1**	**-1**	**0**	**–**	**0**	**–**	**34**
Loan receivables (ac)	31	18	–	16	1	-1	0	–	0	–	33
Money market and capital market receivables (ac)	1	0	–	0	0	–	–	–	0	–	1
Stage 2	**42**	**6**	**–**	**14**	**-1**	**1**	**-12**	**–**	**0**	**–**	**22**
Loan receivables (ac)	23	6	–	5	-1	1	-12	–	0	–	12
Money market and capital market receivables (ac)	19	–	–	9	0	–	–	–	–	–	10
Stage 3	**517**	**110**	**100**	**26**	**0**	**0**	**12**	**5**	**1**	**–**	**519**
Loan receivables (ac)	517	110	100	26	0	0	12	5	1	–	519
Receivables from other transactions	**2**	**0**	**1**	**1**	**–**	**–**	**–**	**–**	**0**	**2**	**2**
Total	**593**	**134**	**101**	**57**	**–**	**–**	**–**	**5**	**1**	**2**	**577**

The loss allowance for financial assets (ac) is reported in the item “Loss allowance (ac) on the assets side of the statement of financial position.

Loss allowance in the reserve from the measurement of debt instruments (fvoci)

The loss allowance for debt instrument (fvoci) amounts to € 0 million (2017: n/a) and is reported on the equity and liabilities side of the statement of financial position under other reserves.

Provisions for unrecognised lending business

€ mn	Balance as at 1 January	Additions	Utilisation	Reversals	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	Interest effect	Currency adjustment	Balance as at 31 December
Stage 1	4	1	–	3	0	0	–	–	0	2
Stage 2	0	0	–	0	0	0	–	–	0	0
Stage 3	2	2	0	1	–	–	–	–	0	3
Total	**6**	**3**	**0**	**4**	**–**	**–**	**–**	**–**	**0**	**5**

The provisions for unrecognised lending business refer to loan commitments and contingent liabilities and are reported on the equity and liabilities side of the statement of financial position under provisions.

No impaired financial assets were recognised for the first time during the current financial year, nor were assets acquired within the context of the realisation of collateral.

Credit quality of financial receivables from other transactions

Financial receivables from other transactions are subject to credit risk. Of the receivables from other transactions in the amount of € 64 million, € 58 million were neither overdue nor impaired, € 4 million were overdue but not impaired and € 2 million were impaired.

(60) Reconciliation of gross carrying amounts of financial assets

The following tables show the development of the gross carrying amounts of financial assets that are subject to the impairment rules and to which the loss allowance mentioned above can be attributed.

Financial assets (ac) 2018

€ mn	Gross carrying amount as at 1 January	Additions	Disposals	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	Impairment and reversal of impairment	Net modification gain or loss	Currency and other changes	Gross carrying amount as at 31 December
Loan receivables	**25,885**	**8,992**	**8,304**	**–**	**–**	**–**	**-100**	**-1**	**323**	**26,795**
Stage 1	23,151	8,879	7,701	53	-205	-1	–	-1	247	24,422
Stage 2	1,167	14	312	-36	210	-229	–	0	-28	786
Stage 3	1,567	99	291	-17	-5	230	-100	0	104	1,587
POCI	0	–	0	–	–	–	–	–	–	0
Money market and capital market receivables	**6,087**	**1,547**	**980**	**–**	**–**	**–**	**–**	**–**	**-76**	**6,578**
Stage 1	4,526	1,547	904	686	-21	–	–	–	-61	5,773
Stage 2	1,561	0	76	-686	21	–	–	–	-15	805
Receivables from other transactions	**76**	**40**	**52**	**–**	**–**	**–**	**–**	**–**	**–**	**64**
Total	**32,048**	**10,579**	**9,336**	**–**	**–**	**–**	**-100**	**-1**	**247**	**33,437**

Financial assets (fvoci) 2018

€ mn	Gross carrying amount as at 1 January	Additions	Disposals	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	Impairment and reversal of impairment	Net modification gain or loss	Currency and other changes	Gross carrying amount as at 31 December
Money market and capital market receivables	**4,343**	**609**	**426**	**–**	**–**	**–**	**–**	**–**	**-83**	**4,443**
Stage 1	4,240	609	426	99	0	–	–	–	-79	4,443
Stage 2	103	–	–	-99	0	–	–	–	-4	–
Total	**4,343**	**609**	**426**	**–**	**–**	**–**	**–**	**–**	**-83**	**4,443**

Please refer to the presentation of the items of the statement of financial position in the section "Notes to the statement of financial position" for information on maximum credit risk exposure since the carrying amount corresponds to the maximum credit risk exposure of Aareal Bank as at the balance sheet date, for both items that are subject to the impairment rules and for financial assets that are not subject to the impairment rules. The collateral received is described in the Economic and Risk Report.

As at the current reporting date, no receivables from the lending business that were written off during the reporting year, were still part of foreclosure proceedings.

(61) Modification effects

If modifications are made to financial assets during the contract term leading to changes in the contractual cash flows and if these changes are not that extensive that the financial asset is derecognised and a new asset is recognised, such modifications are non-substantial modifications. Following a non-substantial modification, the carrying amount of a financial asset is remeasured and a net modification gain or loss is recorded in net interest income or in the loss allowance.

The following table shows the amortised cost before modification of financial assets that were subject to non-substantial modifications in the reporting period as well as the related modification gain or loss.

Modifications in the case of loan receivables (ac)

€ mn	Stage 1	Stage 2	Stage 3
Amortised cost before modification	248	45	484
Net gain or loss on modification	-1	0	0
Amortised cost after modification	**247**	**45**	**484**

During the financial year, no receivables from the lending business were reclassified from Stage 2 or Stage 3 to Stage 1, which had been modified since they were first classified as Stage 2 or Stage 3 receivables.

(62) Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount is presented in the statement of financial position when currently there is a legally enforceable right to set off the recognised amounts, and when the Bank intends either to settle on a net basis – or to realise the asset and settle the liability simultaneously. The following overviews show whether and to what extent financial instruments were actually offset as at the current reporting date. The tables also include disclosures on financial instruments that are part of an enforceable master netting or similar arrangement that do not meet the criteria for offsetting in the statement of financial position.

Financial assets

31 December 2018

€ mn	Gross carrying amounts of recognised financial assets	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial liabilities which were not subject to offsetting	Collateral received	Remaining net amount
Derivatives	1,843	–	1,843	1,031	731	81
Reverse repos	–	–	–	–	–	–
Total	**1,843**	**–**	**1,843**	**1,031**	**731**	**81**

31 December 2017

€ mn	Gross carrying amounts of recognised financial assets	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial liabilities which were not subject to offsetting	Collateral received	Remaining net amount
Derivatives	2,212	–	2,212	1,094	983	135
Reverse repos	–	–	–	–	–	–
Total	**2,212**	**–**	**2,212**	**1,094**	**983**	**135**

Financial liabilities

31 December 2018

€ mn	Gross carrying amounts of recognised financial liabilities	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial assets which were not subject to offsetting	Collateral provided	Remaining net amount
Derivatives	1,611	–	1,611	1,031	538	42
Repos	–	–	–	–	–	–
Total	**1,611**	**–**	**1,611**	**1,031**	**538**	**42**

31 December 2017

€ mn	Gross carrying amounts of recognised financial liabilities	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial assets which were not subject to offsetting	Collateral provided	Remaining net amount
Derivatives	1,645	–	1,645	1,094	551	–
Repos	–	–	–	–	–	–
Total	**1,645**	**–**	**1,645**	**1,094**	**551**	**–**

To reduce counterparty risk, Aareal Bank Group concludes standardised master agreements for financial derivatives and securities repurchase agreements, such as the ISDA Master Agreement, the German Master Agreement on Financial Derivatives or the Master Agreement for Securities Repurchase Transactions. In addition, Aareal Bank enters into collateral agreements (Credit Support Annex to the ISDA Master Agreement and Collateral Annex to the German Master Agreement on Financial Derivatives) in which a mutual collateralisation of all claims between the contracting parties is agreed and which include netting arrangements.

The master agreements for financial derivatives used by Aareal Bank include netting arrangements at a single transaction level (so-called " payment netting"), which provide for a netting of payments when both parties need to make payments in the same currency on the same date, as set out in the contract. Aareal Bank does not offset financial derivatives according to the rules related to payment netting, as the transactions are not settled on a net basis. Aareal Bank Group has not entered into arrangements providing for netting of derivatives across several transactions.

For securities repurchase transactions (repo), depending on the counterparty, payment or delivery netting is made. In line with the rules set out in the master agreement for repo transactions, payments or deliveries of securities may be offset when both counterparties have to make payments in the same currency on the same date, or have to deliver securities of the same type. Transactions effected on the basis of the master agreement for repo transactions generally meet the offsetting requirements of IAS 32. Aareal Bank settles on a net basis in the case of transactions within the framework of GC pooling, which means that these transactions are offset in the statement of financial position.

(63) Assets provided or accepted as collateral

Assets provided as collateral

Aareal Bank Group has provided financial assets as collateral for its liabilities or contingent liabilities. The following overview shows the carrying amount of the collateral provided and the items of the statement of financial position in which they are reported.

€ mn	31 Dec 2018	31 Dec 2017[1]
Money market and capital market receivables (ac, fvoci and fvpl)	1,381	723
Receivables from other transactions (ac)	17	14
Total	**1,398**	**737**

[1] Comparative amounts reclassified according to the new classification format

The protection buyer has no right to sell or re-pledge any of financial assets pledged as collateral (2017: € –). There is a fully cash-collateralised and irrevocable payment obligation in the amount of € 17 million (2017: € 14 million) from the bank levy and also for the deposit guarantee scheme of German banks. This obligation is reported under receivables from other transactions (ac).

Assets accepted as collateral

Aareal Bank Group accepts financial assets as collateral. These assets may be sold or pledged without the collateral owner being in default. No fixed-income securities were accepted as collateral for repo transactions as at the balance sheet date (2017: € –).

Collateral is provided and accepted predominantly on the basis of standardised agreements on securities repurchase transactions and on the collateralisation of forward transactions.

(64) Transfer of financial assets without derecognition

Aareal Bank Group sells securities subject to a take-back requirement as borrower within the framework of genuine repurchase agreements. Within the scope of such agreements, securities were transferred to lenders without resulting in the securities being derecognised since Aareal Bank Group retains the substantial risks and rewards from the securities. The risks to which Aareal Bank Group is still exposed comprise the default risk, the interest rate risk and other price risks. The equivalent values received as hedges during the transfer of securities are accounted for as liabilities to banks, or liabilities to customers. Within the context of securities repurchase transactions, the unrestricted title and the unrestricted power of disposition is transferred to the lender upon delivery of the securities. The lender has the right to sell or pledge these securities, however, he is required to retransfer securities of the same type and in the same amount as at the repurchase date.

As in the previous year, no securities were part of repurchase agreements as at the balance sheet date.

(65) Derivative financial instruments

Overview of market values of derivatives

The following table shows positive and negative market values (including pro-rata interest) of all derivative financial instruments by hedge and risk types:

	Fair value as at 31 Dec 2018		Fair value as at 31 Dec 2017	
€ mn	positive	negative	positive	negative
Fair value hedge derivatives	**1,277**	**1,443**	**1,915**	**1,464**
Interest rate risk	**1,277**	**1,422**	**1,385**	**1,312**
Interest rate swaps	1,277	1,422	1,385	1,312
Interest rate and currency risk	**–**	**21**	**530**	**152**
Cross-currency swaps	–	21	530	152
Derivatives from cash flow hedges	**–**	**–**	**8**	**15**
Interest rate and currency risk	**–**	**–**	**8**	**15**
Cross-currency swaps	–	–	8	15
Hedge of net investments	**–**	**18**	**3**	**–**
Currency risk	**–**	**18**	**3**	**–**
Cross-currency swaps	–	18	3	–
Other derivatives	**657**	**473**	**327**	**224**
Interest rate risk	**190**	**260**	**247**	**190**
Interest rate swaps	184	254	241	184
Swaptions	–	0	–	0
Caps, floors	6	6	6	6
Interest rate and currency risk	**467**	**213**	**80**	**34**
Spot and forward foreign exchange transactions	14	3	37	2
Cross-currency swaps	453	210	43	32
Total	**1,934**	**1,934**	**2,253**	**1,703**

Derivatives have been entered into with the following counterparties:

€ mn	Fair value as at 31 Dec 2018 positive	Fair value as at 31 Dec 2018 negative	Fair value as at 31 Dec 2017 positive	Fair value as at 31 Dec 2017 negative
OECD banks	1,820	1,888	2,087	1,693
Companies and private individuals	114	46	166	10
Total	**1,934**	**1,934**	**2,253**	**1,703**

The following overview shows the cash flows of derivative financial instruments by risk types, based on the contractual maturity. The amounts shown in the table represent the contractually agreed future undiscounted cash flows:

31 December 2018

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Interest rate risk					
Interest rate swaps					
Cash inflows	155	424	1,282	380	2,241
Cash outflows	170	297	1,023	386	1,876
Swaptions					
Cash inflows	–	–	–	–	–
Cash outflows	–	–	0	–	0
Caps, floors					
Cash inflows	0	2	4	1	7
Cash outflows	0	2	4	1	7
Interest rate and currency risk					
Spot and forward foreign exchange transactions					
Cash inflows	1,575	238	–	–	1,813
Cash outflows	1,566	238	–	–	1,804
Cross-currency swaps					
Cash inflows	509	1,528	6,855	51	8,943
Cash outflows	549	1,637	7,198	–	9,384
Total cash inflows	**2,239**	**2,192**	**8,141**	**432**	**13,004**
Total cash outflows	**2,285**	**2,174**	**8,225**	**387**	**13,071**

31 December 2017

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Interest rate risk					
Interest rate swaps					
Cash inflows	161	430	1,360	417	2,368
Cash outflows	144	279	981	358	1,762
Swaptions					
Cash inflows	–	–	–	–	–
Cash outflows	–	–	0	–	0
Caps, floors					
Cash inflows	0	0	5	1	6
Cash outflows	0	0	5	1	6
Interest rate and currency risk					
Spot and forward foreign exchange transactions					
Cash inflows	2,870	341	–	–	3,211
Cash outflows	2,843	337	–	–	3,180
Cross-currency swaps					
Cash inflows	186	1,923	5,133	1,147	8,389
Cash outflows	231	2,032	4,967	1,068	8,298
Total cash inflows	**3,217**	**2,694**	**6,498**	**1,565**	**13,974**
Total cash outflows	**3,218**	**2,648**	**5,953**	**1,427**	**13,246**

The procedure for measuring and monitoring liquidity risk is described in the Risk Report.

(66) Disclosures on hedging relationships

Disclosures on hedging derivatives

The following tables show designated hedging derivatives separately for each type of hedging relationship, risk category and product type:

Positive market value of designated hedging derivatives

€ mn	Carrying amount 31 Dec 2018	Nominal amount 31 Dec 2018	Fair value change 1 Jan-31 Dec 2018
Fair value hedges			
Interest rate risk			
Interest rate swaps	1,277	18,276	-87
Total	**1,277**	**18,276**	**-87**

Negative market value of designated hedging derivatives

€ mn	Carrying amount 31 Dec 2018	Nominal amount 31 Dec 2018	Fair value change 1 Jan - 31 Dec 2018
Fair value hedges			
Interest rate risk			
Interest rate swaps	1,422	12,470	-56
Interest rate and currency risk			
Cross-currency swaps	21	112	-5
Hedge of net investments			
Currency risk			
Cross-currency swaps	18	599	17
Total	**1,461**	**13,181**	**-44**

The following overview presents the nominal amounts of the hedging derivatives by maturities:

31 December 2018

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Fair value hedges					
Interest rate risk					
Interest rate swaps	2,678	3,571	17,031	7,466	30,746
Interest rate and currency risks					
Cross-currency swaps	–	–	112	–	112
Hedge of net investments					
Currency risk					
Cross-currency swaps	205	180	214	–	599
Total nominal amounts	**2,883**	**3,751**	**17,357**	**7,466**	**31,457**

Disclosures on hedged items

The following table shows hedged items separately for each type of hedging relationship and risk category:

Hedged items of fair value hedges

	Active hedging relationships			Discontinued hedging relationships
€ mn	Carrying amount 31 Dec 2018	Accumulated hedge adjustment 31 Dec 2018	Change in hedged fair values 1 Jan - 31 Dec 2018	Balance of hedge adjustments 31 Dec 2018
Interest rate risk				
Loan receivables (ac)	6,888	17	12	29
Money market and capital market receivables (ac)	3,940	645	-31	180
Money market and capital market receivables (fvoci)	3,898	330	-54	54
Money market and capital market liabilities (ac)	17,616	850	-89	76
Subordinated liabilities (ac)	915	49	-5	4
Interest rate and currency risk				
Money market and capital market receivables (ac)	153	41	-5	–

Hedge of net investments

The change in value of currency-hedged net investments in foreign operations amounted to € 22 million in the financial year. The balance of the hedge reserve stood at € -11 million at the year-end.

Net gain or loss from hedge accounting

Fair value hedges

The net gain or loss from hedge accounting include the following ineffective portions of fair value hedges by risk categories:

€ mn	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017
Interest rate risks	-2	-2
Interest rate and currency risks	0	0
Total	**-2**	**-2**

Hedge of net investments

The ineffective portion of currency-hedged net investments in foreign operations amounted to € 0 million, reported in net gains or losses from hedge accounting. No amounts were reclassified from the reserve for currency-hedged net investments to the income statement.

(67) Maturities of financial liabilities

The following two overviews show the future undiscounted cash flows of non-derivative financial liabilities and of loan commitments.

Maturities as at 31 December 2018

€ mn	payable on demand	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Money market and capital market liabilities (ac)	896	2,692	4,864	10,090	10,374	**28,916**
Deposits from the housing industry (ac)	7,719	1,960	–	–	–	**9,679**
Subordinated capital (ac)	–	29	88	656	405	**1,178**
Financial liabilities from other transactions (ac)	118	0	2	0	–	**120**
Financial guarantees	156	–	–	–	2	**158**
Loan commitments	1,480	–	–	–	–	**1,480**

Maturities as at 31 December 2017 [1)]

€ mn	payable on demand	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Money market and capital market liabilities (ac)	1,148	2,324	5,054	10,488	10,457	**29,471**
Deposits from the housing industry (ac)	7,324	1,903	66	17	–	**9,310**
Subordinated capital (ac)	–	24	27	779	459	**1,289**
Financial liabilities from other transactions (ac)	92	–	–	–	–	**92**
Financial guarantees	122	–	–	–	2	**124**
Loan commitments	1,749	–	–	–	–	**1,749**

[1)] Comparative amounts reclassified according to the new classification format

The Risk Report includes a detailed description of the liquidity risk associated with financial liabilities.

Segment Reporting

(68) Operating segments of Aareal Bank

In the financial year 2018, segment reporting by Aareal Bank was prepared in accordance with IFRS 8 Operating Segments.

In accordance with the "management approach" set out in IFRS 8, the segment report discloses, on a segment-specific basis, financial information which is relevant for internal control of an entity and which is also used by such entity's management to make decisions on the allocation of resources as well as to measure the financial performance of segments.

Two operating segments are defined within Aareal Bank in line with internal management reporting, based on the organisational structure established according to the various products and services offered.

The **Structured Property Financing segment** comprises the property financing and refinancing activities. In this segment, Aareal Bank facilitates property investments for its domestic and international clients, and is active in this respect in Europe, North America and Asia-Pacific. It offers commercial property financing solutions, especially for office buildings, hotels, retail, logistics and residential properties. Its particular strength lies in its success in combining local market expertise and sector-specific know-how. In addition to local experts, the Bank also has industry specialists at its disposal, to create financing packages for logistics and retail properties and hotels. This enables Aareal Bank to offer tailor-made financing concepts that meet the special requirements of its national and international clients. What makes Aareal Bank special are its direct client relationships, which – in very many cases – it has maintained for many years.

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

The **Consulting/Services segment** offers the housing and commercial property industries services and products for managing property portfolios and processing payment flows. Within this segment, our subsidiary Aareon AG and the Bank's Housing Industry division work together closely.

We operate our IT system consultancy and related advisory services for the housing and commercial property sector through our Aareon AG subsidiary. Aareon offers its customers reliable, pioneering solutions in the fields of consulting, software and services to optimise IT-supported business processes in the digital age. The ERP (Enterprise Resource Planning) systems, which are tailored to the needs of the respective market, may be supplemented by further digital solutions for purposes of process optimisation. The majority of these integrated systems forms the digital ecosystem "Aareon Smart World". It connects property companies with customers, employees and business partners as well as technical "equipment" in apartments and buildings. Aareon Smart World can be used to restructure and optimise processes.

The applications help to reduce costs, enable the creation of new business models by providing links between all participants and offer more ease-of-use in the dialogue between tenants and employees of the housing industry.

Aareon offers software solutions both in Germany and abroad that may be used in various types of operating environments: in-house services, hosting and Software as a Service (SaaS) from the exclusive Aareon Cloud. Data from Aareon's Cloud Computing is held in Aareon's certified data-processing centre in Mainz, which guarantees data security and protection at the highest level. Following successful advice, implementation and training, customers usually opt for a maintenance model covering regular support services.

In its Housing Industry division, Aareal Bank offers its customers process optimisation, electronic banking and asset management. Aareal Bank distributes BK 01, the leading procedure in the German housing and property management sector for the automated settlement of mass payments. The procedure is integrated in licensed bookkeeping systems. Therefore, customers in Germany may process their payment transactions and account management from the administration software employed. Apart from the German residential and commercial property sector, the German energy and waste disposal industry is a second important customer group of the Bank's Housing Industry division. This enables the offer of further products, facilitating the cross-sector cooperation of target groups and realising synergy effects via end-to-end digital processes. The use of the payment transaction products of Aareal Bank generates deposits that contribute significantly to Aareal Bank Group's refinancing base. The interest rate contribution is reported in the segment's net commission income and then transferred to net interest income.

Income and expenses within Aareal Bank are predominantly attributable to transactions with third parties, and are directly allocated to the responsible business segment. Revenue from transactions between Aareal Bank's segments was not generated in a significant amount. Therefore, we elected not to distinguish between internal and external revenue in the following disclosures. Administrative expenses not directly attributable to any of the business segments are segmented in line with the internal cost allocation, based on the principle of causation.

The results of the business segments are determined by the operating profit as well as by the return on equity (RoE) and the cost/income ratio (CIR). RoE, which indicates a segment's profitability, is calculated as the ratio of the segment's operating result (after non-controlling interests and after AT1 interest) to the portion of equity allocated to that segment on average. The cost/income ratio – determined as the ratio of input to output of resources – is used as an indicator for the cost efficiency of business segments. Equity allocated to the Structured Property Financing segment is calculated on the basis of the capital charge pursuant to Basel IV. For the Consulting/Services segment, it is calculated using equity carried in the statement of financial position.

(69) Segment results

	Structured Property Financing		Consulting/Services		Consolidation/ Reconciliation		Aareal Bank Group	
	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017[1]	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017[1]
€ mn								
Net interest income	547	596	0	0	-12	-12	535	584
Loss allowance	73	82	-1				72	82
Net commission income	9	7	200	191	6	8	215	206
Net derecognition gain or loss	24	50					24	50
Net gain or loss from financial instruments (fvpl)	-2	14	0				-2	14
Net gain or loss from hedge accounting	-2	-7					-2	-7
Net gain or loss from investments accounted for using the equity method	0						0	
Administrative expenses	241	296	227	220	-6	-5	462	511
Net other operating income/expenses	21	69	4	6	0	-1	25	74
Negative goodwill from acquisitions	55						55	
Operating profit	**338**	**351**	**-22**	**-23**	**0**	**0**	**316**	**328**
Income taxes	99	123	-9	-8			90	115
Consolidated net income	**239**	**228**	**-13**	**-15**	**0**	**0**	**226**	**213**
Consolidated net income attributable to non-controlling interests	0	4	2	2			2	6
Consolidated net income attributable to shareholders of Aareal Bank AG	239	224	-15	-17	0	0	224	207
Allocated equity	2,058	1,724	189	165	268	627	2,515	2,516
Cost/income ratio (%)	40.4	40.5	111.6	111.9			58.2	55.5
RoE before taxes (in %)[2]	15.3	18.8	-12.7	-15.4			11.6	11.9
Employees (average)	**800**	**880**	**1,964**	**1,878**			**2,764**	**2,758**
Segment assets	**31,989**	**31,642**	**10,698**	**10,266**			**42,687**	**41,908**

[1] Comparative amounts reclassified according to the new classification format

[2] 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:

	Structured Property Financing		Consulting/Services		Consolidation/ Reconciliation		Aareal Bank Group	
	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017[1]	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017[1]	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017[1]	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017[1]
€ mn								
ERP Products			168	160	-1		167	160
Digital solutions			42	37			42	37
Add-on products			23	21	-12	-10	11	11
Banking business and other activities	12	10	27	25			39	35
Total	**12**	**10**	**260**	**243**	**-13**	**-10**	**259**	**243**

[1] Comparative amounts reclassified according to the new classification format

(70) Income by geographical region

€ mn	2018	2017
Germany	522	621
Rest of Europe	172	161
North America	75	70
Asia/Pacific	3	2
Total	**772**	**854**

Income includes net interest income (excluding loss allowance), net commission income, net gain or loss on derecognition and net gain or loss from financial instruments (fvpl). Since the 2018 financial year, subsidiaries or branches have been allocated to geographical markets based on their registered office or domicile. The previous year's figures were adjusted accordingly.

(71) Consulting/Services segment – reconciliation of the income statement

Reconciliation of the segment result from the income statement classification aligned to an industrial enterprise to a bank income statement classification (which is used for the purposes of segment reporting)

			Income statement classification – bank								
€ mn			Net interest income	Loss allowance	Net commission income	Net gain or loss from financial instruments (fvpl)	Administrative expenses	Net other operating income/expenses	**Operating profit**	Income taxes	**Segment result**
	2018		0	-1	200	0	227	4	**-22**	-9	**-13**
	2017		0		191		220	6	**-23**	-8	**-15**
Income statement classification – industrial enterprise											
Sales revenue	2018	242			242						
	2017	226			226						
Own work capitalised	2018	8					8				
	2017	4					4				
Other operating income	2018	7						7			
	2017	7						7			
Cost of materials purchased	2018	42			42						
	2017	35			35						
Staff expenses	2018	159					159				
	2017	151					151				
Depreciation, amortisation and impairment losses	2018	15					15				
	2017	12					12				
Other operating expenses	2018	63		-1		0	61	3			
	2017	62					61	1			
Interest and similar income/expenses	2018	0	0								
	2017	0	0								
Operating profit	**2018**	**-22**	**0**	**-1**	**200**	**0**	**227**	**4**			
	2017	**-23**	**0**		**191**		**220**	**6**			
Income taxes	2018	-9								-9	
	2017	-8								-8	
Segment result	**2018**	**-13**									
	2017	**-15**									

Other Notes

(72) Assets and liabilities in foreign currency

Foreign currency assets

€ mn	31 Dec 2018	31 Dec 2017
USD	13,096	10,851
GBP	4,408	4,019
CAD	908	715
SEK	608	538
CHF	400	458
DKK	323	411
Other	94	27
Total	**19,837**	**17,019**

Foreign currency liabilities

€ mn	31 Dec 2018	31 Dec 2017
USD	13,084	10,829
GBP	4,340	3,932
CAD	905	719
SEK	584	518
CHF	401	454
DKK	322	436
Other	91	27
Total	**19,727**	**16,915**

(73) Subordinated assets

In the event of insolvency or liquidation of the issuer, subordinated assets are those subordinate to the claims of all other creditors. There were € 0 million of subordinated assets in the financial year 2018 (2017: € –).

(74) Leases

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or a series of payments the right to use an asset for an agreed period of time. In accordance with IAS 17, leases where a material part of risks and rewards incidental to ownership of the leased assets remains with the lessor are classified as operating leases. Where substantially all risks and rewards are transferred to the lessee, the lease is classified as a finance lease. The provisions of IFRIC 4 were complied with as regards the application of IAS 17. Aareal Bank Group acts both as lessor and lessee. All rental contracts are classified as operating leases. They mainly refer to rented or let property.

Properties leased by the Group are reported under other assets.

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

Maturity of minimum lease payments under operating leases

€ mn	31 Dec 2018	31 Dec 2017
Aareal Bank Group as lessee		
up to 1 year	15	13
longer than 1 year, and up to 5 years	37	34
longer than 5 years	13	11
Total minimum lease payments	**65**	**58**
Aareal Bank Group as lessor		
up to 1 year	9	13
longer than 1 year, and up to 5 years	24	35
longer than 5 years	7	16
Total minimum lease payments	**40**	**64**

In the financial year, lease payments of € 16 million (2017: € 14 million) were recognised as expenses.

(75) Contingent liabilities and loan commitments

€ mn	31 Dec 2018	31 Dec 2017
Contingent liabilities	158	124
Loan commitments	1,480	1,749
of which: irrevocable	1,035	1,355

Contingent liabilities include irrevocable payment obligations regarding the bank levy and the liability to the deposit guarantee scheme of German banks. These and the values reported under loan commitments given represent the maximum default risk to which Aareal Bank Group is exposed at the end of the reporting period.

Furthermore, the Bank is involved in legal disputes. Based on a legal analysis, successful outcome of these disputes is more likely than not. Essentially, these are legal disputes with borrowers (or former borrowers) who claim damages against the Bank. These are included in the table above, with a probability-weighted amount of € 109 million (2017: € 51 million), but have not been recognised as liabilities. We estimate the maximum default risk in the low triple-digit million range. The duration of proceedings depends on the complexity of each individual litigation, and the legal remedies available in each case. Likewise, the final amount in the event of defeat may vary considerably, depending upon the duration of proceedings and the legal remedies. Refunds of litigation costs are possible. Accordingly, the recognition of contingent liabilities is also subject to estimation uncertainties.

(76) Consolidated statement of cash flows

Aareal Bank Group's statement of cash flows records cash flows pertaining to the areas of operating activities, investing activities and financing activities for the period under review. The starting point of the consolidated statement of cash flows is the amount of cash and cash equivalents, consisting of cash on hand, balances with central banks as well as public-sector debt instruments and bills of exchange eligible for refinancing at central banks.

The definition of the term "operating activities" is consistent with the composition of the operating profit in the statement of comprehensive income. Cash flows from investing activities include proceeds from and payments in relation to property and equipment and investments in equity instruments and equity investments as well as from investment properties. Cash flows from financing activities include cash flows from transactions with providers of equity and subordinated capital.

In connection with the assets acquired and liabilities assumed, as well as the purchase price paid within the context of the acquisition of Düsselhyp, please refer to our statements in the section "Consolidation".

(77) Regulatory capital and capital management

As regards meeting minimum capital ratios, Aareal Bank Group has to comply with the capital adequacy requirements set out in the Capital Requirements Regulation (CRR), the Capital Requirements Directive (CRD IV), the German Banking Act (Kreditwesengesetz, KWG) and the German Solvency Regulation (Solvabilitätsverordnung, SolvV) pursuant to Basel III. This requires the Bank to maintain own funds (including capital conservation buffer and the forecast countercyclical buffer) of at least 10.6 % of its risk-weighted assets in 2019 (2018: 10.0 %). Risk-weighted assets must be backed by Tier 1 capital of at least 8.6 % (2018: 8.0 %). Compliance with the capital requirements has to be reported to the competent supervisory authorities on a quarterly basis. The capital requirements were complied with at all times during the reporting period.

In 2019, the SREP total capital requirement of the ECB amounts to 12.87 % (2018: 11.74 %) for Aareal Bank Group. It comprises the minimum own funds requirement pursuant to Article 92(1) of the CRR, Pillar 2 Requirement (P2R) as well as capital conservation buffer and a forecast countercyclical buffer. In 2019, the SREP-CET 1 requirement is 9.37 % (2018: 8.24 %), including the abovementioned buffers.

The objectives of capital management are optimising the capital base as well as an efficient capital allocation to the individual business areas in terms of risk and income. Subject to further regulatory changes, Aareal Bank considers a target CET1 ratio (post-finalisation of Basel III – so-called "Basel IV") of around 12.5 % to be appropriate as a target capital ratio relevant for internal control. This ratio, which is significantly above the legal minimum requirement and above the ECB's requirements, is to guarantee the Bank's capacity to act. The capital ratios are managed through the generation of profits, an active dividend policy, optimisation of the capital structure, and an efficient management of risk assets.

Within the context of capital management, projections are made on a regular basis showing the changes of the individual capital components and risk-weighted assets, as well as the resulting capital ratios. This is reported regularly within the framework of management reporting. The strategic allocation of capital to the individual business segments is incorporated in the Group's annual overall planning process.

Aareal Bank Group's regulatory capital is composed of the following:

€ mn	31 Dec 2018[1]	31 Dec 2017
Tier 1 capital (T1)		
Subscribed capital and capital reserves	900	900
Eligible retained earnings	1,590	1,580
Accumulated other comprehensive income	-54	-50
Amounts to be deducted from CET 1 capital	-195	-125
Total Common Equity Tier 1 (CET1) capital	**2,241**	**2,305**
AT1 bond	300	300
Amounts to be deducted from Additional Tier 1 capital	–	-5
Sum total of Additional Tier 1 (AT1) capital	**300**	**295**
Sum total of Tier 1 capital (T1)	**2,541**	**2,600**
Tier 2 (T2) capital		
Subordinated liabilities	830	886
Profit-participation certificates	–	1
Other	48	51
Amounts to be deducted from Tier 2 capital	–	-2
Sum total of Tier 2 capital (T2)	**878**	**936**
Total capital (TC)	**3,419**	**3,536**

[1] When calculating own funds, annual profits including negative goodwill were taken into account, based on the Management Board's proposal for appropriation of profits for the 2018 financial year. The appropriation of profits is subject to approval by the Annual General Meeting. The expected relevant impact of the TRIM exercise on commercial property financings, and of the SREP recommendations concerning ECB's NPL guidelines (NPL stock), were taken into account for determining regulatory capital for 2018. Due to the fact that the ECB has not yet approved the application for inclusion of profits (including negative goodwill) as at 31 December 2018, the corresponding regulatory report did not incorporate attributable annual profits (including negative goodwill), nor the effects of the TRIM exercise. CET1 amounted to € 1,994 million, with T1 at € 2,294 million and TC at € 3,172 million. Assuming the ECB's approval, the regulatory report as at 31 December 2018 would incorporate annual profits including negative goodwill, but excluding the TRIM effects. CET1 would amount to € 2,263 million, with T1 at € 2,563 million and TC at € 3,442 million.

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). The regulatory reports as at 31 December 2018 quantified RWAs (excluding TRIM effects) at € 10,778 million. Especially due to the incorporation of the expected relevant impact of the TRIM exercise on commercial property financings, and of the SREP recommendations concerning ECB's NPL guidelines (NPL stock), RWAs as at 31 December 2018 were broken down as shown in the following table (p. 217).

	EAD	Risk-weighted assets (RWA)			Regulatory capital requirements	EAD	RWA	Regulatory capital requirements
		AIRBA	CRSA	Total				
	31 Dec 2018	31 Dec 2018	31 Dec 2018	31 Dec 2018	31 Dec 2018	31 Dec 2017[1)]	31 Dec 2017[1)]	31 Dec 2017[1)]
€ mn								
Credit risks	**44,722**	**10,347**	**925**	**11,272**	**902**	**44,142**	**10,009**	**801**
Companies	28,674	8,546	314	8,860	709	27,394	7,159	573
Institutions	2,711	301	80	381	30	2,642	386	31
Public-sector entities	11,915	0	312	312	25	12,295	291	23
Other	1,422	1,500	219	1,719	138	1,811	2,173	174
Market price risks				**97**	**8**		**134**	**11**
Operational risks				**1,455**	**116**		**1,433**	**114**
Credit Valuation Adjustment				**215**	**17**		**209**	**17**
Total	**44,722**	**10,347**	**925**	**13,039**	**1,043**	**44,142**	**11,785**	**943**

[1)] The presentation of exposure classes was adjusted to the methodology of the regulatory report, and previous year's figures were adjusted accordingly.

(78) Additional disclosures to the Remuneration Report

Management Board

In the financial year 2018, the Management Board's total remuneration amounted to € 10 million (2017: € 10 million), of which € 5 million (2017: € 5 million) referred to variable components.

Payments to former Management Board members and their surviving dependants totalled € 3 million in 2018 (2017: € 3 million).

The pension obligations to former members of the Management Board and their surviving dependants amounted to a total of € 33 million as at 31 December 2018 (2017: € 33 million).

Supervisory Board

The total remuneration of members of the Supervisory Board for the financial year 2018 amounted to € 2 million (2017: € 2 million). The remuneration for any financial year shall be due and payable one month after the end of the respective financial year.

Remuneration for key executives

The definition of executives in key positions within Aareal Bank Group includes members of management or supervisory bodies of Aareal Bank AG.

Total remuneration of executives in key positions is analysed below:

€ 000's	3 Dec 2018	31 Dec 2017
Short-term benefits	7,349	7,214
Post-employment benefits	3,026	3,031
Other long-term benefits	1,441	1,577
Termination benefits	–	–
Share-based remuneration	2,402	2,628
Total	**14,218**	**14,450**

Provisions for pension obligations concerning key executives totalled € 19 million as at 31 December 2018 (2017: € 16 million).

Disclosures on share-based remuneration

Valuation model and valuation assumptions

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

Amount of cash-settled share-based payment transactions

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

Quantity (number)	2018	2017
Balance (outstanding) at 1 January	**691,546**	**688,668**
Granted during the reporting period	211,421	226,777
Expired during the reporting period	–	–
Exercised during the reporting period	246,067	223,899
Balance (outstanding) at 31 December	**656,900**	**691,546**
of which: exercisable	–	–

The fair value of the virtual shares granted during the reporting period amounted to € 6 million (2017: € 9 million) as at the balance sheet date.

The virtual shares exercised during the reporting period were converted at a weighted average price of the Aareal Bank AG share of € 39.08 (2017: € 35.61).

The virtual shares outstanding at 31 December 2018 have a limited contract term. The weighted average remaining contract term of these virtual shares amounts to 427.31 days (2017: 434.93 days).

Impact on financial performance

The total amount expensed for share-based payment transactions was € 1 million during the financial year 2018 (2017: € 9 million). The portion of the total amount expensed attributable to members of the Management Board amounted to € 0 million (2017: € 3 million) and can be broken down to the individual members of the Management Board as follows:

€	2018	2017
Hermann J. Merkens	-157,261	1,018,900
Marc Hess[1)]	100,822	–
Dagmar Knopek	-176,781	593,432
Christiane Kunisch-Wolff	122,941	413,174
Thomas Ortmanns	-155,427	604,019
Christof Winkelmann	159,461	410,542

[1)] Marc Hess was appointed to the Management Board on 1 October 2018.

In addition, € 0 million (2017: € 0 million) was expensed for former members of the Management Board.

The intrinsic value of the virtual shares exercisable at the reporting date amounted to € 0 million (2017: € 0 million), since there were no exercisable virtual shares at that date. The obligation from share-based payment transactions as at 31 December 2018 amounted to € 28 million (2017: € 36 million). It is reported in the statement of financial position in the line item "Provisions".

(79) Related party disclosures in accordance with IAS 24

The group of related parties of Aareal Bank Group comprises the members of management or supervisory bodies of Aareal Bank AG (see preceding note) and close members of these persons' families. The group of companies related to Aareal Bank Group consists of the companies set out in Note 86 "List of Shareholdings" as well as the companies attributable to the related persons within the meaning of IAS 24.9 (b)(vi).

The following list provides an overview of the balances of existing transactions with related parties:

€ mn	31 Dec 2018	31 Dec 2017
Management Board	–	–
Supervisory Board	–	–
Other related parties	18	76
Total	**18**	**76**

The item "Other related parties" includes a loan of € 18 million which was provided to our investee Mount Street Group Limited on an arm's length basis.

In addition, there were no further significant transactions within the meaning of IAS 24.

(80) Events after the reporting date

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

(81) Contingencies

By means of a Letter of Comfort in favour of the Monetary Authority of Singapore, Aareal Bank AG has undertaken to ensure that Aareal Bank Asia Ltd. is able to fulfil its obligations at any time.

(82) Disclosures pursuant to section 160 (1) no. 8 of the AktG

Pursuant to the German Securities Trading Act (WpHG), any investor whose shareholding in a listed company reaches, exceeds or falls short of certain threshold values in terms of voting rights (whether by purchase, sale or by any other means) must notify the Company and the German Federal Financial Supervisory Authority. The lowest threshold for this notification requirement is 3 %. 100 % of Aareal Bank AG shares are held in free float.

As at 31 December 2018, we were aware of the following shareholders holding a share in the voting rights of at least 3 % pursuant to section 33 (1) of the WpHG:

	Location	Total[1]	Threshold reached on
Responsible entity			
DEKA	Frankfurt	9.60 %	22 May 2018
VBL	Karlsruhe	6.50 %	3 February 2015
Blackrock	Wilmington	5.39 %	4 October 2018
Dimensional Fund	Austin	5.00 %	3 August 2018
Allianz Global Investors	Frankfurt	4.80 %	28 November 2018
JPMorgan Investment Management Inc.[2]	Wilmington	3.07 %	13 November 2018
JPMorgan Chase Bank[2]	Columbus	3.07 %	13 November 2018
JPMorgan Asset Management (UK)[2]	London	3.07 %	13 November 2018
iShares Trust	Wilmington	3.05 %	15 June 2018
State of Norway (through Norges Bank)	Oslo	3.05 %	26 February 2018
DFA International Small Cap Value	Baltimore	3.01 %	7 August 2018

[1] Direct and indirect holdings of voting rights
[2] Holdings of these three entities are mutually allocated to each other, leading to an aggregate holding of 3.07 %.

(83) Declaration of Compliance in accordance with Section 161 of the AktG

The Management Board and the Supervisory Board issued the Declaration of Compliance as stipulated in section 161 of the AktG, and made this Declaration available to shareholders. It is available to the public on the Company's website on www.aareal-bank.com/en/about-us/corporate-governance/declaration-of-compliance/.

(84) Employees

The number of Aareal Bank Group employees is shown below:

	31 Dec 2018[1]	Average 1 Jan-31 Dec 2018[2]	31 Dec 2017[1]	Average 1 Jan-31 Dec 2017[2]
Salaried employees	2,593	2,612	2,644	2,600
Executives	155	152	156	158
Total	**2,748**	**2,764**	**2,800**	**2,758**
of which: part-time employees	569	548	544	531

[1] This number does not include 47 employees of the hotel business (31 December 2017: 57 employees).
[2] This number does not include 191 employees of the hotel business (1 January to 31 December 2017: 198 employees).

(85) Nature and extent of interests in unconsolidated structured entities

In accordance with IFRS 12.24, the nature and extent of interests in unconsolidated structured entities as well as the nature of, and changes in, the risks associated with such interests have to be disclosed in the annual report. An interest in a structured entity arises from a contractual and/or non-contractual involvement which entitles the Group to receive variable returns from the relevant activities of the structured entity. Examples for this are equity or debt instruments of structured entities or the provision of financing, collateral and guarantees to structured entities.

Structured entities are companies where voting rights or similar rights are not the dominant factor to assess control of the company. The relevant activities of structured entities are directed by means of contractual arrangements; any voting rights relate to administrative tasks only. Structured entities are characterised by features or attributes such as restricted activities, a narrow and well-defined objective and/or insufficient equity. In addition, structured entities may relate to financings in the form of multiple contractually linked instruments to investors that create concentrations of credit or other risks. Examples of structured entities are securitisation vehicles, asset-backed financings and some investment funds.

Aareal Bank Group interacts with structured entities such as open-ended property funds and leased property companies. The Group's business relationships are restricted to the provision of financings to structured entities in the form of loans or guarantees. The leased property companies were established by third parties for the financing of particular transactions and have the legal form of a German private limited company with a limited liability company as general partner (GmbH & Co KG). In the year under review and the previous year, Aareal Bank Group did not provide any non-contractual support for unconsolidated structured entities.

To the extent that this is relevant, the following table shows the carrying amounts of assets and liabilities recognised by Aareal Bank Group as at the reporting date as well as the existing off-balance sheet risk exposures that relate to unconsolidated structured entities. The carrying amounts of the assets and off-balance sheet items correspond to the Group's maximum loss exposure from interests in unconsolidated structured entities (without taking into account collateral). The size of the structured entities was determined on the basis of the net fund assets for open-ended property funds and of total assets for leased property companies.

31 December 2018

€ mn	Open-ended property funds	Leased property companies	Total
Assets			
Loan receivables	159	30	**189**
Size range of structured units	**€ 160 million – € 734 million**	**€ 5 million – € 44 million**	

31 December 2017[1]

€ mn	Open-ended property funds	Leased property companies	Total
Assets			
Loan receivables	270	29	**299**
Size range of structured units	**€ 104 million – € 5,908 million**	**€ 10 million – € 28 million**	

[1] Comparative amounts reclassified according to the new classification format

(86) Country-by-Country Reporting

The disclosure requirements refer to information on registered office, revenue, profit or loss, taxes on profit or loss, received government assistance as well as wage and salary earners of Aareal Bank AG, together with its foreign branches and domestic and foreign subsidiaries included in the reporting entity-structure, prior to consolidation.

For this purpose, the Bank's entities – subsidiaries as well as Aareal Bank AG's foreign branches – are allocated to our two business segments, Structured Property Financing and Consulting/Services.

Aareal Bank defines the branch offices' operating profit, which is used as a proxy for revenue, as the sum of the following consolidated income statement items (in accordance with IFRSs):

- Net interest income before loss allowance
- Net commission income
- Net derecognition gain or loss
- Net gain or loss from financial instruments (fvpl)
- Net gain or loss from hedge accounting
- Net gain or loss from investments accounted for using the equity method
- Net other operating income/expenses
- Negative goodwill

Taxes disclosed are tax expenses in accordance with IFRSs.

The number of wage and salary earners relates to average full-time equivalent staff employed during the financial year.

The following overview shows all countries where Aareal Bank AG has offices, including foreign branches and subsidiaries. Please refer to the list of shareholdings as regards the allocation of individual subsidiaries to the relevant country of domicile. Aareal Bank AG's foreign branches are located in France, Ireland, Italy, Poland, Sweden and the UK.

2018

	Revenues	Profit/loss before taxes	Taxes on profit or loss	Number of wage and salary earners
	€ mn	€ mn	€ mn	Full-time equivalents
Structured Property Financing segment	**646**	**338**	**99**	**935**
Belgium	1	1	–	–
France	9	5	2	4
Germany	460	289	46	844
Ireland	3	5	0	1
Italy	75	-34	30	32
Poland	11	8	1	5
Singapore	3	1	0	5
Spain	0	0	0	–
Sweden	3	1	0	3
United Kingdom	8	5	0	7
USA	78	57	20	34
Consolidation	-5	–	–	–
Consulting/Services segment	**204**	**-22**	**-9**	**1,611**
France	25	6	2	186
Germany	130	-32	-12	961
Netherlands	30	6	1	261
Norway	0	-2	0	7
Sweden	7	-1	0	79
United Kingdom	12	1	0	117
Consolidation	–	–	–	–
Total	**850**	**316**	**90**	**2,546**

Government assistance was not received in the financial year 2018.

Aareal Bank Group's return on assets, calculated as the ratio of net profit to total assets, was 0.52% as at the record date.

2017

	Revenues	Profit/loss before taxes	Taxes on profit or loss	Number of wage and salary earners
	€ mn	€ mn	€ mn	Full-time equivalents
Structured Property Financing segment	**724**	**351**	**123**	**1,024**
Belgium	0	0	–	–
France	7	3	2	5
Germany	554	248	113	932
Ireland	4	2	0	2
Italy	58	22	-1	31
Poland	10	7	1	6
Singapore	2	0	0	5
Spain	2	2	0	–
Sweden	4	2	0	3
United Kingdom	6	3	1	7
USA	82	63	7	33
Consolidation	-5	-1	–	–
Consulting/Services segment	**197**	**-23**	**-8**	**1,382**
France	30	5	1	177
Germany	108	-33	-11	752
Netherlands	36	6	1	252
Norway	1	0	–	8
Sweden	10	-1	0	79
United Kingdom	12	0	0	114
Consolidation	–	–	1	–
Total	**921**	**328**	**115**	**2,406**

(87) List of shareholdings

The list of shareholdings is prepared pursuant to section 313 (2) of the HGB. The disclosures in relation to the companies' equity and earnings are retrieved from the financial statements based on the respective local financial reporting principles.

31 December 2018

No.	Company name	Registered office	Shareholding	Equity	Results
			%	€ mn	€ mn
1	Aareal Bank AG	Wiesbaden			
	I. Fully-consolidated subsidiaries				
2	1st Touch Ltd.	Southampton	100.0	GBP 2.4 mn	GBP -0.2 mn 2)
3	Aareal Bank Asia Ltd.	Singapore	100.0	SGD 18.7 mn	SGD 1.2 mn 1)
4	Aareal Beteiligungen AG	Frankfurt	100.0	227.8	0.0 3)
5	Aareal Capital Corporation	Wilmington	100.0	USD 507.7 mn	USD 48.0 mn 4)
6	Aareal Estate AG	Wiesbaden	100.0	2.5	0.0 3)
7	Aareal First Financial Solutions AG	Mainz	100.0	3.2	0.0 3)
8	Aareal Gesellschaft für Beteiligungen und Grundbesitz Erste mbH & Co. KG	Wiesbaden	94.9	2.6	0.1 1)
9	Aareal Holding Realty LP	Wilmington	99.8	USD 190.6 mn	USD -17.4 mn 4)
10	Aareal Immobilien Beteiligungen GmbH	Wiesbaden	100.0	462.2	0.0 3)
11	Aareon AG	Mainz	100.0	136.6	24.6
12	Aareon Deutschland GmbH	Mainz	100.0	34.7	0.0 3)
13	Aareon Finland Oy	Helsinki	100.0	0.0	0.0
14	Aareon France S.A.S.	Meudon-la Forêt	100.0	10.6	3.5 2)
15	Aareon Nederland B.V.	Emmen	100.0	26.2	2.5 2)
16	Aareon Norge AS	Oslo	100.0	NOK 0.6 mn	NOK -4.2 mn 2)
17	Aareon Sverige AB	Mölndal	100.0	SEK 30.7 mn	SEK -8.0 mn 2)
18	Aareon UK Ltd.	Coventry	100.0	GBP 4.4 mn	GBP -0.3 mn 2)
19	AV Management GmbH	Mainz	100.0	0.4	0.0 3)
20	BauContact Immobilien GmbH	Wiesbaden	100.0	8.6	0.0
21	BauGrund Immobilien-Management GmbH	Bonn	100.0	0.5	0.0 3)
22	BauGrund Solida Immobilien GmbH	Frankfurt	100.0	0.1	0.0
23	BauGrund TVG GmbH	Munich	100.0	0.1	0.0 1)
24	BauSecura Versicherungsmakler GmbH	Hamburg	51.0	3.6	3.5
25	BVG – Grundstücks- und Verwertungsgesellschaft mit beschränkter Haftung	Frankfurt	100.0	217.3	0.0 3)
26	DBB Inka	Dusseldorf	100.0	100.7	0.5
27	Deutsche Bau- und Grundstücks-Aktiengesellschaft	Berlin	100.0	1.2	-0.3 1)
28	Deutsche Structured Finance GmbH	Wiesbaden	100.0	4.3	-1.6
29	DSF Flugzeugportfolio GmbH	Wiesbaden	100.0	0.0	0.0 3)
30	Düsseldorfer Hypothekenbank AG	Dusseldorf	100.0	227.7	-90.4
31	Facilitor B.V.	Enschede	100.0	1.2	0.8 2)
32	FIRE B.V.	Utrecht	60.0	0.0	0.0 2)

>

1) Preliminary figures as at 31 December 2018; 2) Equity and results as at 31 December 2017;
3) Profit and loss transfer agreement / control and profit transfer agreement; 4) Disclosures in accordance with IFRSs; 5) Joint operation

No.	Company name	Registered office	Shareholding	Equity	Results
			%	€ mn	€ mn
33	GEV Besitzgesellschaft mbH	Wiesbaden	100.0	30.0	0.0 [3]
34	GEV Beteiligungsgesellschaft mbH	Wiesbaden	100.0	0.1	0.0
35	GVN-Grundstücks- und Vermögensverwaltungs-gesellschaft mit beschränkter Haftung	Frankfurt	100.0	0.5	0.0 [3]
36	IV Beteiligungsgesellschaft für Immobilieninvestitionen mbH	Wiesbaden	100.0	2.5	0.0 [1]
37	Izalco Spain S.L.	Madrid	100.0	13.9	-0.8 [1]
38	Jomo S.p.r.l.	Brussels	100.0	25.4	0.6 [1]
39	Kalshoven Automation B.V.	Amsterdam	100.0	0.5	0.5 [2]
40	La Sessola Holding GmbH	Wiesbaden	100.0	86.6	0.0 [1]
41	La Sessola S.r.l.	Rome	100.0	108.0	-7.6 [1]
42	La Sessola Service S.r.l.	Rome	100.0	2.7	-0.9 [1]
43	Manager Realty LLC	Wilmington	100.0	USD 0.0 mn	USD 0.0 mn [4]
44	Mercadea S.r.l.	Rome	100.0	7.3	0.1 [1]
45	Mirante S.r.l.	Rome	100.0	7.4	-2.9 [1]
46	mse Augsburg GmbH	Augsburg	100.0	0.1	-0.3 [1]
47	mse Immobiliensoftware GmbH	Hamburg	100.0	1.1	0.4 [1]
48	mse RELion GmbH	Augsburg	100.0	0.6	0.4 [1]
49	Northpark Realty LP	Wilmington	100.0	USD 109.0 mn	USD 4.7 mn [4]
50	Participation Achte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 [3]
51	Participation Elfte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 [3]
52	Participation Neunte Beteiligungs GmbH	Wiesbaden	100.0	149.0	0.0 [3]
53	Participation Zehnte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 [3]
54	phi-Consulting GmbH	Bochum	100.0	1.9	0.2
55	Sedum Grundstücksverwaltungsgesellschaft mbH & Co.Vermietungs KG	Wiesbaden	94.9	-5.5	-1.2 [1]
56	Square DMS B.V.	Grathem	100.0	1.2	0.2 [2]
57	Terrain-Aktiengesellschaft Herzogpark	Wiesbaden	100.0	4.7	0.0 [3]
58	Terrain Beteiligungen GmbH	Wiesbaden	94.0	56.6	1.9 [1]
59	Westdeutsche Immobilien Servicing AG	Mainz	100.0	50.1	0.0 [3]
60	WP Galleria Realty LP	Wilmington	100.0	USD 96.5 mn	USD 2.0 mn [4]
	II. Joint Arrangements				
61	Konsortium BauGrund/TREUREAL [5]	Bonn	50.0	0.0	-0.1 [1]
62	Rive Défense S.A.S.	Paris	50.0	-125.2	-3.4
	III. Associates				
63	DSF PP Justizzentrum Thüringen GmbH & Co. KG	Frankfurt	48.4	0.3	0.0 [2]
64	Mount Street Group Limited	London	20.0	GBP -0.4 mn	GBP -2.9 mn [1]
65	Mount Street US Group LLP	Wilmington	20.0	USD -0.2 mn	USD -0.2 mn [1]
66	Westhafen Haus GmbH & Co. Projektentwicklungs KG	Frankfurt	25.0	-0.1	-0.1 [2]
67	Westhafen-Gelände Frankfurt am Main GbR	Frankfurt	33.3	0.1	0.1 [2]
	IV. Other enterprises				
68	BrickVest Ltd.	London	9.9	GBP 2.0 mn	GBP -1.8 mn [2]

[1] Preliminary figures as at 31 December 2018; [2] Equity and results as at 31 December 2017;
[3] Profit and loss transfer agreement / control and profit transfer agreement; [4] Disclosures in accordance with IFRSs; [5] Joint operation

(88) Executive Bodies of Aareal Bank AG

The members of the Management Board and the Supervisory Board disclose their offices held, in accordance with the requirements set out in section 285 of the HGB and Article 435 (2) of Regulation (EU) No 575/2013, in conjunction with the EBA Guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013 (EBA/GL/2016/11) and the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2017/12).

Supervisory Board

Marija Korsch, Chairman of the Supervisory Board **Former partner of Bankhaus Metzler seel. Sohn & Co. Holding AG**		
Aareal Bank AG	Chairman of the Supervisory Board	
Just Software AG	Member of the Supervisory Board	
Instone Real Estate Group N.V.	Member of the Supervisory Board	(since 13 February 2018)
Nomura Financial Products Europe GmbH	Member of the Supervisory Board	(since 15 November 2018)
(Non-commercial mandates)		
FAZIT – Stiftung Gemeinnützige Verlagsgesellschaft mbH	Shareholder and member of the Advisory Board	
Städelsches Kunstinstitut und Städtische Galerie	Member of the Administration	
Gesellschaft der Freunde der Alten Oper Frankfurt e.V.	Deputy Chairman of the Management Board	
Stiftung Centrale für private Fürsorge	Chairman of the Foundation's Executive Board	

Prof. Dr Stephan Schüller, Deputy Chairman of the Supervisory Board **Businessman; former Spokesman of the General Partners of Bankhaus Lampe KG until 31 March 2018**		
Aareal Bank AG	Deputy Chairman of the Supervisory Board	
Howaldt & Co. Investmentaktiengesellschaft TGV	Chairman of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH (liquidation planned)	Member of the Supervisory Board	(until 31 March 2018)

York-Detlef Bülow*, Deputy Chairman of the Supervisory Board (until 31 March 2018) **Aareal Bank AG**	
Aareal Bank AG	Deputy Chairman of the Supervisory Board

Thomas Hawel* **Aareon Deutschland GmbH**	
Aareal Bank AG	Member of the Supervisory Board
Aareon Deutschland GmbH	Deputy Chairman of the Supervisory Board

Petra Heinemann-Specht* (since 1 April 2018) **Aareal Bank AG**	
Aareal Bank AG	Member of the Supervisory Board

Dieter Kirsch*, Deputy Chairman of the Supervisory Board (from 31 March 2018 to 31 December 2018) **Aareal Bank AG**	
Aareal Bank AG	Member of the Supervisory Board

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

>

Richard Peters		
President and Chairman of the Management Board of Versorgungsanstalt des Bundes und der Länder		
Aareal Bank AG	Member of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH (liquidation planned)	Member of the Supervisory Board (not active)	
(Non-commercial mandates)		
EAPSPI (European Association of Public Sector Pension Institutions)	Member of the Board of Directors	(until 30 September 2018)
VBLV e.V.	Chairman of the Management Board	

Dr Hans-Werner Rhein		
German Lawyer (Rechtsanwalt)		
Aareal Bank AG	Member of the Supervisory Board	
Gothaer Allgemeine Versicherung AG	Member of the Supervisory Board	(until 7 December 2018)
(Offices held at other listed companies)		
Deutsche Familienversicherung AG	Chairman of the Supervisory Board	
(Non-commercial mandates)		
Müller-Matthieu Stiftung	Chairman of the Supervisory Board	
ARIAS Deutschland e.V.	Chairman of the Supervisory Board	
St. Petri Stiftung, Hamburg	Member of the Board of Managing Directors	

Sylvia Seignette		
Former CEO for Germany and Austria, Crédit Agricole CIB (formerly Calyon)		
Aareal Bank AG	Member of the Supervisory Board	

Elisabeth Stheeman		
External Member of the Financial Policy Committee, Bank of England, Prudential Regulation Authority		
Aareal Bank AG	Member of the Supervisory Board	
(Offices held at other listed companies)		
TLG Immobilien AG	Member of the Supervisory Board	(until 29 January 2018)
Korian SA	Member of the Supervisory Board	

Hans-Dietrich Voigtländer		
Senior Partner at BDG Innovation + Transformation GmbH & Co. KG		
Aareal Bank AG	Member of the Supervisory Board	

Prof. Dr Hermann Wagner, Chairman of the Audit Committee		
German Chartered Accountant, tax consultant		
Aareal Bank AG**	Member of the Supervisory Board	
btu beraterpartner Holding AG	Member of the Supervisory Board	
Squadra Immobilien GmbH & Co. KGaA	Member of the Supervisory Board	
(Offices held at other listed companies)		
PEH Wertpapier AG	Member of the Supervisory Board	
Consus Real Estate AG ("Scale" segment of the Regulated Unofficial Market)**	Member of the Supervisory Board	(since 30 June 2018)
DEMIRE Deutsche Mittelstand Real Estate AG	Chairman of the Supervisory Board	(until 27 June 2018)

Beate Wollmann*		
Aareon Deutschland GmbH		
Aareal Bank AG	Member of the Supervisory Board	

* Employee representative member of the Supervisory Board of Aareal Bank AG; ** For banks subject to the CRR, assumption of more than four Supervisory Board offices requires the separate approval by the competent supervisory authority. This approval had been granted for the composition of the Supervisory Board until 27 June 2018. Following a change to this composition, the Bank applied for this approval to be reconfirmed, which the supervisory authority has not yet granted to date.

Composition of Supervisory Board's committees

Executive and Nomination Committee	
Marija Korsch	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
Dieter Kirsch	
Richard Peters	
Dr Hans-Werner Rhein	

Technology and Innovation Committee	
Hans-Dietrich Voigtländer	Chairman
Marija Korsch	Deputy Chairman
Thomas Hawel	
Richard Peters	
Elisabeth Stheeman	

Audit Committee	
Prof. Dr Hermann Wagner	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
Marija Korsch	
Richard Peters	
Hans-Dietrich Voigtländer	
Beate Wollmann	

Remuneration Control Committee	
Marija Korsch	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
Dieter Kirsch	
Hans-Dietrich Voigtländer	

Risk Committee	
Sylvia Seignette	Chairman
Elisabeth Stheeman	Deputy Chairman
Petra Heinemann-Specht	
Marija Korsch	
Dr Hans-Werner Rhein	
Prof. Dr Hermann Wagner	

Committee for Urgent Decisions (until 31 Dec 2018)
Sylvia Seignette
Elisabeth Stheeman
Petra Heinemann-Specht
Marija Korsch
Dr Hans-Werner Rhein
Prof. Dr Hermann Wagner

Management Board

Hermann Josef Merkens, Chairman of the Management Board
Corporate Strategy, Project & Credit Portfolio Management, Corporate Communications, Investor Relations incl. Sustainability, Board Office, Human Resources, Legal, Audit

(Offices held at companies of Aareal Bank Group)		
Aareal Estate AG	Chairman of the Supervisory Board	
Aareal Capital Corporation	Chairman of the Board of Directors	
Aareon AG	Deputy Chairman of the Supervisory Board	
Aareal Beteiligungen AG (formerly Corealcredit Bank AG)	Chairman of the Supervisory Board	
SoftS IT Solutions AG	Deputy Chairman of the Supervisory Board	(until 20 April 2018)

Marc Hess, Member of the Management Board (since 1 October 2018)
Finance & Controlling, Treasury

Dagmar Knopek, Member of the Management Board
Credit Management, Workout and Operations

HypZert GmbH	Chairman of the Supervisory Board	
(Offices held at companies of Aareal Bank Group)		
Aareon AG	Member of the Supervisory Board	(until 31 December 2018)
Westdeutsche Immobilien Servicing AG (formerly Westdeutsche ImmobilienBank AG)	Chairman of the Supervisory Board	

Christiane Kunisch-Wolff, Member of the Management Board
Risk Controlling, Regulatory Affairs and Compliance

(Offices held at companies of Aareal Bank Group)	
Westdeutsche Immobilien Servicing AG (formerly Westdeutsche ImmobilienBank AG)	Member of the Supervisory Board

Thomas Ortmanns, Member of the Management Board
Housing Industry, Information Technology and Organisation

(Offices held at companies of Aareal Bank Group)		
Aareon AG	Chairman of the Supervisory Board	
SoftS IT Solutions AG	Chairman of the Supervisory Board	(until 20 April 2018)

Christof Winkelmann, Member of the Management Board
Sales Unit Structured Property Financing

(Offices held at companies of Aareal Bank Group)	
Aareal Bank Asia Limited	Chairman of the Board of Directors
Aareal Capital Corporation	Member of the Board of Directors
La Sessola Service S.r.l.	Member of the Management Board
La Sessola S.r.l.	Member of the Management Board

Responsibility Statement

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

Wiesbaden, 5 March 2019

The Management Board

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

Independent Auditors' Report[1)]

To Aareal Bank AG, Wiesbaden

Report on the Audit of the Consolidated Financial Statements and of the Group Management Report

Audit Opinions

We have audited the consolidated financial statements of Aareal Bank AG, Wiesbaden, and its subsidiaries (the Group), which comprise the statement of financial position as at 31 December 2018, the statement of comprehensive income, the statement of changes in equity and the statement of cash flows for the financial year from 1 January to 31 December 2018, and notes to the consolidated financial statements, including a summary of significant accounting policies. In addition, we have audited the group management report of Aareal Bank AG for the financial year from 1 January to 31 December 2018. In accordance with the German legal requirements, we have not audited the content of those parts of the group management report listed in the "Other Information" section of our auditor's report.

In our opinion, on the basis of the knowledge obtained in the audit,

- the accompanying consolidated financial statements comply, in all material respects, with the IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to § (Article) 315e Abs. (paragraph) 1 HGB (Handelsgesetzbuch: German Commercial Code) and, in compliance with these requirements, give a true and fair view of the assets, liabilities, and financial position of the Group as of 31 December 2018, and of its financial performance for the financial year from 1 January to 31 December 2018, and

- the accompanying group management report as a whole provides an appropriate view of the Group's position. In all material respects, this group management report is consistent with the consolidated financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our audit opinion on the group management report does not cover the content of those parts of the group management report listed in the "Other Information" section of our auditor's report.

Pursuant to § 322 Abs. 3 Satz (sentence) 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the consolidated financial statements and of the group management report.

Basis for the Audit Opinions

We conducted our audit of the consolidated financial statements and of the group management report in accordance with § 317 HGB and the EU Audit Regulation (No. 537/2014, referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial

[1)] Translation of the independent auditor's report issued in German language on the consolidated financial statements prepared in German language by the executive directors of Aareal Bank AG. The German text is authoritative.

Statement Audits promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW). We performed the audit of the consolidated financial statements in supplementary compliance with the International Standards on Auditing (ISAs). Our responsibilities under those requirements, principles and standards are further described in the "Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Group Management Report" section of our auditor's report. We are independent of the group entities in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions on the consolidated financial statements and on the group management report.

Key Audit Matters in the Audit of the Consolidated Financial Statements

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the financial year from 1 January to 31 December 2018. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our audit opinion thereon; we do not provide a separate audit opinion on these matters.

In our view, the matters of most significance in our audit were as follows:

1. Recoverability of the Italian mortgage loan portfolio
2. Recoverability of properties acquired from previous loan exposures as reported in the property, plant and equipment and other assets balance sheet items
3. First-time consolidation of Düsseldorfer Hypothekenbank AG
4. Measurement of financial instruments in connection with the initial application of IFRS 9

Our presentation of these key audit matters has been structured in each case as follows:

① Matter and issue
② Audit approach and findings
③ Reference to further information

Hereinafter we present the key audit matters:

1 Recoverability of the Italian mortgage loan portfolio

① In the consolidated financial statements of Aareal Bank AG, loans and advances to customers in the amount of € 2.7 billion that are secured by properties in Italy (hereinafter "Italian mortgage loan portfolio") are reported as of 31 December 2018. As of 31 December 2018, the allowances for credit losses for the Italian mortgage loan portfolio amounts to a total of € 402 million. Italy's difficult macroeconomic situation has in past years, in part, led to financial difficulties and restructuring proceedings for Aareal Bank AG's borrowers. The realisation period of the properties on which the Italian mortgage loan portfolio is based generally takes a number of years depending on their size, location and type. Aareal Bank AG analyzes the financial circumstances of borrowers using, inter alia, the annual financial statements, business plans and rent rolls provided, and generally examines the market values of the associated collateral at least once a year. In the majority of cases, Aareal Bank AG obtains external valuations to determine the market values of the properties pledged as collateral. Property market values are calculated by the appraisers in each case as the present values of future cash flows using the discounted cash flow method, with the appraisers deriving the assumptions about future cash flows that can be generated by the property using the information and business plans provided by the borrowers, or determined on the basis of floor area-related comparative values. If it is found when assessing the borrower that there has been a default and the income from the collateral is expected to be insufficient, the Company applies a specific valuation allowance (Stage 3). When determining the specific valuation allowances for the Italian mortgage loan portfolio, the executive directors make assumptions concerning cash flow, realisation and completion as well as assumptions concerning the probability of scenarios. Since even relatively small changes in these assumptions have a significant influence on the associated collateral value and the measurements are subject to uncertainties in this regard, this matter was of particular significance during our audit.

② As part of our audit we evaluated, inter alia, the existing documents relating to the financial circumstances of the borrowers and the recoverability of the pledged collateral in a risk-focused sample of exposures. We evaluated the valuations performed by the appraisers in terms of their suitability, up-to-dateness and methodology, as well as the transparency of the value calculation. At the same time, we gained an understanding of the original data, value parameters and assumptions on which the valuations were based, evaluated these critically and assessed whether they were within a justifiable range. In this context, we involved our own real estate experts. In specific cases, we carried out our own property inspections. In addition, we based our assessment of the executive directors' assumptions concerning cash flow, realisation and completion on general and sector-specific market expectations as well as on documentation and explanations from the executive directors about expected cash inflows and outflows as well as assumptions concerning the probability of scenarios. Furthermore, we examined the relevant credit processes in the Aareal Bank AG's internal control system in terms of the appropriateness of their design and tested their effectiveness. Taking account of the information available, we conclude that the assumptions made by the executive directors for testing the impairment of the Italian mortgage loan portfolio and the processes implemented are appropriate.

③ The Company's disclosures regarding the risk allowances are contained in notes 7, 29 and 40 in the notes to the consolidated financial statements, which also comprise the risk allowances for the Italian mortgage loan portfolio.

❷ Recoverability of properties acquired from previous loan exposures as reported in the property, plant and equipment and other assets balance sheet items

① In the consolidated financial statements of Aareal Bank AG, properties acquired from previous loan exposures were reported as of 31 December 2018 in the amount of € 134 million in the property and equipment balance sheet line item in accordance with IAS 16 "Property, Plant and Equipment" and in the amount of € 209 million under the other assets balance sheet line item in accordance with IAS 2 "Inventories". The properties were acquired by Aareal Bank AG through fully consolidated real estate special purpose entities. Aareal Bank AG tests the properties acquired from former credit exposures at least once a year for impairment using external valuations. The market values of the properties are calculated in each case as the present values of future cash flows using the discounted cash flow method, with the appraisers deriving the assumptions about future cash flows using the information and projections provided by the executive directors, or determined on the basis of floor area-related comparative values. In addition, the executive directors make assumptions about leasing and marketing. Since even relatively small changes in these assumptions have a significant influence on the market values of the properties and the measurements are therefore subject to uncertainties, this matter was of particular significance during our audit.

② As part of our audit, we particularly evaluated the valuations performed by the external appraisers in terms of their up-to-dateness and methodology, as well as the transparency of the value calculation. At the same time, we gained an understanding of the original data, value parameters and assumptions on which the valuations were based, evaluated these critically and assessed whether they were within a justifiable range. In this context, we involved our own real estate experts. In addition, we based our assessment of the cash flow, leasing and marketing assumptions made by the executive directors on, inter alia, a comparison with general and sector-specific market expectations as well as on documentation and explanations from the executive directors about expected cash flows. Furthermore, we evaluated the classification of the properties and, therewith, the respective accounting policies to be applied under IAS 2 and IAS 16. Taking account of the information available, we conclude that the assumptions made by the executive directors for testing the impairment of the properties acquired from former exposures and the classifications applied are appropriate.

③ We refer to the Company's disclosures on property, plant and equipment and other assets contained in notes 17, 19, 45 and 48 in the notes to the consolidated financial statements.

❸ First-time consolidation of Düsseldorfer Hypothekenbank AG

① With effect from 31 December 2018, Aareal Bank AG acquired 100 % of the shares in Düsseldorfer Hypothekenbank AG. The total purchase price for the acquisition was € 149 million. The acquisition was accounted for as a business combination using the acquisition method in accordance with IFRS 3. In the context of the purchase price allocation, the identified assets and assumed liabilities and contingent liabilities of the company acquired were recognized at their fair values. Taking into account the acquired net assets of € 204 million that are to be allocated to the Company, this resulted in negative goodwill from capital consolidation of € 55 million, which was recognized in profit or loss pursuant to IFRS 3.34 in 2018. Due to the uncertainties in the estimations made in connection with the measurement of assets and liabilities as part of the purchase price allocation, and the overall material impact of the amounts involved in the acquisition on the assets, liabilities, financial position and financial performance of the Aareal Bank Group, this matter was of particular significance in the context of our audit.

② In auditing the acquisition of Düsseldorfer Hypothekenbank AG, we initially inspected and assessed the corresponding contractual agreements and reconciled the purchase price paid as consideration for the acquired business operations received with the supporting payment documentation provided to us. Based on that, we evaluated the balance sheet underlying the acquisition based on the fair values at the time of first-time consolidation. This involved assessing the appropriateness of, among other things, the models on which the valuations were based as well as the valuation parameters and assumptions used. Given the special features relating to the calculation of the fair values within the context of the purchase price allocation, we received support in our assessment from our valuation specialists. We also checked the calculation of the negative goodwill from capital consolidation and the further verification of the carrying amounts of the acquired assets and liabilities that has to be performed under IFRS 3.36 prior to the recognition of the negative goodwill through profit or loss. We also evaluated the disclosures in the notes to the financial statements that are required under IFRS 3. Overall, we were able to satisfy ourselves that this acquisition was presented appropriately in the financial statements and that the estimates and assumptions made by the executive directors are comprehensible and adequately substantiated.

③ The Company's disclosures on the first-time consolidation are contained in note 3 of the notes to the consolidated financial statements.

❹ Measurement of financial instruments in connection with the initial application of IFRS 9

① Aareal Bank has been applying the accounting standard IFRS 9 "Financial Instruments" since 1 January 2018. The classification of financial assets is now split into three categories, resulting in differences in measurement for the purposes of subsequent recognition in each case. The business model in which the financial instruments are held and the contractual structure of these financial instruments are decisive factors in their classification under IFRS 9. Taking market-related modifications into account, the initial application of the provisions governing the classification of financial instruments had a positive effect of € 22 million after tax, which was recognized in reported equity. For those financial instruments that are measured at amortized cost or at fair value through other comprehensive income, the new impairment provisions (expected credit loss model) replace the previous incurred credit loss model. Risk provisions are now presented in a 3-stage model, with financial instruments being recognized in stage 1 as a general rule. Expected twelve-month losses are to be recognized for these financial instruments. If the default risk increases considerably compared with the time of initial recognition, the amount of the expected losses over lifetime (stage 2) is recognized under risk provisions. The same applies to financial instruments that are credit-impaired (stage 3). Within this context, the bank has adjusted its internal models and processes for the calculation of the expected loss pursuant to IFRS 9. The initial application of the rules governing risk provisions had an effect of € -49 million after taxes in reported equity as of 1 January 2018. Due to the scope for judgment and uncertainties in the estimations made in connection with the initial application of IFRS 9 and subsequent measurement, and given the overall material impact of the amounts involved on the financial performance of the Aareal Bank Group, these matters were of particular significance in the context of our audit.

② As part of our audit, we evaluated the technical and procedural implementation of the requirements for the classification and measurement of financial instruments pursuant to IFRS 9. Among other things, we evaluated the technical concepts, the allocation of the financial instruments to business models, the models for calculating the expected loss and their implementation in the bank's processes in order to determine whether they were consistent with IFRS 9. In order to do so, we initially used sample testing to check whether the financial instruments had been classified to the various measurement categories in accordance with IFRS 9 and whether the models used by the bank to calculate the expected loss met the requirements set out in IFRS 9. We also assessed whether the data used was valid and complete. In addition, we checked whether significant increases in credit risk had been appropriately defined by the bank and used sample testing to analyze whether the classification within the bank's portfolio had been performed correctly. We also evaluated whether the assumptions used by Aareal Bank AG with regard to the realization scenarios, proceeds, periods and costs when calculating the stage 3 risk provisions fell within an appropriate range. We evaluated the relevant processes used in the classification and measurement of the financial instruments in terms of their appropriate design, and tested their functionality.

Based on our audit procedures, we were able to satisfy ourselves that the assumptions used by the executive directors to classify and measure financial instruments in connection with the initial application of IFRS 9 and subsequent measurement are appropriate overall.

③ The Company's disclosures on the initial application of IFRS 9 are contained in note 2 of the notes to the consolidated financial statements.

Other Information

The executive directors are responsible for the other information. The other information comprises the following non-audited parts of the group management report:

- the statement on corporate governance pursuant to § 289f HGB and § 315d HGB included in section "Corporate Governance Statement" of the group management report

- the separate non-financial report pursuant to § 289b Abs. 3 HGB and § 315b Abs. 3 HGB

The other information comprises further the remaining parts of the annual report – excluding cross-references to external information – with the exception of the audited consolidated financial statements, the audited group management report and our auditor's report.

Our audit opinions on the consolidated financial statements and on the group management report do not cover the other information, and consequently we do not express an audit opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- is materially inconsistent with the consolidated financial statements, with the group management report or our knowledge obtained in the audit, or

- otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Executive Directors and the Supervisory Board for the Consolidated Financial Statements and the Group Management Report

The executive directors are responsible for the preparation of the consolidated financial statements that comply, in all material respects, with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB and that the consolidated financial statements, in compliance with these requirements, give a true and fair view of the assets, liabilities, financial position, and financial performance of the Group. In addition, the executive directors are responsible for such internal control as they have determined necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the executive directors are responsible for assessing the Group's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting unless there is an intention to liquidate the Group or to cease operations, or there is no realistic alternative but to do so.

Furthermore, the executive directors are responsible for the preparation of the group management report that, as a whole, provides an appropriate view of the Group's position and is, in all material respects, consistent with the consolidated financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, the executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a group management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the group management report.

The supervisory board is responsible for overseeing the Group's financial reporting process for the preparation of the consolidated financial statements and of the group management report.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Group Management Report

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the group management report as a whole provides an appropriate view of the Group's position and, in all material respects, is consistent with the consolidated financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our audit opinions on the consolidated financial statements and on the group management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with § 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) and supplementary compliance with the ISAs will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements and this group management report.

We exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements and of the group management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit of the consolidated financial statements and of arrangements and measures (systems) relevant to the audit of the group management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an audit opinion on the effectiveness of these systems.

- Evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.

- Conclude on the appropriateness of the executive directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements and in the group management report or, if such disclosures are inadequate, to modify our respective audit opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to be able to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements present the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Group in compliance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express audit opinions on the consolidated financial statements and on the group management report. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinions.

- Evaluate the consistency of the group management report with the consolidated financial statements, its conformity with German law, and the view of the Group's position it provides.

- Perform audit procedures on the prospective information presented by the executive directors in the group management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate audit opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the related safeguards. From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

Other Legal and Regulatory Requirements

Further Information pursuant to Article 10 of the EU Audit Regulation

We were elected as group auditor by the annual general meeting on 23 May 2018. We were engaged by the supervisory board on 30 May 2018. We have been the group auditor of the Aareal Bank AG, Wiesbaden, and its legal predecessors without interruption since the financial year 1976.

We declare that the audit opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

German Public Auditor Responsible for the Engagement

The German Public Auditor responsible for the engagement is Ralf Schmitz.

Frankfurt / Main, 5 March 2019

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

Ralf Schmitz	**Lukas Sierleja**
Wirtschaftsprüfer	**Wirtschaftsprüfer**
(German Public Auditor)	**(German Public Auditor)**