# Group Management Report

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Aareal Bank Group is an international property specialist. It is active in more than 20 countries across three continents – in Europe, North America, and in the Asia/Pacific region.

## Fundamental Information about the Group

### Business model

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

The strategic business segments of Aareal Bank Group are commercial property financing and services, software products and digital solutions for the property sector and related industries.

#### Structured Property Financing

In the Structured Property Financing segment, Aareal Bank facilitates property investments for its domestic and international clients, and is active in this respect in Europe, North America and the Asia/Pacific region. Aareal Bank finances commercial property investments, especially for office buildings, hotels, retail, logistics and residential properties, with a focus on existing buildings. By combining local market expertise with sector-specific know-how from the Group's head office, Aareal Bank can offer financing concepts that meet the special requirements of its national and international clients, as well as concluding structured portfolio and cross-border financings.

Aareal Bank manages its sales activities in the individual regions worldwide via a network of sales centres (hubs). In addition to the locally-based experts, the distribution centres for sector specialists covering hotels, retail and logistics properties, as well as those catering to the specific needs of investment fund clients, are located in Wiesbaden. There are two regional hubs in Europe: one hub combines sales activities for the euro zone, with a focus on the Benelux countries, France, Germany, Italy and Spain. An additional hub focuses on sales activities outside the euro zone, with a focus on the UK and Central and Eastern Europe. Distribution in Northern Europe is managed from the head office in Wiesbaden. As before, the hubs have a network – comprising branches in London, Paris, Rome, Stockholm and Warsaw – at their disposal. Furthermore, the Dublin branch holds securities. Representative offices are located in Istanbul, Madrid, and Moscow.

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

#### Funding

Aareal Bank is an active issuer of Pfandbriefe, which account for a major share of its long-term funding. Moody's Aaa rating of the Pfandbriefe confirms the quality of the cover assets pool. To cater to a broad investor base, Aareal Bank uses a wide range of other refinancing tools, including senior preferred and senior non-preferred bonds, as well as other promissory notes and bonds. Depending on market conditions, the Bank places large-sized public issues or private placements. In the Consulting/Services segment the Bank also generates deposits from the housing industry, which represent a strategically important additional source of funding. Furthermore, it has recourse to institutional money market investor deposits.

#### Consulting/Services

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

Present at 37 locations in Austria, Germany, Finland, France, the Netherlands, Norway, Sweden, and the UK, Aareon offers its customers consulting, software and services to optimise IT-supported business processes in the digital age, generating a stable and long-term business volume based on the experience gained in the past years with the enterprise resource planning (ERP) systems it offers. In addition, Aareon develops a portfolio of digital solutions with its international research and development teams and in cooperation with PropTech enterprises, offering these solutions internationally. ”Aareon Smart World”, the digital ecosystem, connects these solutions, networking property companies with customers, staff and business partners, as well as connecting technical devices in apartments and buildings. Aareon benefits from a cross-border transfer of know-how, leveraging the respective country-specific focal areas of digitalisation to expand its range of products and services. Aareon offers software solutions both in Germany and abroad that may be used in various types of operating environments: in-house services, hosting and Software as a Service (SaaS) from the exclusive Aareon Cloud.

In its Housing Industry division, Aareal Bank offers its customers products and solutions for optimising digital payments, electronic banking and cash management processes. It markets its BK01 software as a procedure in the German housing property industry for the automated settlement of mass payments. The procedure is integrated in licensed bookkeeping systems. Therefore, customers in Germany may process their payment transactions and account management from the administration software employed. In addition to the German property industry, the German energy sector forms a second major client group of the Bank’s Housing Industry division for the services mentioned above. This enables the offer of further products, facilitating the cross-sector cooperation of client groups and realising synergies via end-to-end digital processes. In conjunction with payment transactions processed via Aareal Bank’s systems, deposits are generated that contribute significantly to Aareal Bank Group’s refinancing base.

Within the Consulting/Services segment, Aareon and the Bank’s Housing Industry division work closely together. The majority of clients in the Bank’s Housing Industry division are also clients of Aareon.

## Management system

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

The following indicators implemented within the scope of business and return management are Aareal Bank Group’s key financial indicators. They were revised at the turn of the year within the scope of the strategic development ”Aareal Next Level”:

- **Group/consolidated**
  - Net interest income (in accordance with IFRSs)
  - Net commission income (in accordance with IFRSs)
  - Loss allowance (in accordance with IFRSs)
  - Administrative expenses (in accordance with IFRSs)
  - Operating profit (in accordance with IFRSs)
  - Return on equity (RoE; before taxes)[1]

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

  – Consolidated net income allocated to ordinary shareholders of Aareal Bank[1) ] as of 1 January 2020
  – Earnings per ordinary share (EpS)[2)]
  – Common Equity Tier 1 ratio (CET1 ratio) – Basel IV (estimated) –
  – Liquidity Coverage Ratio (LCR) until 31 December 2019

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

- **Consulting/Services segment until 31 December 2019**
  – Aareon's contribution to consolidated operating profit (in accordance with IFRSs)

- **Aareal Bank's Housing Industry division segment as of 1 January 2020**
  – Average deposit volume from the housing industry
  – Net commission income (in accordance with IFRSs)

- **Aareon segment as of 1 January 2020**
  – Sales revenue (in accordance with IFRSs)
  – Adjusted EBITDA[4)]

The Group's existing risk management system is used to manage and monitor the various risk exposures of Aareal Bank Group entities, in a centralised manner. All management-relevant information is systematically collected and analysed, to develop suitable strategies for risk management and monitoring. We also employ forecasting models for balance sheet structure, liquidity and portfolio development for strategic business and revenue planning. In addition to business-related management tools, we also use various other instruments to optimise our organisation and workflows. These include comprehensive cost management, centralised management of project activities and Human Resources controlling, for example.

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

In the Consulting/Services segment, or in the Bank's new Housing Industry division and Aareon segments, respectively, managing the Group entities allocated to the segment is oriented upon specific indicators depending on the respective company's core business. In addition, we use specific management indicators typical for advisory and other services in the IT business. Deposits generated from the housing industry business and net commission income will become key financial indicators, and Aareon's contribution to consolidated operating profit will be replaced by adjusted EBITDA, a standard target figure commonly applied to software companies, supplemented by sales revenue.

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

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

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

[4)] "Earnings before interest, taxes, depreciation and amortisation" Excluding strategic investments and non-recurring effects

# Report on the Economic Position

## Macro-economic environment

The year 2019 was defined by many uncertainties and changes on both an economic and geopolitical front. Besides the economic slowdown compared with previous years, especially in the industrial sector, there were also significant developments in the interest rate environment and in central bank policy. Conflicts or political uncertainties in several regions of the world at the same time impacted directly or indirectly on the environment. The protectionist measures in several countries were recognised as one of the key drivers of the uncertainty.

### Economy

The economy slowed down in the euro zone, and real gross domestic product grew by 1.2 %; the growth was thus lower year-on-year (2018: 1.9 %). This was especially attributable to a weak industrial sector, which impacted Germany and Italy in particular.

The UK's economy grew by 1.4 % (2018: 1.3 %). Exports were up 3.7 % year-on-year, mainly due to the inventory build-up of many companies as a result of the EU exit. The latter was a burdening factor overall that affected most economic players. The UK officially left the European Union on 31 January 2020 after the EU Withdrawal Agreement Bill was passed on 20 December 2019. As of 1 February, a transitional period is in place until year-end 2020, during which the UK remains a part of the EU single market. To avoid a hard Brexit, it is imperative that a trading agreement is concluded by 31 December 2020, which does not contribute to moderate the uncertainty reigning since 2019.

In the US, real economic growth cooled off to 2.3 % (2018: 2.9 %), especially due to fewer investments. This level can be described as moderate for the US. Consumers continued to benefit from the good employment situation, which supported consumption. At 1.6 %, growth in Canada was lower than in the previous year (2.0 %). Lower export growth and less investments were the main reasons for this development.

As expected, economic growth in the Asia/Pacific region was lower than in the previous year. This was particularly evident in China, which recorded growth of 6.1 % per annum compared with 6.7 % p.a. in 2018. The decline was attributable to the trade conflict with the US as well as to the slowdown in credit growth. Growth in economic output amounted to 1.8 % in Australia and was thus down on the previous year (2.7 %), with lower consumer spending in the second half of the year a contributory factor.

### Annual rate of change in real gross domestic product

| % | 2019[1] | 2018[2] |
|---|---|---|
| **Europe** | | |
| Euro zone | 1.2 | 1.9 |
| Austria | 1.5 | 2.3 |
| Belgium | 1.4 | 1.5 |
| Finland | 1.5 | 1.7 |
| France | 1.3 | 1.7 |
| Germany | 0.6 | 1.5 |
| Italy | 0.2 | 0.7 |
| Netherlands | 1.7 | 2.5 |
| Spain | 2.0 | 2.4 |
| Other European countries | | |
| Poland | 4.2 | 5.1 |
| Russia | 1.3 | 2.3 |
| Sweden | 1.2 | 2.3 |
| Switzerland | 0.8 | 2.8 |
| United Kingdom | 1.4 | 1.3 |
| **North America** | | |
| Canada | 1.6 | 2.0 |
| USA | 2.3 | 2.9 |
| **Asia/Pacific** | | |
| Australia | 1.8 | 2.7 |
| China | 6.1 | 6.7 |

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

The labour markets were positive in almost all regions in 2019. The unemployment rate in the euro zone fell by a total of 0.6 percentage points to 7.6 %. Higher declines were recorded in Spain and Italy in particular. The unemployment rate in the US declined to 3.7 % and to 5.2 % in Australia. In contrast, the unemployment rate in the UK rose by 0.7 percentage points to 3.2 %.

Inflationary pressure eased in the currency areas that are relevant for Aareal Bank Group, especially due the economic slowdown. Inflation fell by 0.6 percentage points both in the euro zone and the US to 1.2 % and 1.8 %, respectively. It fell by as much as 0.7 percentage points in the UK to 1.8 %.

### Financial and capital markets, monetary policy and inflation

The year 2019 on the capital markets was defined by falling long-term and short-term interest rates in nearly all currency areas. While a basic expectation for rate increases still prevailed last year, this changed following the adjustments made by key central banks to their monetary policy. The markets were open without limitation for new issues and refinancing, which was reflected in yields close to 0 % and a 3.4 % increase in gross sales of Mortgage Pfandbriefe in Germany up to the end of October.

During the year, the European Central Bank (ECB) announced the introduction of new long-term refinancing transactions (TLTRO) and its intention to leave the key interest rates at their current level until mid-2020 at least. However, it lowered the interest rate for the deposit facility by 10 basis points to -0.50 %, additionally scaling the deposit rates depending on the deposit volume. It also relaunched an asset purchase programme of € 20 billion per month since November. Having raised its main refinancing rate (fed funds) in December 2018, the US Federal Reserve (Fed) turned its policy around and lowered it three times during 2019, by 25 basis points on each occasion. It also emphasised the return to an expansionary monetary policy when it started buying US$ 60 billion of treasury bills per month. The Bank of England made no changes to interest rates in light of the unclear situation surrounding Brexit. The Swedish Riksbank left its main interest rate unchanged in 2019 but decided in December to raise it by 0.25 percentage points to 0.0 % from 8 January 2020.

The euro's performance vis-a-vis the currencies that are relevant for Aareal Bank was varied during the year. There was no uniform trend in the euro/US dollar exchange trade either. The US dollar had made gains up to October, only to lose these again over the remainder of the year. Nonetheless, its value at year-end was above that of the end of the previous year. Although the pound sterling at year-end was higher against the euro than at the start of the year, it shed around 9 % in value between May and August as a result of the uncertainties surrounding the UK's withdrawal from the EU before climbing again in the last quarter of the year. The Swiss franc and the Canadian dollar both made gains over the euro, while the Swedish krona and the Australian dollar weakened.

Short-term interest rates[1)] fell in most of the relevant currency areas. Measured in euros, they fell in the single-basis point range, thus reinforcing the negative interest rate environment. Measured in US dollar, they fell by around 90 basis points, by 40 basis points in Canadian dollar and by as much as approximately 120 basis points in Australian dollar. The pound sterling also declined, by 12 basis points in this case. Short-term interest rates denominated in Swedish krona bucked the trend to increase by around 20 basis points and were therefore above the zero per cent line, having fallen below it at the start of the year.

A continuous downward trend, whose magnitude was almost identical in all relevant currency areas, established itself for long-term interest rates[2)] in the course of the year.

Yields on ten-year government bonds fell during 2019 in the countries that are relevant to

[1)] Calculated on the basis of 3-month Euribor or the corresponding LIBOR or other comparable rates for other currencies
[2)] Calculated on the basis of swaps in the respective currencies

Aareal Bank, falling below the zero per cent mark for Germany. However, the spreads of Italian and Spanish government bonds relative to long-term German issues tightened due to the more pronounced decline in yields in Italy and Spain.

Notwithstanding political uncertainties, the primary market in the euro zone's covered bond segment was very strong in 2019 and defined by falling yields. Covered bonds totalling € 135 billion were issued last year, the highest volume since 2015, with German issuers accounting for the highest share of € 26.5 billion or 40 placements.

As in previous years, the ECB had stepped up its role as a buyer again since the end of year within the framework of its purchase programme, in response to the weak macro-economic developments in 2019.

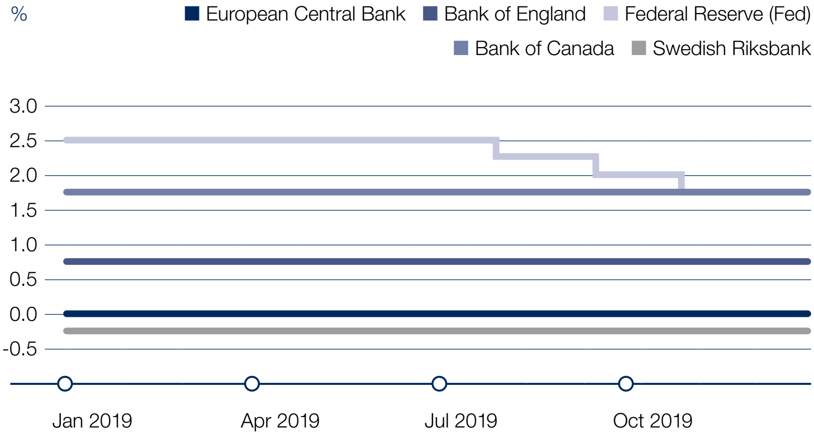
Many investors hoped in vain again for a rise in interest rates in 2019. The ECB's expansionary monetary policy led to a significant decline in yields during the year.

The German Pfandbrief, which is considered formative for the European covered bond market, celebrated its 250th birthday in 2019.

### Regulatory environment

The environment in which banks are operating continues to be defined by highly dynamic regulatory requirements, as well as by changes in banking supervision. This includes, in particular, the implementation of the final draft of the Basel III framework into EU law (known as "Basel IV"), which was endorsed by the Basel Committee's Group of Governors and Heads of Supervision (GHOS). Furthermore, the EU Commission's revision of supervisory regimes (CRR II, CRD V, BRRD II and SRMR) at EU level as well as the EBA documents (Guidelines on PD and LGD estimation, treatment of defaulted exposures, and determination of downturn LGD), will all bring about further regulatory changes. The provision put forward by the ECB, EBA and the EU Commission on the treatment of non-performing loans must also be taken

**Key rate developments in 2019**[1)]




1) The chart shows the upper level of the corridor for Fed Funds.

into account. Moreover, both national and European regulators are imposing various new requirements – including in connection with IT/information security risks, or regarding the prevention of money laundering, tax evasion and terrorist financing. Furthermore, politics and the banking supervision deem it necessary to establish sustainability more strongly with society, and as a regulatory requirement within the economy. As such, the EU's Technical expert group on sustainable finance published the "Technical report on the EU taxonomy", and BaFin issued its "Guidance Notice on Dealing with Sustainability Risks" at the end of 2019.

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

Following an amendment to the German Regulation Determining Critical Infrastructure (Verordnung zur Bestimmung Kritischer Infrastrukturen – "BSI-KritisV") in 2017, Aareal Bank AG is now additionally subject to reporting requirements vis-à-vis the German Federal IT Security Authority (BSI). The BSI required that areas and systems classified as "critical infrastructure" had to be certified by mid-2019.

## Sector-specific and business developments

### Structured Property Financing segment

Transaction activity worldwide in commercial property was lower than in the previous year. However, differences were observed depending on the property type. While transaction volumes in retail property declined by around 30 %, they increased for the other relevant property types by between 4 % and 10 %. Reticence among investors in retail property was evident in light of the upheavals, through online trading among other things.

Office properties benefited from the long economic cycle and the positive sentiment that continues to prevail in the service sector. In most markets, yields[1)] remained on a very low level in 2019 – in part significantly below 4 %. They eased in Europe by around 25 basis points on average during the course of the year, while remaining stable in the US. They also remained stable in China and Australia. A low single-percentage increase on average was observed in rents offered in Europe, the US and Australia. They remained stable on the other hand in China.

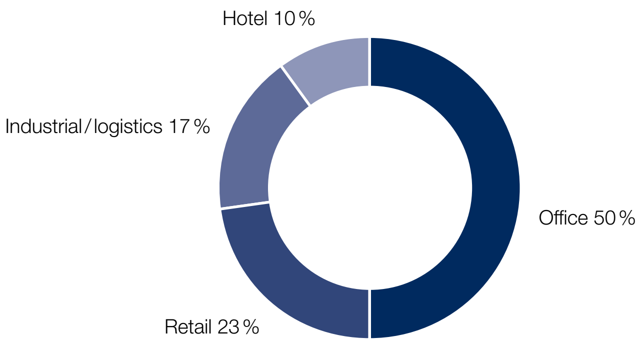
In contrast, yields on retail property rose by a few basis points on average in Europe in 2019, while remaining stable in the Asia/Pacific region and the US. Low single-percentage declines in rents on average were observed in Europe. Rents remained stable in the Asia/Pacific region and in the US.

Yields on European logistics properties decreased by an average of 25 basis points, whilst rents offered in Europe fell by an average of 1.7 % (2018: 2.5 %).

The willingness among market participants to provide finance varied during the year. In the Bank Lending Survey for the third quarter, the ECB reported on falling lending standards in Europe and lower margins due to heightened competition between the banks. However, this applied to all areas of the economy. The margin and competitive situation can also be applied to commercial property markets, as Aareal Bank observed pressure on margins in many European markets during the course of the year. In the UK, however, the willingness to provide financing for commercial property purchases fell. Lending in the US was up 13 % year-on-year in 2019, with the volume of CMBS issued particularly increasing in November, albeit less than in the previous year from a full-year perspective. All in all, it can be said that competition remains intense, which is supported by the pressure on margins in numerous European markets. Margins remained under pressure in North America too, but remained higher than in the euro zone.

In a highly competitive environment defined by uncertainties, Aareal Bank Group generated new business volume totalling € 7.7 billion (2018: € 9.5 billion) in the year under review, this was in line with our planning.

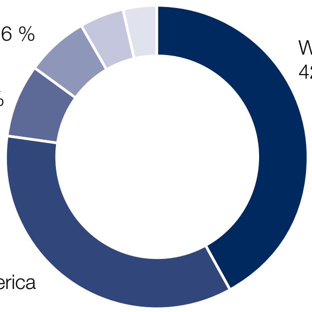
**Share of transaction volume observed worldwide in 2019**
%

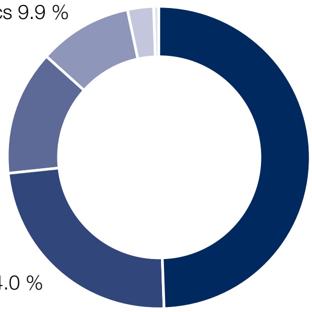



1) Falling yields are usually associated with rising property market values, all other things remaining equal.

**New business[1] 2019**

by region | by type of property (%)




* Including Germany

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

The share of newly-originated loans relative to new business was 80.1 % (2018: 75.8 %) or € 6.2 billion (2018: € 7.2 billion). Renewals amounted to € 1.5 billion (2018: € 2.3 billion). At 60.1 % (2018: 58.8 %), Europe accounted for the largest share of Aareal Bank Group's new business, followed by North America with 35.1 % (2018: 38.6 %) and the Asia/Pacific region with 4.8 % (2018: 2.6 %). The higher share of financings in the Asia/pacific region is due entirely to newly-originated loans.

With a share of 49.5 % (2018: 26.7 %), office property accounted for the largest share in new business in terms of property type, followed by hotel property, with 24.0 % (2018: 35.3 %), ahead of retail property with 13.3 % (2018: 23.3 %) and logistics property with 9.9 % (2018: 7.8 %). The share of residential property was 2.8 % (2018: 5.5 %), while other property and financings accounted for 0.5 % (2018: 1.4 %).

### Europe

Transaction volumes generated in Europe in 2019 were roughly 10 % lower than in the previous year which was attributable in particular to lower transaction activities in retail and logistics properties, and to a decline of around 30 % in the UK, which is one of the largest European markets. In the UK, the exit from the EU was one of the reasons for the subdued market; however, investor reticence for retail properties also negatively impacted transaction volumes. The volumes transacted in office and hotel property on the other hand was higher year-on-year. In Europe, cross-border and institutional investors were on the buy side for the most part, while REIT structures and private investors tended to be sellers.

Rental growth in the market for office property in Europe was positive on average in 2019. This trend has persisted since early 2013. At the same time, yields fell by an average of 25 basis points (2018: -8 basis points).

The situation with retail property painted a different picture. Shopping centre rents, in particular, fell by 1.8 % (2018: +2.2 %) across the whole of Europe. The weighted yield rose by 26 basis points (2018: +3 basis points).

Logistics properties remained attractive for investors in 2019. Whilst rents dropped by 1.7 % year-on-year (2018: +2.5 %), this did not affect Aareal Bank's key markets. An average decline of 25 basis points (2018: -23 basis points) in weighted investment yields attested overall continued investor demand.

Hotel properties showed largely positive trends in Europe in 2019, thanks to the sustained economic boom, with occupancy rates rising by 0.4 % year-on-year. A 1.8 % increase in the average room rate led to a 2.2 % growth in average revenue per available room, which was down on the previous year (2018: 5.2 %). The increase in the number of rooms available was reflected here. The particularly positive performance in London should be highlighted. Despite uncertainties surrounding Brexit, the increase in average revenue per available room was twice that of the European average.

The Bank originated new business of € 4.6 billion (2018: € 5.6 billion) in Europe during the year under review. As in previous years, Western Europe again accounted for the largest share of € 3.2 billion (2018: € 3.5 billion) with the strongest countries being France and Germany. Southern Europe followed with € 0.6 billion (2018: € 1.2 billion), Eastern Europe with € 0.5 billion (2018: € 0.3 billion) and Northern Europe with € 0.3 billion (2018: € 0.6 billion).

### North America

The volume of transferred commercial property in the US in 2019 was roughly unchanged from the previous year's figure. Office property values were stable, while fewer retail and hotel properties – as measured by volume – were transferred than in the previous year. Transaction volumes in hotel properties in Canada were roughly 18 % lower than in the previous year. Institutional and private investors were on the buy side for the most part, while cross-border investors and REIT structures tended to be sellers.

In the market for office property, rents offered in the US rose overall by just over 2 %. The growth in rents in the metropolitan areas on the west coast tended higher than those on the east coast. On the other hand, yields hardly changed compared with the end of the previous year.

Rent offered for retail property in the US increased by 1.0 %, although there were regional differences here in the amount as well as in the course of growth. Some locations such as Boston or Chicago featured falling quoted rents. The yields did not change compared with the end of the previous year.

On the hotel markets in the US, growth in average revenue per available room stagnated in the year under review, with average room rates going up by 1.0 % and occupancy rates remaining at the previous year's level. Seeing as revenue per available room is at its highest since 2007, the discussed development is still positive. Average revenue per available hotel room was stable in Canada. Lower occupancy rates were offset by a higher average room rate.

Aareal Bank originated new business of € 2.7 billion in North America during the year under review (2018: € 3.7 billion). This business was concluded in the US and Canada.

### Asia/Pacific region

The volume of transferred commercial property in the Asia/Pacific region in 2019 was approx. 10 % below the previous year's figure. The level in Australia, on the other hand, remained the same year-on-year. Cross-border and institutional investors were on the buy side for the most part, while REIT structures and private investors tended to be sellers.

The situation on the market for office property was mixed in the Asia/Pacific region. While rents in Australia increased significantly by just over 5 %, they fell in China by an average of 3.5 %.

Developments on the market for retail property in the Asia/Pacific region were comparable. Rents and yields were largely stable.

Hotel property in the Asia/Pacific region experienced a 3.2 % decline overall in revenue per available room, which was due to falling occupancy rates and lower average room rates. Regionally, the decline is attributable in particular to negative developments in Northeast Asia.

The Bank originated new business of € 0.4 billion in the Asia/Pacific region during the year under review (2018: € 0.2 billion), including financing of student housing complexes in Australia.

### Integration of former Düsseldorfer Hypothekenbank AG

As planned, Aareal Bank Group concluded the integration of former Düsseldorfer Hypothekenbank AG (Düsselhyp) during the first half of 2019, with the split-off of former Düsselhyp's banking operations.

## Consulting/Services segment

### Bank division Housing Industry

Business development in the German housing industry proved solid in 2019 as well. Rental income has increased overall as in the previous year. Together with the long-term financing structures and very low interest rates, they secure a solid foundation and facilitate entrepreneurial investments. Nationwide, rents were around 2.7 % higher year-on-year (compared with an increase of 2.9 % in 2018).

However, market development varied from region to region. While rents rose by 0.8 % on average in rural areas in the third quarter of 2019, average rents in the municipal districts fell by 0.3 %. They also stagnated in the most popular cities ("Schwarmstädte"), while continuing to rise in the surrounding areas; this suggests that tenants are migrating out of metropolitan areas.

There is still a housing shortage. At 257,000, the number of construction permits for apartments in 2019 is down by nearly 2 % on the previous year's figure. A lack of available and affordable building land and of employees in the responsible licensing authorities is making it difficult to improve the situation; low capacity at the construction firms and high construction costs are holding back major investments. The federal government's coalition agreement estimated the average demand for new apartments at 375,000 per annum (from 2017 to 2021); this continues to be clearly missed.

The vacancy ratio based on the housing stock managed by GdW enterprises varies: at 1.4 %, the ratio in the former West German Federal states is unchanged from the previous year and should rise to 8.5 % (2018: 8.3 %) in the former East German states.

The Housing Industry division further strengthened its market position in the 2019 financial year, bringing in more business partners from the institutional housing and commercial property industries – managing more than 235,000 residential units between them – for the payments and deposit-taking businesses. Moreover, it intensified existing business relationships. We also continuously succeeded to position ourselves as a partner in the energy and waste disposal industry, particularly within the scope of digitalisation, especially through interface products (such as BK 01 eConnect and BK 01 immoconnect) facilitating cross-sector collaboration amongst our client groups. Examples include accounting documentation and invoicing of energy supplies.

With plusForta AG, Aareal Bank has acquired one of the leading German providers of tenant deposit guarantees in 2019. The additional tenant deposit alternative will be gradually integrated in our technical systems and expands the range of property industry services in the area of deposit guarantees. The purchase of software from Deutsche Kautionspartner for managing rent deposits held with other banks will complete the range in addition to Aareal Bank's account maintenance service.

In addition, the Housing Industry division has analysed the development of alternative online payment systems very intensively and is integrating corresponding procedures into existing programmes and processes. The corresponding Aareal Exchange & Payment Platform product is currently in a pilot phase and is expected to be placed on the market in 2020.

At present, more than 3,500 business partners throughout Germany are using our process-optimising products and banking services. The high volume of deposits, averaging € 10.7 billion (2018: € 10.4 billion) in the year under review, is in line with the strategic orientation. The share of rent deposits and reserves in accordance with the

German Residential Property Act was increased once again. Deposits averaged € 10.9 billion in the fourth quarter of 2019 (Q4 2018: € 10.4 billion) which we see as a sign of the trust our clients put in us.

### Aareon

Aareon is a consultancy and IT systems house for the property industry and its partners in Europe. It pursues a profitable growth strategy, and continued to grow in 2019. Key factors to its success are client orientation, the growth in digital solutions, further strengthening of the ERP systems and exploration of new relevant markets and related sectors associated with the property industry. In the course of Aareon's forward-looking orientation and further intensification of research and development, a strategic investment programme focusing on digital solutions was launched specifically for this purpose. The process of internal optimisation to enhance the organisational performance and profitability also continued, and the operative organisational structure with three cross-border divisions – sales, operating (including ERP and outsourcing) and digital business – was organised to enhance proximity to the market and clients.

Aareon's contribution to earnings in the 2019 financial year was € 37 million (2018: € 36 million), including strategic investments of € 3 million, thus corresponding to its earnings forecast. This was essentially due to recurring revenues and the consulting business in all product segments, as well as to the significant revenue growth of digital solutions which are reported under commission income.

Numerous additional clients, including key accounts, were acquired for the Wodis Sigma ERP solution in the DACH region (Germany, Austria and Switzerland). Among these new customers, there are still many previous GES clients, most of whom have opted in favour of one of the Wodis Sigma modern ERP systems or for SAP® solutions and Blue Eagle, or their systems were already migrated. As expected, the favoured version is the one that uses Wodis Sigma as a service from the exclusive Aareon Cloud. Aareon continued to implement a large number of migration projects. The total number of Wodis Sigma customers has therefore increased to around 1,050 as at year-end. The business volumes conducted with Wodis Sigma as well as with SAP® solutions and Blue Eagle increased year-on-year. The increased business volume and regular price adjustments led to higher revenues from maintenance and SaaS contracts. Consulting revenue increased as well. Additional commercial property clients were acquired for the RELion ERP solution, resulting in higher licence and consulting revenue. The mse subsidiaries were renamed as Aareon RELion in November. The positive trend in the outsourcing business continued unabated. BauSecura's insurance business has been running slightly above the previous year's level.

The marketing process for the Aareon Occupant Change Management solution continued to run on the utilities market.

In the Netherlands, several key accounts opted for long-term contracts with the Tobias ERP solution – some products were rolled out with key accounts, too. No losses of major clients were reported. The market launch of the new Tobias 365 ERP product generation started in the second quarter on the basis of Microsoft® Dynamics® 365. The distribution of the Dutch REMS ERP solution for the commercial property business was in line with the previous year. In France, several new clients were acquired in the course of the ELAN Law, which was passed in October 2018. Several new clients were acquired in the UK, including one important key account. ERP demand also concentrated on individual software adjustments and additional modules. Aareon Sverige was able to win key tenders with the Incit Xpand ERP solution, for example with several Swedish local authorities. The key tender with the housing company OBOS, managing around 220,000 units, was won in Norway. Following the successes on the Finnish market, Aareon Sverige founded the subsidiary Aareon Finland OY at the start of the year.

Digitalisation is becoming increasingly important for the property industry. With its Aareon Smart World digital ecosystem, Aareon offers integrated solutions for automating the business processes and networking business partners and market participants. The digital transformation process for customers is therefore focused on creating added value. Aareon continues to steadily expand this offer, and benefits from the transfer of international know-how in research and development, as well as from the exchange with the proptech and start-up scene. In the Netherlands, Aareon Nederland acquired a minority stake in the Dutch PropTech OSRE B.V. ORSE designed a digital solutions platform that makes property sales and rental transactions more efficient. The first investment of subsidiary AV Management GmbH, which operates under the Ampolon Ventures brand, was ophigo which was presented at the MIPIM in Cannes and Expo Real in Munich. ophigo offers a digital platform for finding office space.

In November, Aareon signed the contract to acquire CalCon with effect from 1 January 2020. This acquisition supports Aareon's international growth strategy. The epiqr product for structural condition assessment and the new CalCon AIBATROS product generation will complement Aareon Smart World's product range.

The business volume generated with digital solutions has continued to grow strongly, by approximately 20 % year-on-year, with a growing number of clients enhancing their ERP systems with the addition of integrated digital solutions, thus developing their own digital ecosystem. The Aareon Smart Platform was introduced in Germany, France and the Netherlands, with five customers in France already opting for this offer. The Aareon Smart Platform is an open platform that allows clients and partners to develop own solutions and integrate them securely into Aareon Smart World.

## Financial Position and Financial Performance

### Financial performance

#### Group

Consolidated operating profit in the 2019 financial year amounted to € 248 million (2018: € 316 million), thus corresponding to our earnings forecast. The comparative figure for the previous year benefited from a material non-recurring income of € 55 million negative goodwill from the initial consolidation of former Düsseldorfer Hypothekenbank AG (Düsselhyp), whilst the corresponding costs for the integration in the year under review amounted to € 11 million.

Net interest income amounted to € 533 million (2018: € 535 million) and was thus stable, as planned.

The loss allowance of € 90 million (2018: € 72 million) corresponded with the forecast that was increased in the third quarter (previously: € 50 million to € 80 million expected) to take account of the higher burden from accelerated de-risking.

Net commission income of € 229 million developed positively as planned, in particular due to the higher contribution from Aareon (2018: € 215 million).

The net derecognition gain amounted to € 64 million (2018: € 24 million), exceeding our forecast increased in the third quarter (previously: € 20 million to € 40 million expected) mainly as a result of structural adjustments to our securities portfolio after acquiring former Düsselhyp.

The net loss from financial instruments (fvpl) and on hedge accounting totalled € -3 million (2018: € -4 million).

Administrative expenses increased as expected, to € 488 million (2018: € 462 million), in particular due to running costs, integration expenses incurred in conjunction with the integration of former Düsselhyp, and Aareon's business expansion.

All in all, consolidated operating profit for the 2019 financial year totalled € 248 million, after € 316 million in 2018. Taking into consideration tax expenses of € 85 million and non-controlling interest income of € 2 million, consolidated net income attributable to shareholders of Aareal Bank AG amounted to € 161 million (2018: € 224 million).

### Consolidated net income of Aareal Bank Group

| € mn | 1 Jan - 31 Dec 2019 | 1 Jan - 31 Dec 2018 |
|---|---|---|
| Net interest income | 533 | 535 |
| Loss allowance | 90 | 72 |
| Net commission income | 229 | 215 |
| Net derecognition gain or loss | 64 | 24 |
| Net gain or loss from financial instruments (fvpl) | 1 | -2 |
| Net gain or loss from hedge accounting | -4 | -2 |
| Net gain or loss from investments accounted for using the equity method | 1 | 0 |
| Administrative expenses | 488 | 462 |
| Net other operating income/expenses | 2 | 25 |
| Negative goodwill from acquisitions | – | 55 |
| **Operating profit** | **248** | **316** |
| Income taxes | 85 | 90 |
| **Consolidated net income** | **163** | **226** |
| Consolidated net income attributable to non-controlling interests | 2 | 2 |
| Consolidated net income attributable to shareholders of Aareal Bank AG | 161 | 224 |

Assuming the pro rata temporis accrual of net interest payments on the AT1 bond, consolidated net income allocated to ordinary shareholders stood at € 145 million (2018: € 208 million). Earnings per ordinary share amounted to € 2.42 (2018: € 3.48) and return on equity (RoE) before taxes stood at 8.7 % (2018: 11.6 %). Thus, both indicators were in line with our forecast.

#### Structured Property Financing segment

Operating profit in the Structured Property Financing segment amounted to € 276 million (2018: € 338 million). The comparative figure for the previous year benefited from a material non-recurring income of € 55 million negative goodwill from the initial consolidation of former Düsselhyp, whilst the corresponding costs for the integration in the year under review amounted to € 11 million.

Net interest income amounted to € 549 million (2018: € 547 million) and was thus stable, as expected.

The loss allowance of € 90 million (2018: € 73 million) corresponded with the forecast that was increased in the third quarter (previously: € 50 million to € 80 million expected) to take account of the higher burden from accelerated de-risking.

The net derecognition gain amounted to € 64 million (2018: € 24 million), exceeding our forecast increased in the third quarter (previously: € 20 million to € 40 million expected) mainly as a result of structural adjustments to our securities portfolio after acquiring former Düsselhyp.

The net loss from financial instruments (fvpl) and on hedge accounting totalled € -3 million (2018: €- 4 million).

Administrative expenses increased as expected, to € 254 million (2018: € 241 million), in particular due to running costs and integration expenses incurred in conjunction with the integration of former Düsselhyp.

Overall, operating profit for the Structured Property Financing segment was € 276 million (2018: € 338 million). Taking income tax expenses of € 95 million into consideration (2018:

€ 99 million), the segment result was € 181 million (2018: € 239 million).

### Consulting/Services segment

Net interest income of € -16 million in the Consulting/Services segment (2018: € -12 million) continued to be burdened by the negative margin from the deposit-taking business due to the persistently low level of interest rates.

Net commission income of € 227 million developed positively as planned, in particular due to higher contribution from Aareon (2018: € 212 million).

Administrative expenses increased, as expected, to € 242 million (2018: € 227 million), due to Aareon's business expansion and strategic investments.

### Structured Property Financing segment result

| € mn | 1 Jan - 31 Dec 2019 | 1 Jan - 31 Dec 2018 |
|---|---|---|
| Net interest income | 549 | 547 |
| Loss allowance | 90 | 73 |
| Net commission income | 10 | 9 |
| Net derecognition gain or loss | 64 | 24 |
| Net gain or loss from financial instruments (fvpl) | 1 | -2 |
| Net gain or loss from hedge accounting | -4 | -2 |
| Net gain or loss from investments accounted for using the equity method | 1 | 0 |
| Administrative expenses | 254 | 241 |
| Net other operating income/expenses | -1 | 21 |
| Negative goodwill from acquisitions | – | 55 |
| **Operating profit** | **276** | **338** |
| Income taxes | 95 | 99 |
| **Segment result** | **181** | **239** |

### Consulting/Services segment result

| € mn | 1 Jan - 31 Dec 2019 | 1 Jan - 31 Dec 2018 |
|---|---|---|
| Net interest income[1)] | -16 | -12 |
| Loss allowance | 0 | -1 |
| Net commission income[1)] | 227 | 212 |
| Net gain or loss from financial instruments (fvpl) | 0 | 0 |
| Net gain or loss from investments accounted for using the equity method | 0 | – |
| Administrative expenses | 242 | 227 |
| Net other operating income/expenses | 3 | 4 |
| **Operating profit** | **-28** | **-22** |
| Income taxes | -10 | -9 |
| **Segment result** | **-18** | **-13** |

[1)] As of this reporting year, interest on deposits from the housing industry is shown under the net interest income of the Consulting/Services segment (previously included in net commission income). The previous year's figures were adjusted accordingly.

Overall, segment operating profit for 2019 was € -28 million (2018: € -22 million). Aareon's contribution was € 37 million (2018: € 36 million).

Taking income taxes into consideration, the segment result amounted to € -18 million (2018: € -13 million).

## Financial position

Consolidated total assets as at 31 December 2019 amounted to € 41.1 billion, after € 42.7 billion as at 31 December 2018. The previous year's figure was impacted by the initial consolidation of former Düsselhyp at year-end 2018. This temporary increase was compensated mainly by the structural adjustment to the securities portfolio in the year under review.

### Cash reserve and money market receivables

The cash reserve and money market receivables position contains excess liquidity invested at short maturities. As at 31 December 2019, this comprised predominantly cash funds and deposits with central banks and money-market receivables from banks.

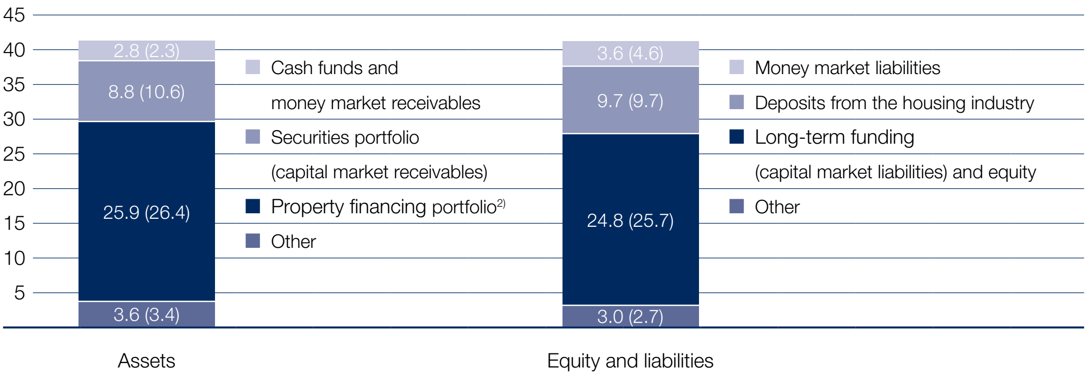
### Property financing portfolio

The volume of Aareal Bank Group's property financing portfolio[1] stood at € 25.9 billion as at 31 December 2019, down by around two percentage points from the year-end level 2018 (€ 26.4 billion); this was due – in part – to accelerated de-risking. Including former WestImmo's private client and local authority lending businesses it was within our forecast.

Portfolio allocation by region and continent changed only selectively compared with the end of the previous year. Whilst the portfolio share of exposures in Western Europe rose by around 2.7 percentage points and in North America by around 2.1 percentage points, it was down by around 2.8 percentage points for Southern Europe due to accelerated de-risking in Italy, and fell by around 1.6 percentage points in Eastern Europe. It remained relatively stable for all other regions. Accelerated de-risking also led to a corresponding lower LTV in Southern Europe.

**Statement of financial position – structure as at 31 December 2019 (31 December 2018)**

€ bn

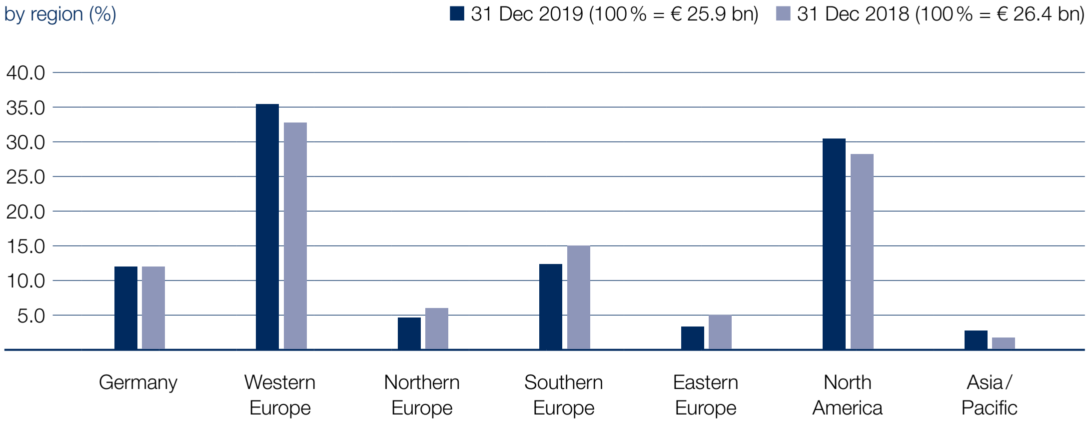



[1] Excluding former WestImmo's private client business and local authority lending business

[2] Excluding € 0.4 billion in private client business (31 December 2018: € 0.6 billion) and € 0.4 billion in local authority lending business by the former Westdeutsche ImmobilienBank AG (WestImmo) (31 December 2018: € 0.5 billion), and excluding loss allowance

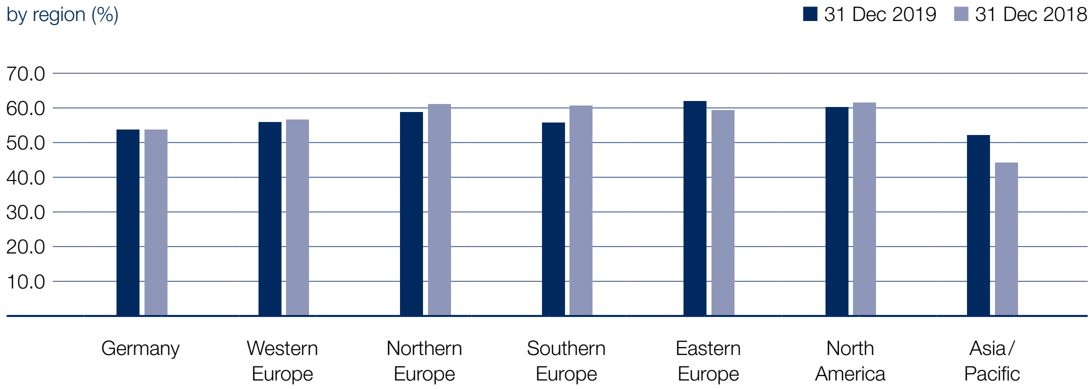
### Property financing volume[1)] (amounts drawn)

by region (%)




### Average LTV of property financing[1)]

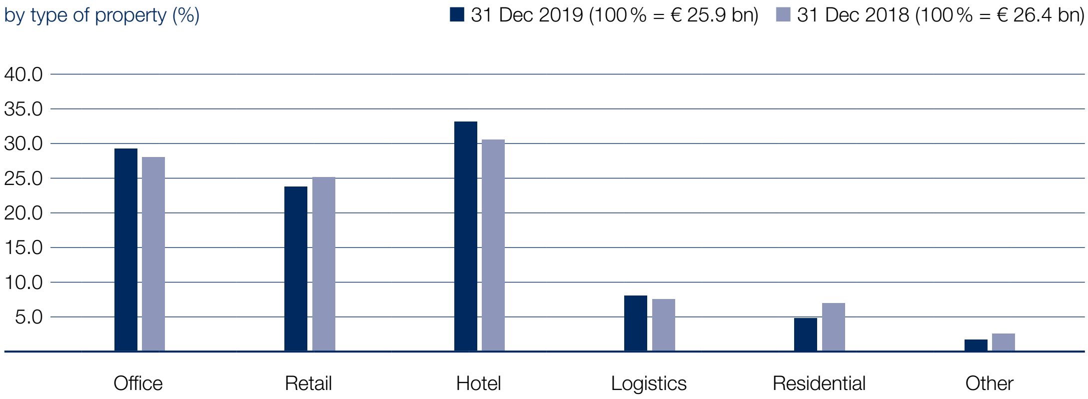
by region (%)




Note that the loan-to-value ratios are calculated on the basis of drawdowns and market values, including supplementary collateral with sustainable value, excluding defaulted property financings.

### Property financing volume[1)] (amounts drawn)

by type of property (%)




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

**Average LTV of property financing**[1)]

by type of property (%)


Note that the loan-to-value ratios are calculated on the basis of drawdowns and market values, including supplementary collateral with sustainable value, excluding defaulted property financings.

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

The breakdown of the portfolio by property type did not change significantly during the reporting period. The share of hotel property increased by 2.6 percentage points compared to year-end 2018, whilst the share of residential property was reduced by two percentage points. The share of financings for office, logistics, and retail property as well as other financings in the overall portfolio remained almost unchanged compared to year-end 2018. Accelerated de-risking in Italy incurred an LTV decrease for housing properties.

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

### Treasury portfolio

Aareal Bank holds a high-quality treasury portfolio, which fulfils two major tasks as part of the overall management of the Bank. On the one hand, the bulk of the securities are held for the liquidity portfolio, which accounts for a major part of the liquidity reserve from both the economic and normative perspective of risk-bearing capacity. In addition to the liquidity portfolio, part of the Treasury portfolio is also used as a collateral portfolio. We define this mainly as the securities and promissory note loans that are used as collateral for the two Pfandbrief programmes.

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

As at 31 December 2019, the total nominal volume of the Treasury portfolio[1)] was € 7.3 billion (31 December 2018: € 8.7 billion). The previous year's figure was impacted by the initial consolidation of former Düsselhyp at year-end 2018. This temporary increase was compensated mainly by the structural adjustment to the securities portfolio in the year under review.

The portfolio comprises the asset classes public-sector borrowers, covered bonds and bank bonds (financials), with the public-sector asset class accounting for the biggest portion of the portfolio (currently approximately 97 %). The high credit-worthiness requirements are also reflected in the rating breakdown in the portfolio. 99 % of the portfolio has an investment grade rating[2)], and 78 % of the positions have an AAA to AA- rating (2018: 71 %). The share of BBB ratings was reduced to 14 % (2018: 20 %) as a result of the structural adjustment to the securities portfolio.

1) As at 31 December 2019, the securities portfolio was carried at € 8.8 billion (31 December 2018: € 10.6 billion).

2) The rating details are based on the composite ratings.

The portfolio currently comprises almost exclusively (98 %) securities denominated in euros and its average remaining term on the reporting date was 6.4 years.

Given the high requirements as regards the liquidity of the positions as part of their use for the liquidity portfolio, 94 % of the portfolio can be pledged as collateral with the ECB and 79 % fulfils the requirements for ”High Quality Liquid Assets” (as defined in the Liquidity Coverage Ratio (LCR)).

## Financial position

### Money-market liabilities and deposits from the housing industry

Generally, in addition to deposits from housing industry clients and institutional investors, Aareal Bank also uses interbank and repo transactions for short-term refinancing, the latter being used primarily to manage liquidity and cash positions.

As at 31 December 2019, Aareal Bank had € 9.7 billion at its disposal in deposits generated from the business with the housing industry (31 December 2018: € 9.7 billion). Beyond that, there were no repos and no liabilities vis-à-vis Deutsche Bundesbank or the ECB.

### Long-term funding and equity

**Funding structure**

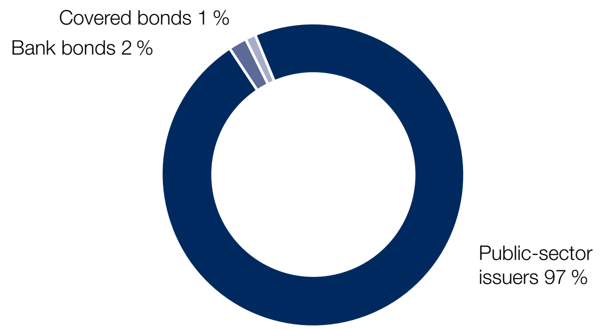
Aareal Bank Group continues to be solidly funded, a development visible by its major share of long-term funding. This encompasses registered and bearer Pfandbriefe, promissory note loans, medium-term notes, other bonds and subordinated issues. The latter include subordinated liabilities and Additional Tier 1 (AT1) bond.

As at 31 December 2019, the notional volume of the long-term refinancing portfolio was € 20.6 billion. The book values of the long-term refinancing portfolio totalled € 22.2 billion.

The Liquidity Coverage Ratio (LCR) at Group level exceeded 150 % on the reporting days during the period under review and was thus above our target value.

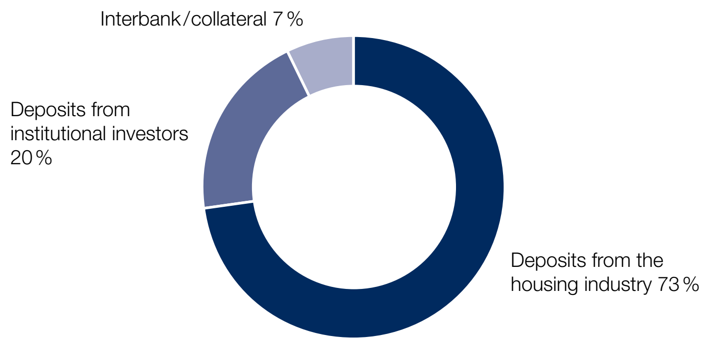
**Treasury portfolio as at 31 December 2019**

% Total volume (nominal): € 7.3 bn



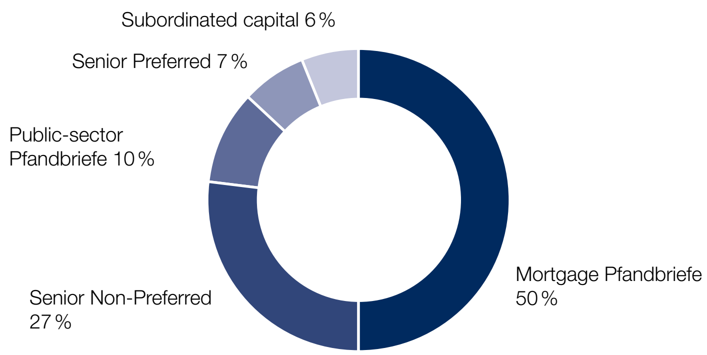

**Money market funding mix as at 31 December 2019**

% Total volume: € 13.3 bn




**Capital market funding mix as at 31 December 2019**

% Total volume: € 20.6 bn



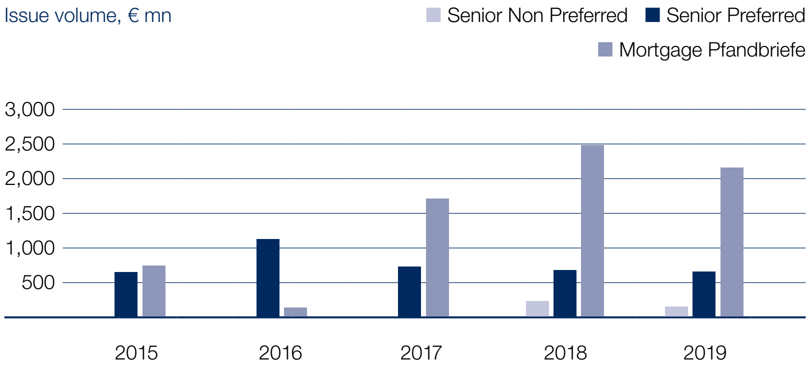
### Refinancing activities

Throughout the financial year 2019, Aareal Bank Group was able to raise liquidity in the amount of € 2.9 billion on the capital market. Of this volume, € 2.2 billion are attributable to Pfandbriefe, € 0.6 billion to senior preferred bonds and € 0.1 billion to senior non-preferred bonds. This figure included two euro-denominated bench-mark Mortgage Pfandbrief transactions sized at € 0.75 billion and € 0.5 billion, and one USD 0.6 billion benchmark Mortgage Pfandbrief issue. We also placed a senior preferred € 0.5 billion benchmark issue with national and international investors.

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

### Issuing activities – 2015 to 2019

Issue volume, € mn




### Equity

Aareal Bank Group's total equity as disclosed in the statement of financial position amounted to € 2,861 million as at 31 December 2019 (31 December 2018: € 2,928 million), comprising € 300 million for the Additional Tier 1 (AT 1) bond. Please also refer to the statement of changes in equity, and to our explanations in Note 57.

The Common Equity Tier 1 ratio (CET 1 ratio) – Basel IV (estimated) – continued to lie above the target value of 12.5 % in the year under review.

### Regulatory indicators[1]

| | 31 Dec 2019[2] | 31 Dec 2018 |
|---|---|---|
| € mn | | |
| Common Equity Tier 1 (CET 1) | 2,191 | 2,241 |
| Tier 1 (T1) | 2,491 | 2,541 |
| Total capital (TC) | 3,343 | 3,419 |
| % | | |
| Common Equity Tier 1 ratio (CET 1 ratio) | 19.6 | 17.2 |
| Tier 1 ratio (T1 ratio) | 22.3 | 19.5 |
| Total capital ratio (TC ratio) | 29.9 | 26.2 |
| | | |
| Common Equity Tier 1 ratio (CET 1 ratio) – Basel IV (estimate) –[3] | 13.5 | 13.2 |

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

[2] When calculating own funds, annual profits were taken into account, based on the Management Board's proposal for appropriation of profits for the 2019 financial year, and incorporating the pro-rata accrual of net interest payable on the AT1 bond. 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 the NPL inventory as well as the ECB's NPL guidelines for exposures newly classified as NPLs, were taken into account for determining regulatory indicators.

[3] Underlying estimate, given a 72.5 % output floor based on the final Basel Committee framework dated 7 December 2017. The calculation of the material impact upon Aareal Bank is subject to the outstanding EU implementation as well as the implementation of additional regulatory requirements (CRR II, EBA requirements etc.).

# Our Employees

## Qualification and training programmes

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

The Group consistently pursued this strategy throughout the year under review. The Bank focused on specific and generic training measures – for example, in the form of qualification programmes for (agile as well as traditional) project management, as well as supporting measures related to organisational and team development, which were tailored to the Group-wide reorganisation efforts. At Aareon, the training focus was on targeted development measures for managers, comprising training, diagnostics and consulting offers, coaching, training for digital leadership, as well as training measures for traditional and agile project management. Both Aareal Bank and Aareon also attached great importance to further building language and communications skills within the scope of internationalisation: to this end, a digital language learning portal is used, which provides instructions for learning English as well as five other European languages. This learning portal allows all employees throughout the Group to improve their language skills, anywhere (even at home) and at any time.

The in-service study course Bachelor of Arts Real Estate offered by EBZ for students training to become qualified housing and property specialists was carried out this way for the first time in 2019.

The fourth cross-mentoring programme was initiated at Aareal Bank and Aareon. Cross-mentoring describes the targeted exchange of employees from different companies; it is a personnel development measure aimed at promoting knowledge transfer.

## Promoting the next generation

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

Aareal Bank's programme aimed at promoting the next generation comprises not only trainee programmes, but also the dual studies Business Informatics and Business Administration in cooperation with DHBW Mannheim and RheinMain University, as well as the on-the-job Bachelor's degree Business Administration in cooperation with the University of Applied Sciences Mainz. Aareal Bank closely

### Employee data as at 31 December 2019

| | 31 Dec 2019 | 31 Dec 2018 | Change |
|---|---|---|---|
| Number of employees at Aareal Bank Group | 2,788 | 2,748 | 1.5% |
| Years of service | 11.6 years | 12.7 years | -1.1 years |
| Staff turnover rate | 4.6% | 5.8% | |

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

collaborates with universities in the region via various initiatives.

Besides training programmes, Aareon offers the dual courses of study ”Business information systems” and ”Media, IT and management” as well as various vocational training opportunities for office managers, IT applications developers, or IT systems integrators.

As in previous years, the Bank and Aareon held the Girls' Day as part of its measures for promoting the next generation. Furthermore, Aareon supported the initiative JOBLINGE aimed at socially deprived young citizens. First participants of this programme have meanwhile embarked on their training. To promote trainees and science, Aareon is cooperating with several universities, and supporting students as part of the German scholarship of the Johannes Gutenberg University in Mainz.

## Remuneration system

In addition to a fixed remuneration component, all permanent employees receive performance-based variable remuneration. Salaries are reviewed annually, to ensure that individual remuneration packages are appropriate. The objective is to offer a remuneration level that is both appropriate and attractive to all Group employees.

## Work-life balance

Aareal Bank Group places great importance on supporting its employees to achieve compatibility between career and family. This is emphasised by a broad range of dedicated support services such as partnerships with childcare institutions or service providers for the provision of private childcare, holiday programmes for employees' children, the availability of parent-child workrooms, flexible working policies, part-time positions and the option of mobile working or alternating teleworking for all employees. Another component of improving the work-life balance of the employees consists of services that make it easier to combine working life with the care of those who require it. This includes, among other things, the offer of counselling and support in the event of illness as well as nursing care for close relatives (available throughout Germany), and the option of participating in various training courses for better compatibility between family, care and work. As an innovative company that promotes the digital transformation process holistically and manages the related process of change for its employees, Aareon had already launched the ”work4future” project in 2017. Based on the existing principles of a human resources policy aligned to different phases in life, it focuses on flexible work models, smart and effective employee collaboration, and the digital workplace. The works agreement on mobile working was implemented in 2019, increasing our employees' work flexibility. A digital collaboration tool was introduced for internal communications, and the room concepts are continuously being improved within the scope of internal programmes.

## Health

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

In order to protect and promote the health of its employees in a targeted manner, Aareal Bank Group offers a comprehensive range of health-promoting measures in the areas of information, prophylaxis, exercise and ergonomics, nutrition, mental health and relaxation that are always based on employees' current needs. In the year under review, these included preventative, individual health consultations held in the Bank on various topics, workshops on topics such as relaxation, nutrition and fasciae, stress prevention and management measures, health checks, colon cancer screening, skin screenings and flu vaccinations. In 2019, Aareon's occupational health management implemented numerous measures for supporting employees in a digital working world.

# Risk Report

## Aareal Bank Group Risk Management

The ability to correctly assess risks, and to manage them in a targeted manner, is a core skill in banking. Accordingly, being able to control risks in all their relevant variations is a key factor for a bank's sustainable, commercial success. This economic motivation for a highly-developed risk management system is continuously increased by extensive regulatory requirements for risk management. For this reason, we implemented the new ECB Guidelines on the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP) at the beginning of the year. The comments set out below in the Risk Report take the new guidelines into account.

### Risk management – scope of application and areas of responsibility

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

Uniform methods and procedures are deployed to monitor material risks generally associated with banking business across all entities of Aareal Bank Group. Specific risk monitoring methods have been developed and deployed to suit the relevant risk exposure at the subsidiaries. In addition, risk monitoring for these subsidiaries at Group level is carried out via the relevant control bodies of the respective entity, and Equity Investment Risk Controlling.

| Type of risk | Risk management | Risk monitoring |
|---|---|---|
| **Overall responsibility: Management Board and Supervisory Board of Aareal Bank AG** | | |
| Loan loss risks | | |
| Property Financing | Loan Markets & Syndication<br>Credit Risk<br>Project & Credit Portfolio Management<br>Credit Transaction Management<br>Workout | Risk Controlling<br><br><br><br>Second Line of Defence (NPL) |
| Treasury business | Treasury | Risk Controlling |
| Country risks | Treasury<br>Credit Risk<br>Credit Transaction Management | Risk Controlling |
| Interest rate risk in the banking book (IRRBB) | Treasury; Transaction Committee | Risk Controlling,<br>Finance & Controlling |
| Market risks | Treasury; Transaction Committee | Risk Controlling |
| Operational risks | Process owners | Risk Controlling |
| Investment risks | Group Strategy | Risk Controlling,<br>Finance & Controlling,<br>Kontrollorgane |
| Property risks | Aareal Estate AG | Risk Controlling |
| Business and strategic risks | Group Strategy | Risk Controlling |
| Liquidity risks | Treasury | Risk Controlling |
| **Process-independent monitoring: Internal Audit** | | |

Overall responsibility for risk management and risk monitoring remains with the Management Board and the Supervisory Board of Aareal Bank AG. The adjacent diagram (p. 57) provides an overview of the responsibilities assigned to the respective organisational units.

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

The risk monitoring function (the "Second Line of Defence") regularly measures utilisation of risk limits, and reports on the risk situation. In this context, the Management Board is supported by the Risk Executive Committee (RiskExCo). The RiskExCo develops proposals for resolutions in line with delegated tasks, and promotes risk communications and a risk culture within the Bank. The risk management system was supplemented by a recovery plan, in line with regulatory requirements, which comprises the definition of threshold values for key performance indicators – both from an economic and a normative perspective. These are designed to ensure that any negative market developments having an impact upon our business model are identified at an early stage and corresponding action is taken in order to safeguard the sustained continuation of business operations.

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

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

### Strategies

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

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

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

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

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

### Risk-bearing capacity and risk limits

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

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

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

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

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

The purpose of internal capital is to serve as a risk-bearing component under the economic perspective. Within Aareal Bank Group, the current regulatory Tier I capital serves as the basis for determining economic aggregate risk cover. Accordingly, available internal capital comprises Common Equity Tier I (CET1) capital, supplemented by Additional Tier I (AT1) capital. Tier 2 capital, as well as projected results to be incurred during the risk analysis horizon, are not taken into account. Moreover, the value-oriented approach adopted under the economic perspective requires suitable adjustments to be made to regulatory Tier I capital, in order to bring aggregate risk cover into line with the economic assessment. Specifically, this may entail adjustments regarding conservative valuation, or a management buffer.

The taxonomy of potential risks under the economic perspective is largely oriented upon the established classification under the previous going-concern/gone-concern approaches. A change was made in

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

| € mn | 31 Dec 2019 | 1 Jan 2019[1)] |
|---|---|---|
| Tier 1 (T1) capital | 2,491 | 2,541 |
| CVA/hidden encumbrances/management buffer | -111 | -162 |
| **Aggregate risk cover** | **2,381** | **2,379** |
| **Utilisation of freely available funds** | | |
| Loan loss risks | 525 | 685 |
| Interest rate risk in the banking book (IRRBB) | 93 | 101 |
| Market risks | 360 | 530 |
| Operational risks | 123 | 116 |
| Investment risks | 30 | 29 |
| Property risks | 60 | 49 |
| Business and strategic risks | 81 | 81 |
| **Total utilisation** | **1,272** | **1,591** |
| **Utilisation (% of aggregate risk cover)** | **53 %** | **67%** |

1) adjusted for the new confidence interval of 99.9 %

2019 for credit spread and migration risk in the banking book (CSRBB), which no longer constitutes a separate type of risk but is included in loan loss and market risks, as part of the economic perspective. As a result, the number of risk types for which separate limits are determined has been reduced from eight to seven.

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

Looking at correlation effects between material types of risk within the framework of the economic ICAAP perspective, Aareal Bank Group has prudently opted for aggregation of risk levels; accordingly, no risk-mitigating correlation effects are being taken into account. Where, for the purposes of calculating risk-bearing capacity, risks are measured on the basis of quantitative risk models, these have been based on a uniform confidence interval of 99.9 % since 1 January 2019. Until 31 December 2018, a value of 95 % had been applied.

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

A detailed monthly report provides information regarding the utilisation of individual limits for the material types of risk, as well as on the overall limit utilisation. These are being monitored as part of daily reporting. No limit breaches were detected during the period under review.

Utilisation of aggregate risk cover developed during the period under review as shown below.

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

### Stress testing

Stress testing, and the analysis of stress test results, form an additional focal aspect of our risk management system. This involves conducting stress tests for all material risks, using both historical parameters as well as hypothetical stress testing scenarios. To also be able to assess cross-relationships between the various types of risk, we have defined multi-factor stress scenarios, so-called "global" stress tests. For instance, the impact of the crisis affecting financial markets and the economy, which broke out in 2007, on individual types of risk and aggregate risk is analysed within the scope of a historical scenario. In the hypothetical scenario, current potential developments are derived from factors such as political developments, and are combined with significant macroeconomic deterioration. The stress testing methodology implemented also takes into account the impact of any risk concentrations. Stress scenarios are analysed both from an economic and a normative perspective, with the respective cross-relationships being taken into consideration – meaning that any economic risks which may materialise (from a normative view) over the analysis period being incorporated in the normative perspective, unless they are sufficiently covered already.

Aareal Bank Group uses a Brexit plan to monitor the impact on Aareal Bank's risk exposures and business activities. In this plan, the Bank has drawn up various options for action designed to minimise the impact upon the Bank.

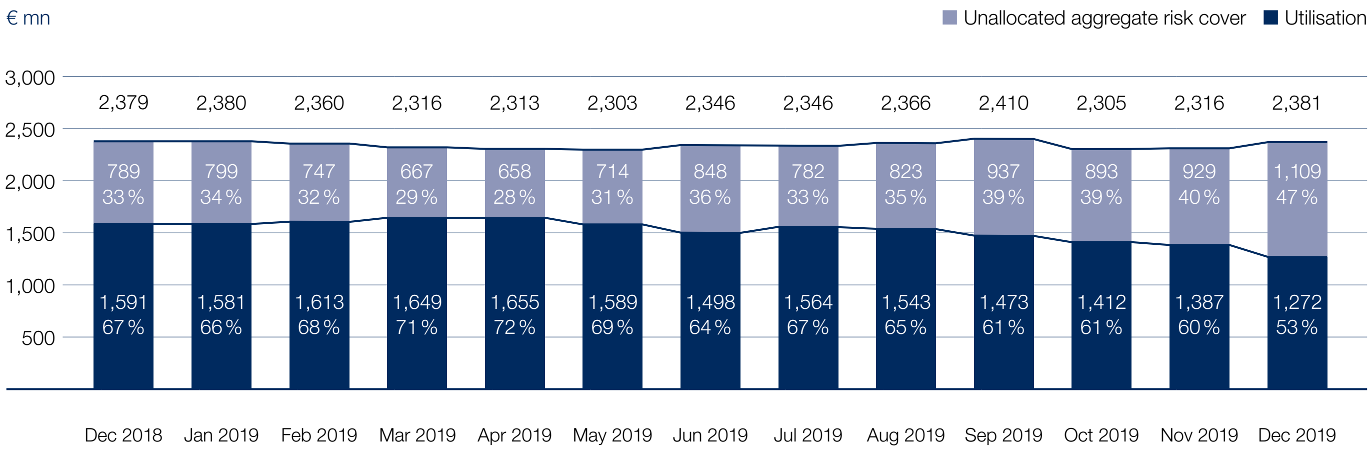
The Management Board and the Supervisory Board are informed of the results of stress analyses and the Brexit Plan on a quarterly basis.

### Lending business

#### Division of functions and voting

Aareal Bank Group's structural organisation and business processes consider regulatory requirements regarding the organisational structure and procedures in the credit business.

**Utilisation of aggregate risk cover during the course of 2019**



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

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

The RiskExCo, which has delegated authority to the heads of Risk Controlling, Operations, and Project & Credit Portfolio Management (which are independent of Sales units), is responsible for the approval of counterparty, issuer, or country limits. We have implemented and documented the clear separation of Sales and Credit Management processes across all relevant divisions.

### Process requirements

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

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

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

### Early risk detection procedures

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

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

A CRE Credit Risk Committee (CRC) has been established in order to enhance the Bank's procedures for the early detection of risks. The CRC promotes the risk culture by identifying and addressing risk-relevant issues concerning individual credit exposures; the committee is also involved in each credit exposure with mandatory rating that is subject to higher risk exposure. Specifically, the CRC decides upon the exercise of discretion regarding classification of exposures as ”normal”, ”intensified” or ”problem loan” handling, as well as approval of action plans. The transfer of know-how is enhanced through the cross-divisional representation on the CRC.

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

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

## Risk classification procedures

Aareal Bank employs risk classification procedures tailored to the requirements of the respective asset class for the initial, regular, or event-driven assessment of counterparty credit risk. The rating scales and exposure definitions have been customised to match the respective methods. Responsibility for development, quality assurance, and monitoring implementation of risk classification procedures, and for annual validation, lies with two separate divisions outside the Sales units.

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

### Property financing business

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

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

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

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

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

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

### Financial institutions

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

### Sovereign states and local authorities

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

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

## Trading activities

### Functional separation

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

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

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

The detailed assignment of responsibilities is outlined below.

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

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

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

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

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

### Process requirements

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

Change processes (as defined in section AT 8 of the MaRisk) are consistently measured via Group-wide framework directives, with the RiskExCo involved in all cases. Moreover, processes and systems are designed in a way that allows to incorporate new products into the risk monitoring system swiftly and adequately, in order to ensure the flexibility of the Sales units in their business activities.

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

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

## Loan loss risks

### Definition

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

### Credit risk strategy

Based on the Bank's overall business strategy, Aareal Bank's credit risk strategy sets out all material aspects of the Group's credit risk management and policies. The credit risk strategy serves as a strategic guideline for dealing with each respective category of risk within Aareal Bank Group; it also provides a binding, overarching framework applicable to all divisions.

The credit risk strategy will be reviewed, at least once a year, as to its suitability regarding the Bank's risk-bearing capacity and its business environment; amendments will be made as necessary. The associated process is instigated by senior management, and implemented by Risk Controlling, which submits a proposal, which has been agreed upon with all divisions to senior management. The Supervisory Board then duly acknowledges and approves the credit risk strategy adopted.

Designed in principle for a medium-term horizon, the credit risk strategy is adapted when necessary to reflect material changes in the Group's credit risk and business policies, or in the Group's business environment (as in the case of the financial markets crisis).

### Risk measurement and monitoring

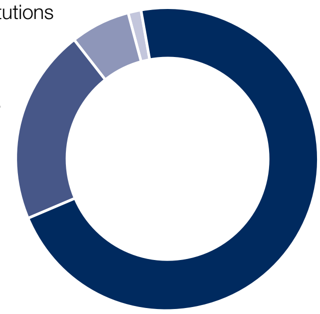
Regulatory requirements are taken into account for the organisation of operations and workflows in the credit and trading businesses.

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

Aareal Bank employs different risk classification procedures tailored to the requirements of the respective type of business for the initial, regular, or event-driven assessment of counterparty credit risk. Forward-looking as well as macro-economic information is taken into consideration for risk

**Breakdown of on-balance sheet and off-balance sheet business**

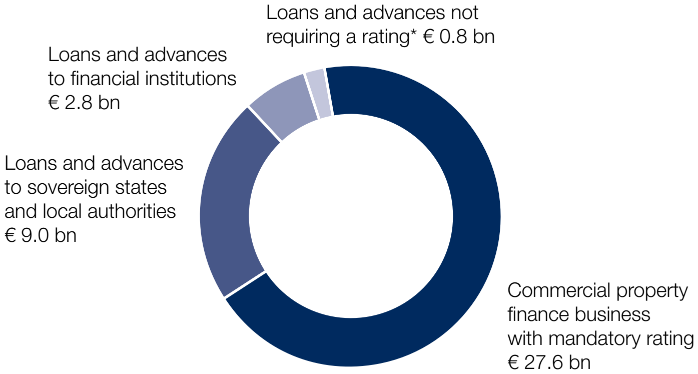
by rating procedure, € bn 31 Dec 2019




* Including the private client business of former WestImmo

**Breakdown of on-balance sheet and off-balance sheet business**

by rating procedure, € bn 31 Dec 2018




* Including the private client business of former WestImmo

classification procedures, and in the valuation of collateral. The respective procedures and parameters are subject to regular review and adjustment. Responsibility for development, quality assurance, and monitoring implementation of procedures, is outside the Sales units.

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

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

The tables on the following pages provide a breakdown of gross carrying amounts of on-balance sheet as well as off-balance sheet credit business, money-market business, and capital markets business, by rating class and loss allowance stages, in line with credit risk management at Group level. Figures are based on Aareal Bank Group's internal default risk rating classes. The default definition follows the definition pursuant to Article 178 of the CRR, which is decisive for management purposes. Qualitative default definitions were further refined during the year under review, without any material impact. Accelerated de-risking led to a reduction in defaulted commercial property finance business with mandatory rating by approximately € 0.6 billion.

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

Trading activities are restricted to counterparties for whom the requisite limits are in place. All trades are immediately taken into account for the purposes of borrower-related limits. Compliance with limits is monitored in real time by Risk Controlling. Persons holding position responsibility are informed about relevant limits and their current usage, regularly and without delay.

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

In summary, during the period under review, the existing set of tools and methods continued to enable the Bank to adopt suitable risk management or risk mitigation measures, where required, at an early stage.

## On-balance sheet commercial property finance business with mandatory rating

| | 31 Dec 2019 | | | | | 31 Dec 2018 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Stage 1 | Stage 2 | Stage 3 | fvpl [1] | Total | Stage 1 | Stage 2 | Stage 3 | fvpl [1] | Total |
| € mn | | | | | | | | | | |
| Class 1 | | | | | | | | | | |
| Class 2 | 62 | | | | **62** | 117 | | | | **117** |
| Class 3 | 430 | | | 2 | **432** | 255 | | | | **255** |
| Class 4 | 1,368 | | | | **1,368** | 1,486 | | | | **1,486** |
| Class 5 | 3,447 | | | 495 | **3,942** | 3,566 | | | 94 | **3,660** |
| Class 6 | 4,300 | 20 | | 64 | **4,384** | 3,966 | 21 | | 256 | **4,243** |
| Class 7 | 3,872 | | | 75 | **3,947** | 3,420 | | | | **3,420** |
| Class 8 | 6,051 | 35 | | 209 | **6,295** | 5,166 | 112 | | 181 | **5,459** |
| Class 9 | 2,936 | | | 56 | **2,992** | 3,463 | 42 | | 116 | **3,621** |
| Class 10 | 860 | 344 | | | **1,204** | 1,510 | 28 | | | **1,538** |
| Class 11 | 174 | | | | **174** | 285 | 91 | | 39 | **415** |
| Class 12 | 1 | 16 | | | **17** | 531 | 62 | | | **593** |
| Class 13 | | 60 | | | **60** | | 66 | | | **66** |
| Class 14 | | | | | | | | | | |
| Class 15 | | | | | | | | | 3 | **3** |
| Defaulted | | | 935 | 149 | **1,084** | | | 1,564 | 22 | **1,586** |
| Total | 23,501 | 475 | 935 | 1,050 | 25,961 | 23,765 | 422 | 1,564 | 711 | 26,462 |

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

## Off-balance sheet commercial property finance business with mandatory rating

| | 31 Dec 2019 | | | | | 31 Dec 2018 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Stage 1 | Stage 2 | Stage 3 | fvpl [1] | Total | Stage 1 | Stage 2 | Stage 3 | fvpl [1] | Total |
| € mn | | | | | | | | | | |
| Classes 1-2 | | | | | | | | | | |
| Class 3 | 22 | | | | **22** | | | | | |
| Class 4 | 25 | | | | **25** | 39 | | | | **39** |
| Class 5 | 63 | | | 17 | **80** | 32 | | | 6 | **38** |
| Class 6 | 117 | | | | **117** | 190 | | | 25 | **215** |
| Class 7 | 141 | | | 25 | **166** | 175 | | | | **175** |
| Class 8 | 271 | 4 | | | **275** | 312 | 5 | | | **317** |
| Class 9 | 101 | | | | **101** | 120 | | | | **120** |
| Class 10 | 34 | | | | **34** | 75 | | | | **75** |
| Class 11 | 1 | | | | **1** | 5 | | | | **5** |
| Class 12 | | | | | | 29 | | | | **29** |
| Classes 13-15 | | | | | | | | | | |
| Defaulted | | | 2 | | **2** | | | 78 | | **78** |
| Total | 775 | 4 | 2 | 42 | 823 | 977 | 5 | 78 | 31 | 1,091 |

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

## On-balance sheet loans and advances to financial institutions

| | 31 Dec 2019 | | | | | 31 Dec 2018 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Stage 1 | Stage 2 | Stage 3 | fvpl[1] | Total | Stage 1 | Stage 2 | Stage 3 | fvpl[1] | Total |
| € mn | | | | | | | | | | |
| Class 1 | 815 | | | | **815** | 1,242 | | | | **1,242** |
| Class 2 | | | | | | 32 | | | | **32** |
| Class 3 | 172 | | | | **172** | 15 | | | | **15** |
| Class 4 | 82 | | | | **82** | 85 | | | | **85** |
| Class 5 | 49 | | | | **49** | 514 | | | | **514** |
| Class 6 | | | | | | 100 | | | | **100** |
| Class 7 | 836 | | | | **836** | 387 | | | 35 | **422** |
| Class 8 | 417 | | | | **417** | 284 | | | | **284** |
| Class 9 | 35 | | | | **35** | 16 | | | 43 | **59** |
| Class 10 | 26 | | | | **26** | 25 | | | 26 | **51** |
| Classes 11-18 | | | | | | | | | | |
| Defaulted | | | | | | | | | | |
| **Total** | **2,432** | **–** | **–** | **–** | **2,432** | **2,700** | **–** | **–** | **104** | **2,804** |

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

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

| | 31 Dec 2019 | | | | | 31 Dec 2018 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Stage 1 | Stage 2 | Stage 3 | fvpl[1] | Total | Stage 1 | Stage 2 | Stage 3 | fvpl[1] | Total |
| € mn | | | | | | | | | | |
| Class 1 | 2,505 | | | | **2,505** | 2,621 | | | | **2,621** |
| Class 2 | 2,680 | | | 65 | **2,745** | 2,666 | | | 76 | **2,742** |
| Class 3 | 739 | | | 67 | **806** | 797 | | | 70 | **867** |
| Class 4 | 100 | | | | **100** | 145 | | | 32 | **177** |
| Class 5 | 176 | | | | **176** | 239 | | | 62 | **301** |
| Class 6 | 262 | | | | **262** | 436 | | | | **436** |
| Class 7 | 189 | | | | **189** | 163 | | | 105 | **268** |
| Class 8 | 6 | | | | **6** | | | | | |
| Class 9 | 925 | 125 | | | **1,050** | 711 | 805 | | 89 | **1,605** |
| Classes 10-20 | | | | | | | | | | |
| Defaulted | | | | | | | | | | |
| **Total** | **7,582** | **125** | **–** | **132** | **7,839** | **7,778** | **805** | **–** | **434** | **9,017** |

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

### Credit risk mitigation

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

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

Mortgage lending values or fair values are set or determined in accordance with the responsibilities for decision-making on lending, and form an integral part of the lending decision. The values to be determined by the Bank are generally pegged on the valuation prepared by a valuer, which is subject to an internal plausibility check. Any diverging assessment must be substantiated in writing. In any case, the market and mortgage lending values determined by the Bank must not exceed the values assessed by independent internal or external valuers.

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

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

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

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

### Credit risk mitigation for trading activities

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

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

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

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

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

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

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

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

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

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

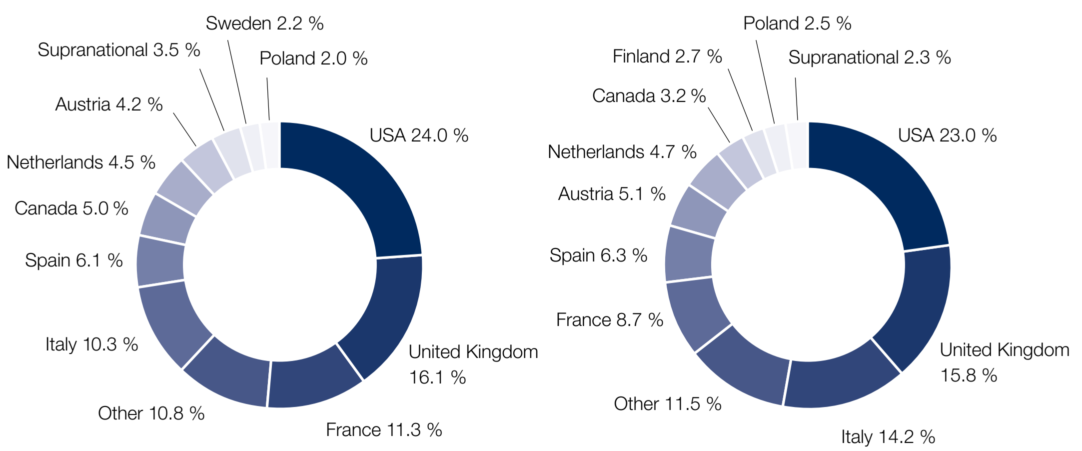
### Country risks

Our comprehensive approach to risk management also includes measuring and monitoring country risk exposure. When defining country risk, in addition to the risk of sovereign default or default of state entities, Aareal Bank also considers the risk

**Breakdown of country exposure in the international business**

%

31 Dec 2019 | 31 Dec 2018



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

The diagram on page 70 illustrates the risk exposure by country (comprising receivables and off-balance sheet obligations) in the Bank's international business, at year-end. In the property financing business, country exposures are allocated by location of the property used as collateral. For exposures not collateralised by property, the allocation is based on the borrower's country of domicile. This reflects the exposure of the property finance business, as well as the activities of Treasury.

## Interest rate risk in the banking book

### Definition

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

Specifically, for Aareal Bank this includes:

- risks arising from maturity transformation in the event of yield curve shifts (so-called gap risk), which, in turn, are broken down into:

  – risks from cash flows which are sensitive to interest rates, relative to the general yield curve (interest rate risk or repricing risk);

  – risks arising from the valuation of future cash flows, relative to the general yield curve (yield curve risk);

- risks from cash flows which are sensitive to interest rates, in terms of spreads to the general yield curve (basis risk);

- risks from explicit and implied options (option risk);

- risks arising from changing valuation of pension liabilities (pension risk);

- risks from fluctuations in the value of fund assets (fund risk); and

- risks from changes in Aareal Bank's specific funding spreads (funding risk).

### Risk measurement and monitoring

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

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

A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. Determined on a daily basis for the Group and all its operating units, the VaR figure takes into account the correlation between individual risk types. Statistical parameters used in the VaR model are calculated directly from a 250-day historical data pool maintained within the Bank. The loss potential is determined applying a 99.9 % confidence interval under the economic perspective.

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

#### Interest rate sensitivity

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

#### Present-value impact of an interest rate shock

The tables beside show the changes in present value as prescribed by BaFin circular 06/2019, applying EBA guidelines EBA/GL/2018/02 on controlling interest rate risk in the banking book (IRRBB).

The standard test prescribed therein outlines present value changes in the banking book in the event of a maximum 200 basis point parallel shift for each currency. As in the previous years, the ratio of the aggregate results to Aareal Bank Group's regulatory capital is clearly below the prescribed threshold of 20%.

Furthermore, present value changes are determined (and their ratio to Tier I capital shown) for six early-warning indicators, applying the prescribed scenarios. The ratio of the aggregate result to Aareal Bank Group's Tier I capital is clearly below the prescribed threshold of 15 %.

### Changes in present value

| | 31 Dec 2019 | | 31 Dec 2018 | |
|---|---|---|---|---|
| | -200 bp | +200 bp | -200 bp | +200 bp |
| € mn | | | | |
| EUR | 37 | 5 | -140 | 204 |
| GBP | -20 | 21 | -12 | -12 |
| USD | -28 | 18 | -10 | -10 |
| Other | -13 | 8 | -12 | -12 |
| **Total** | **-24** | **52** | **-174** | **170** |
| **Percentage ratio to regulatory capital** | **0.7** | **1.6** | **5.3** | **5.2** |

| | 31 Dec 2019 |
|---|---|
| € mn | |
| Parallel shock up | -30 |
| Interest rate coefficient for parallel shock up (%) | 1.2 |
| Parallel shock down | 52 |
| Interest rate coefficient for parallel shock down (%) | 2.1 |
| Steepener shock | 38 |
| Interest rate coefficient for steepener shock (%) | 1.5 |
| Flattener shock | -44 |
| Interest rate coefficient for flattener shock (%) | 1.8 |
| Short rates shock up | -40 |
| Interest rate coefficient for short rates shock up (%) | 1.6 |
| Short rates shock down | 51 |
| Interest rate coefficient for short rates shock down (%) | 2.0 |
| **Tier 1 (T1) capital** | **2,491** |

## Market risks

#### Definition

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

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

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

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

Various risks previously shown under CSRBB have been included under market risks upon introduction of the economic perspective for risk-bearing capacity under the ICAAP. Specifically, for Aareal Bank this includes:

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

Risks from the rating migration of loans (migration risk), previously also included in CSRBB, are now part of credit risks. To differentiate spread risks (credit spread risk and sovereign risk) in terms of their credit risk exposure, reported market risk is adjusted accordingly.

### Risk measurement and monitoring

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

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

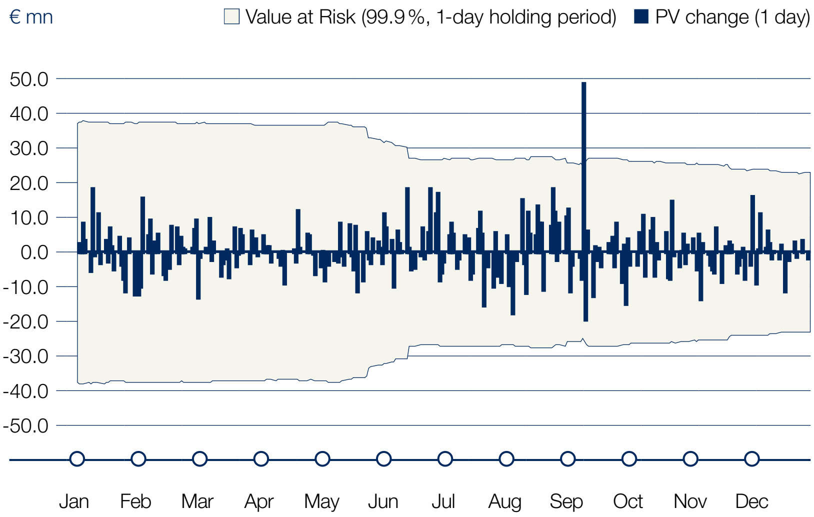
A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. Determined on a daily basis for the Group and all its operating units, the VaR figure takes into account the correlation between individual risk types. Statistical parameters used in the VaR model are calculated directly from a 250-day historical data pool maintained within the Bank. The loss potential is determined applying a 99.9 % confidence interval.

Furthermore, in addition to the risk category limit, a separate trading limit has been determined for Aareal Bank AG, as an institution authorised to maintain a trading book.

### Backtesting

The quality of forecasts made using statistical models is checked through a monthly backtesting process. The quality of the statistical procedure used to measure risk is checked using a binomial test, whereby daily profits and losses from market

**Presenet values and 1-day VaR during the course of 2019**



fluctuations are compared with the upper projected loss limit (VaR) forecast on the previous day (known as "clean backtesting"). In line with the selected confidence level of 99.9 %, only a small number of events are expected to break out of the VaR projection (≤ 1 for a 250-day period).

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

No negative outliers were observed at Group level during the past 250 trading days, affirming the high forecasting quality of the VaR model we use.

## Operational risks

### Definition

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

### Risk measurement and monitoring

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

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

- Self-assessments: analysis thereof can provide management with indicators of any potential risks within the organisational structure.

- Risk inventories that include a periodic systematic identification and compilation of all relevant risks.

- A loss database, in which relevant damages incurred are reported, and in which they can be monitored until they are officially closed.

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

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

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

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

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

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

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

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

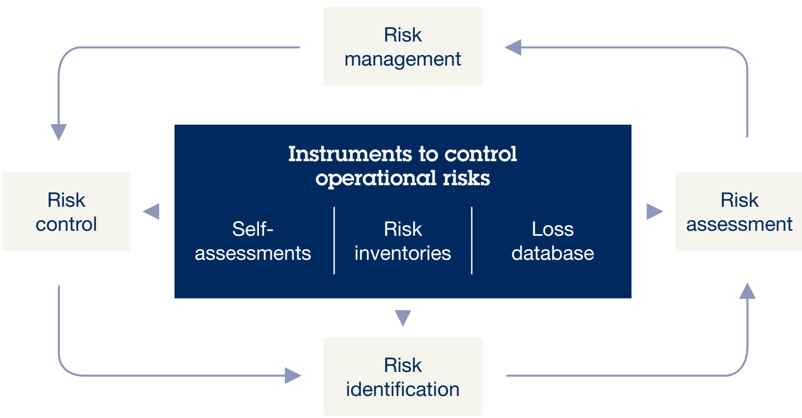
Tools to control operational risk are supplemented by a system to manage and monitor outsourced activities and processes (outsourcing), whereby the relevant organisational units regularly assess the performance of outsourcing providers, using defined criteria. The results of this process, and actions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

## Investment risks

### Definition

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

### Management of operational risks




### Risk measurement and monitoring

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

The existing procedures used to measure and monitor risk exposure are supplemented by subjecting the equity portfolio to regular stress testing. Strategy Development, as well as Finance & Controlling and Risk Controlling, are responsible for measuring and monitoring investment risk exposure.

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

## Property risks

### Definition

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

Due to the special character of property risk (involving marketing risks, for example), special methods and procedures are employed to deal with investment risk. All relevant property holdings are subject to regular audits, including a review and assessment of their risk situation. Property risks increased during the period under review, as a result of the acquisition of property SPVs from former credit exposures to Italy.

### Risk measurement and monitoring

In order to measure and monitor risks, property yields are analysed for different regions, and over the time horizons available: on this basis, potential yield increases over a one-year horizon are determined applying a 99.9 % confidence interval. The loss in a property's value results from the difference between the current market value and the property value adjusted for the yield increase.

## Business and strategic risks

### Definition

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

### Risk measurement and monitoring

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

Investment risk is measured across segments: it is quantified assuming that additional upfront investment is required to establish an investment opportunity which was previously unavailable. Such upfront investment is assumed to represent potential risk.

## Liquidity risks

### Definition

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

### Risk measurement and monitoring

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

#### Cash flow forecast

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

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

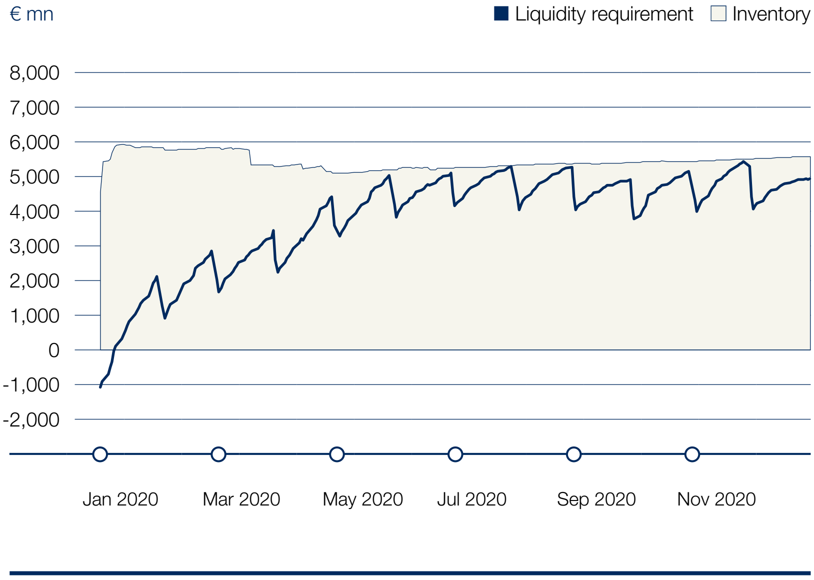
### Stress testing
Moreover, we employ stress tests and scenario analyses to assess the impact of sudden stress events onto the Bank's liquidity situation. The various standardised scenarios used are evaluated on the basis of the liquidity run-off profile.

We generally consider the withdrawal of deposits from the housing industry as the most significant scenario. Even in this stress scenario, liquidity is sufficient to cover the expected liquidity needs under stress conditions.

### Time to illiquidity
To safeguard adequate liquidity beyond the three-month horizon covered by the liquidity run-off profile, we use the concept of time to illiquidity as a parameter. For this purpose, a liquidity run-off profile was developed which compares liquidity requirements occurring with the liquidity stock, for a one-year period. Time to illiquidity ("TtI") denotes the remaining period (expressed in days) during which Aareal Bank Group can be regarded as sufficiently liquid, even under adverse conditions. In other words, liquidity requirements (including security add-on for adverse future events) do not exceed the liquidity stock.

The calculations are based on contractual cash flows and the short-term risk assessment methodology (liquidity run-off profile), as well as the portfolio development within the current plan scenario.

The following chart shows the projected development of the liquidity stock, together with aggregate liquidity requirements (incorporating planned portfolio developments, and including security add-ons for adverse future events) until the end of 2020. The chart demonstrates that the liquidity stock will always exceed liquidity requirements, even under adverse conditions.

### Liquidity development



Further details are provided in the comments on the Bank's liquidity in the section on the "Financial position".

### Funding profile
Diversifying the Bank's refinancing profile by type of investor, and by product, represents a further key aspect of our approach to liquidity risk management. Core sources of funding such as customer deposits and funds invested by institutional clients – alongside covered and uncovered bond issues – constitute the foundation of our liability profile. In this context, we refer to the comments regarding the breakdown of funding between money markets and capital markets, as set out in the description of financial position.

### Concentration limits
Besides the pure measurement of risk indicators, we also monitor concentrations of liquid assets and of funding sources, determining the percentage

share of the ten largest counterparties and/or positions, relative to the total portfolio.

A limit is set for each indicator in order to restrict the dependency upon individual positions or counterparties.

#### LCR forecast

We have developed the LCR forecast as a measurement tool designed to ensure that we maintain compliance with the regulatory Liquidity Coverage Ratio. A preview of the Liquidity Coverage Ratio is calculated over a horizon of up to three years, determining the ratio of highly liquid assets to cumulative net cash outflows for various end-of-month dates – thus identifying any potential liquidity shortfalls or reserves.

#### NSFR forecast

The NSFR forecast, which is a projection of the Net Stable Funding Ratio over a period of up to three years, represents another important component of our liquidity management. This measurement tool allows us to forecast the regulatory Net Stable Funding Ratio for future dates, thus identifying any potential liquidity shortfalls or reserves in terms of the NSFR at an early stage.

## Accounting-Related Internal Control and Risk Management System

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

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

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

### Organisation of the accounting-related ICS and RMS

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

Aareal Bank prepares its financial statements in accordance with the German Commercial Code (Handelsgesetzbuch – "HGB"), and its consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs) as applicable in the European Union. The Finance & Controlling division controls accounting processes and is responsible for ensuring conformity with legal requirements, as well as with any further internal and external provisions. The accounting-related requirements that have to be applied are documented in guidelines. Furthermore, the Finance & Controlling division is responsible for developing IT guidelines.

During the period under review, Aareal Bank fully migrated large parts of its core banking system, including the general ledger and sub-ledgers for loans, investments, creditors and debtors to SAP S/4 HANA, the latest SAP software version. In addition to enhanced processing speed, the Bank thus benefits from innovative functions, and from simpler and more efficient systems maintenance.

For the consolidated financial statements in accordance with IFRSs, the companies that form part of the Group create an IFRS package as at the respective reporting date. This includes financial statements prepared under IFRSs and in accordance with the IFRS Group Accounting Manual, as well as the Notes and consolidation information (intercompany balances). All packages are recorded by the Finance & Controlling division in a consolidation software and aggregated for the purpose of preparing the consolidated financial statements.

The Supervisory Board is responsible for monitoring the Management Board. Within the scope of financial reporting, it approves the single-entity financial statements of Aareal Bank AG as well as the consolidated financial statements and group management report Measures taken by the Supervisory Board to ensure an efficient performance of its control functions include the establishment of an Audit Committee, which is primarily responsible for financial reporting issues and monitors the effectiveness of Aareal Bank's Internal Control System. It analyses and assesses the presented financial statements and internal risk reports as well as the annual report submitted by Internal Audit. In addition, the Audit Committee is responsible for determining the focal points of the audit, as well as for evaluating the auditors' findings. The Audit Committee includes an expert in the fields of accounting or auditing, pursuant to section 100 (5) of the German Public Limited Companies Act (Aktiengesetz – "AktG").

Internal Audit also assumes a monitoring function not related to the process. It reports directly to the Management Board, and provides auditing and consulting services which are designed to optimise Aareal Bank's business processes with regard to accuracy, safety and efficiency. The Internal Audit division supports the Management Board by evaluating the effectiveness and appropriateness of the process-dependent Internal Control System and of the Risk Management System in general. Any detected weaknesses regarding the identification, evaluation and reduction of risks are reported and addressed within the context of specific action plans.

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

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

## Components of the accounting-related ICS and RMS

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

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

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

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

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

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

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

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

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

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

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

## Report on Expected Developments and Opportunities

### Macro-economic environment

Developments for the economy, as well as for financial and capital markets, are exposed to diverse major risks and threats – which also have an impact on the commercial property markets. The economic forecast is defined by significant uncertainty. The key factors in this regard relate to geopolitical risks, protectionist economic policy and a less dynamic economy.

Sudden or excessive changes in interest rates may trigger revaluations and changes in investor behaviour, potentially leading to a decline in asset prices arising from a change in capital allocation. Emerging economies in particular will have to face capital outflows, and may have to raise their own interest rates. The economies were rendered vulnerable due to the protracted period of low interest rates caused by a lack of effort to reform and consolidate and increased levels of private debt. On the other hand, a longer-lasting period of low interest rates complicates an exit from such an environment, heightening the risks for the financial and capital markets. In this context, traditional central bank policy may lose its impact.

Protectionist measures, particularly those adopted by the US, pose a threat to both economic performance and the financial markets. An open trade war cannot currently be ruled out this year (it has already started in part), which, in addition to the reduction in trade in goods and services, could also cause turbulence on the financial markets.

Geopolitical conflicts can also cause shock jumps, in for example the price of oil, which can lead to a recession in less robust economic conditions.

The rapid spread of the coronavirus at the beginning of 2020 might have a negative impact upon many economies, and thus on the development of Aareal Bank Group's business and profitability for the full year, and perhaps beyond.

However, the political shift away from European cohesion not only represents the greatest threat for the EU but for Europe too. This is substantiated by Brexit, regional pro-secession efforts for example in Catalonia, and in particular by nationally focused governments in Central and Eastern Europe. This could also have a negative impact on the economy.

Higher and, in parts, continuing high levels of indebtedness in combination with a lack of reform efforts pose further risks in many countries and regions. In this context, changes in monetary policy may have a negative impact upon market confidence, triggering crises. Furthermore, private debt has risen considerably, especially in the emerging markets, and could lead to market corrections and systemic crises.

## Economy

Global economic growth in 2020 is expected to be lower than in 2019. However, the weak economic phase from the second half of 2019 is expected to persist until mid-year 2020. The second half of the year will likely benefit from an expansionary monetary and financial policy. Survey-based indicators currently suggest that the economic weakness should bottom out in 2020. In view of the information to hand, a recession in 2020 is not predicted up to now, even though it cannot be ruled out entirely.

We expect real gross domestic product in the euro zone to grow by around 0.8 % in 2020. This is 0.4 percentage points lower than in 2019, which we view as being a noticeable decline. This is implied by survey-based indicators and expectations of lagging effects, for example on the labour market, but the global effects of the coronavirus are also expected to have a negative impact.

We expect an economic growth of 1.0 % in the UK for the current year. Supported by fiscal and monetary policy, quarter-on-quarter growth in the current year should improve gradually. However, the unregulated relationship with the EU will inhibit further positive developments. Of importance here is whether the prospect of a trade agreement with the EU at the end of the year or unregulated trade relations for the end of the transition phases will be the most likely development.

Real economic growth of 1.6 % is expected in the US in 2020. Consumer spending will support growth, with the contribution made by investments and trading playing a somewhat lesser role. Economic growth of 1.2 % for the current year is expected in Canada.

In China, we expect economic growth of 5.4 % in the current year, negatively impacted by the coronavirus pandemic. The risks arising from the trade conflict with the US are likely to ease, which should stabilise growth. However, the high levels of corporate debt represents a risk for future economic development. In addition, the coronavirus pandemic may further dampen growth.

Real economic growth of 1.9 % is expected in Australia in 2020. Growth in 2020 is burdened by lower commodity prices, slower credit growth and lower expectations of tourism due to the long-lasting bush fires.

## Financial and capital markets, monetary policy and inflation

These risks and uncertainties listed above are also impacting on financial markets in the current year. Were they to materialise to a significant extent, they might cause turbulence on capital markets as well. Under these conditions, volatility is expected to be higher overall than the year before. We continue to believe that the financial markets will remain receptive towards refinancing and new securities issues.

With the relaunch of its asset purchase programme, the ECB will remain on an expansionary path. Even the change at the head of the ECB will not lead to any fundamental changes. In the US, the Fed could respond to low inflation and economic growth below the previous year's level by cutting the key interest rate once more. In the UK, the Bank of England has tied its monetary policy orientation to the effects of Brexit. As the uncertainties persist, further interest rate increases are not expected in 2020.

Changes to monetary policy and economic weakness would tend to lead to a decline in long and short-term interest rates. However, as the central bank measures will be less powerful than in the past, long and short-term interest rates are likely to remain stable in 2020. On the other hand, short-term interest rate in the US are likely to be lower at the end of the year, as the FED's purchase programme is aimed more at the short-term interest rate corridor.

Inflation could rise overall by a few basis points in 2020, not least due to higher energy prices. Geopolitical risks, e.g. in Iran, can impact on oil prices and hence on inflation to a certain extent. Lower economic momentum is likely to cap the increase in the relevant currency areas.

### Regulatory environment

The trend towards a tighter regulatory framework in the banking business is set to persist during the coming years. For instance, the finalisation of the Basel III framework, adopted by the Basel Committee's Group of Governors and Heads of Supervision (GHOS), will bring about extensive changes to the approaches used for determining risk-weighted capital requirements (a concept known as "Basel IV").

The new requirements of CRR II, CRD V and BRRD II were also finalised and still have to be transposed into national law, where relevant. In addition, EBA has passed guidelines on PD and LGD estimates, the treatment of risk exposures, and the determination of downturn LGDs – which will need to be implemented.

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

The requirements are supplemented at a European level by another MaRisk amendment at national level, which is awaiting consultation in 2020.

Furthermore, supervisory authorities are increasingly focusing on the topic of sustainable finance – not least due to BaFin's Guidance Notice on Dealing with Sustainability Risks.

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

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

## Sector-specific and business developments

### Structured Property Financing segment

Demand for commercial properties will vary in 2020, depending on the region and property type. A shortage of top-class properties, along with reticence among different investors to invest in specific markets (such as the UK with a view to the trade relations that still exist with the EU) or in specific property types (such as retail, with regard to the changes brought about by online trading, among other things), will make itself felt in global transaction volumes. These are unlikely to exceed the previous year's levels.

Commercial property markets, as well as the economy, are exposed to major risks and threats. Besides economic influences, individual shifts in the interest rate environment can have a negative impact on market values. Moreover, other uncertainty factors and risks in the macro-economic environment are also relevant for commercial property markets.

Several factors will influence the market value of commercial property over the course of the year. While the economy and historically low interest rates are likely to support property values, political uncertainty, economic downturns or investor reticence can have an adverse effect on values. Despite the persistent economic cycle, the market cycle is still intact, therefore also potentially leading to cyclical downturns in the commercial property market.

Based on the conditions described above, we therefore anticipate a largely stable development[1)] on average of ± 2.5 % in the market values of commercial property in many markets this year.

We expect a stable development of market values of ± 2.5 % in 2020 in most European countries, such as Finland, France, Germany, the Netherlands, Poland, Russia and Sweden. For Spain, on the other hand, we consider positive growth 2.5 % to be possible. Uncertainties persist in the UK due to the as yet unresolved issue surrounding the contractual relations with the EU at the end of the transition period. An exit with a quick solution should have a positive effect on market values, while a protracted and unclear process would likely drive down market values by more than 2.5 %. Political uncertainty in Italy could have a negative impact on property values. Despite the stable development overall, we could see declining values in some European sub-markets or for some property types.

We assume property values in the US will remain stable at ± 2.5 % on the whole. A stable performance of ± 2.5 % 2020 also looks likely for Canada in 2020.

In Australia and China, stable market values of ± 2.5 % on average for commercial property are expected.

These developments should also tend to apply to office and logistics properties. The performance of retail property on average could be negative overall.

As was the case last year, the European hotel markets are for the most part expected to report positive growth in average revenues per available room. Occupancy rates in most markets are expected to be higher, historically.

Some market participants expect a less dynamic economy to lead to stagnating (or falling less than 1 %) occupancy rates and average room rates on the US hotel market. In Canada, the stable development of average revenue per available room is likely to continue. As we see it, the risk of a decline is a more likely prospect than an increase due to lower year-on-year economic growth. The increase in the number of rooms available should also lead to a further decline in the occupancy rate.

For the Asia/Pacific region, we anticipate occupancy ratios and average revenues per available room for 2020 as a whole to remain in line with the previous year in the hotel markets of many metropolitan areas.

The competition for commercial property financing, which is described as intense, is likely to persist on many markets this year, whereby we consider the readiness of lenders to reduce their margins as a given, even though a plateau might be about to emerge, particularly in Europe. Banks are expected to continue adhering to their preference for financing first-class properties in prime locations with stable loan-to-value ratios.

We have incorporated various market aspects and our business strategy, which are reflected in the motto of "Aareal Next Level", in our assessment of anticipated new business volumes for the current year. For the Structured Property Financing segment, we are targeting new business of between € 7 billion and € 8 billion for the 2020 financial year, whereby the focus is set to remain on the higher-margin US market and Western Europe. Aareal Bank Group's property financing portfolio should amount to between € 26 billion and € 28 billion at the end of 2020, subject to currency fluctuations. To manage our portfolio and risk exposure, we also use syndications which facilitate larger-sized financing solutions.

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

[1)] The performances of individual property types or of individual markets and sub-markets may deviate from the expectations referred to above.

## Consulting/Services segment

### Bank division Housing Industry

The German housing and commercial property industries are expected to continue showing solid development in 2020, on the back of rising rental income and a high degree of stability in property values.

The companies will continue to optimise and develop existing portfolios, driven especially by political and socio-political aspects, such as refurbishing buildings to make them suitable for the elderly, district development or the significantly underdeveloped urban centres. The demands of climate protection targets for Germany and the decisive bearing on the property industry to achieve them is putting serious demands on resources. The fact that the necessary investments are not economically feasible is posing a problem and will lead to political tension in the years ahead. Political decisions and their impact on the profitability of the measures, as well as greater expectations of the energy retrofitting ability and increasing regulatory requirements may be affecting future corporate investment activities.

The stable development on the residential property market is expected to prevail in 2020. Regional differences are likely to increase further. Due to the ongoing urbanisation trend, we expect demand for apartments to rise further, especially in economically strong conurbations. Property investors and potential sellers within the housing and commercial property industries should continue to benefit from these market developments.

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

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

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

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

### Aareon

Aareon will continue in 2020 to pursue the growth strategy based on its strategy programme integrated in Aareal Bank's strategic orientation. Overall, sales revenue is expected to rise significantly.

Aareon expects a slight increase in sales revenue in the ERP business, anticipating new customer gains and an increasing business volume with existing clients to contribute. Various customer projects will be rolled out in 2020, thus generating higher revenues from maintenance and SaaS. Overall, a shift from licence revenues to recurring revenues continues to be expected, due to the increased conclusion of maintenance and SaaS contracts. The new cloud-based Tobias 365 ERP product generation in the Netherlands will lead to a decline in the revenues to be realised with this product, as migrations from the formerly in-house to the cloud solution will result in a shift in revenues to the future. This effect will be felt especially in 2020 and 2021, but will lead to higher revenues in the future. The migration business in Germany will ease slightly and the business with existing clients will continuously be driven forward. As at 31 December 2020, most clients using the GES product will have migrated to Wodis Sigma or SAP® solutions and BlueEagle. Sales revenue in the energy utility market is expected to rise sharply. Developing further capacity should allow more projects to be implemented. Marked increases are also expected in the commercial property market. Additional customer acquisition is expected in the DACH region with the RELion products and in the Netherlands with REMS.

The digital solutions are the main drivers of organic sales growth in Aareon. Besides the organic sales growth through further market penetration with existing and new solutions, the acquisition of the CalCon Group as at 1 January 2020 will lead to a significant increase in digital solutions revenue. Furthermore, Aareon plans to make further significant investments in expanding its range of digital solutions related to new technologies, and to participate in the start-up scene, to accelerate organic growth. Aareon expects the first sales revenues from these measures in 2020. The CRM (customer relationship management) and WRM (workplace relationship management) products from the existing portfolios will contribute primarily to these. There is still very strong demand among clients to digitalise their processes.

Based on the explanations outlined above, Aareon envisages a marked overall increase in sales revenue to between € 272 million and € 276 million (2018: € 252 million). The company estimates an adjusted EBITDA[1)] in a range of 68 million to € 71 million (2018: € 64 million). We have adjusted the performance indicator in line with a standard target figure often applied to software companies within the scope of developing a value proposition independently of Aareal Bank.

### Business strategy

Aareal Bank Group's strategy focuses on sustainable business success. In an environment characterised by technological change, further growing regulatory requirements, altered client needs and fiercer competition, its aim is to secure the foundation while also leveraging new revenue potential. Following on from the "Aareal 2020" programme for the future, the medium-term strategic development process will continue under the motto of "Aareal Next Level". The general strategic orientation will continue – with large-volume, international commercial property financing on the one hand and consulting and services for the housing sector in Europe and related industries on the other. The individual business activities will be developed in a targeted manner, in order to sharpen their own independent profiles, accelerate the Group's growth overall and create value for the shareholders and other stakeholders.

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

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

### Group targets

Aareal Bank Group believes the market and competitive environment will remain challenging in the current year. It also expects ongoing political and economic uncertainties. No relief is to be expected either from regulatory pressures or from the low interest rate environment. As a result of the spread of the coronavirus and the efforts to combat it, considerable volatility and serious implications can currently be observed on the capital markets, but also in the overall economic environment. At present, it is impossible to assess to what extent these may influence the business and earnings development, hence they are not included in the forecasts.

We will – as stated in "Aareal Next Level" – introduce measures in the current year to stabilise and optimise the existing business, and will expedite investments in new products and in future growth.

We anticipate a slightly lower net interest income, compensated by a higher contribution from Aareon to net commission income, and thus overall stable net interest and net commission income (2019: € 762 million). Loss allowance is expected to decline to a risk cost level of just under 30 basis points (in terms of the property financing portfolio), and thus below the figure for 2019 (€ 90 million). Administrative expenses are expected to rise slightly year-on-year (2019: € 488 million), whereby the effects from Aareon's business growth are likely to more than offset lower expenses incurred by the Bank.

For the current year, we expect consolidated operating profit and a return on equity (before taxes) at similar levels compared to 2019 (€ 248 million and 8.7 %, respectively). The forecasts for loss allowance and operating profit do not include any effects from a potential, selective continuation of accelerated de-risking activities. Consolidated net income allocated to ordinary shareholders of Aareal Bank and earnings per share (EpS) are anticipated to be stable compared to the previous year's figures of € 145 million and € 2.42 – even considering possibly accelerated de-risking.

Assuming a more positive environment, the initiatives undertaken in the context of "Aareal Next Level" will permit to achieve RoE before taxes of around 12 % over the medium term.

As in the previous year, new business volume for the current year is expected to range between € 7 billion and € 8 billion. Subject to exchange rate fluctuations and market conditions permitting, the property financing portfolio will continue to remain in a range between € 26 billion and € 28 billion.

We are aiming for net commission income growth of 15 % year-on-year (2019: € 23 million) in the Bank's Housing Industry division segment, expecting an average deposit volume from the housing industry of € 10 billion to € 11 billion.

Aareon, which in future will be reported as an individual segment, is expected to increase its revenue by a low double-digit figure, to between € 272 million and € 276 million (2019: € 252 million), and generate an also higher adjusted EBITDA[1] of € 68 million to € 71 million (2019: € 64 million).

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 % fully phased to be appropriate. The CET1 ratio is expected to slightly exceed the target ratio at year-end.

## Remuneration Report

Remuneration is a key element of managing the business, and of managing risk. The remuneration strategy at Aareal Bank Group forms part of the Company's efforts to ensure that employees' remuneration is in line with market conditions and the performance achieved. At the same time, it helps to align the Group's remuneration intentions with cur-

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

rent regulatory requirements. When setting remuneration, Aareal Bank Group therefore pays attention to ensuring that the proposed remuneration motivates employees to achieve the Group's strategic business and earnings targets whilst remaining within the boundaries set by the Group's risk appetite and corporate values. Whilst good performance is remunerated accordingly (through a bonus), any breaches of internal or external rules are penalised through sanctions (penalties).

The Chairman of the Supervisory Board and Aareal Bank AG's shareholders discuss remuneration transparency and the remuneration system on a regular basis. To increase the transparency, the current Remuneration Report was revised. The Supervisory Board will continue to address potential adjustments to the remuneration system for the Management Board and related reporting, discussing it with major stakeholders.

## Remuneration system for the Management Board

### Overview

The Supervisory Board of Aareal Bank AG designs a remuneration system which provides incentives to Management Board members for achieving the Bank's strategic goals and targets, within the framework of the defined risk appetite, risk strategies and in line with the corporate and risk culture, and the values determined in the Code of Conduct. As a "significant institution" which is subject to direct supervision by the European Central Bank, Aareal Bank's scope in setting remuneration is subject to tight restrictions, pursuant to the specific regulatory requirements for banks, pursuant to the EU Capital Requirements Regulation (2013/575/EU), the German Banking Act (Kreditwesengesetz – KWG), and the German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – InstVergV).

### Remuneration structure

Total target remuneration comprises a fixed component (including ancillary benefits and contributions to retirement provisions) and a variable component, the structure of which is governed by law.

The amount of variable remuneration is based on previously agreed targets. The assessment period for target achievement must be at least three years long, adding a five-year deferral period for at least 60 % of variable remuneration, and – pursuant to section 20 (5) of the InstitutsVergV – 50 % of variable remuneration shall be disbursed into financial instruments used by companies, i. e., especially shares or share-based instruments to be held for a minimum period of one year. Aareal Bank uses virtual shares as such an instrument. This way, members of the Management Board participate in the Bank's development for up to six years. Performance of virtual shares is capped at 300 %.

Due to the target determination period of at least three years, all Aareal Bank's remuneration targets qualify as long-term incentives (LTIs). 50 % of the entire variable remuneration is paid in form of share-based instruments.

Aareal Bank cannot merely provision for a holding period for shares after the targets have been achieved – as the German Corporate Governance Code for instance recommends. Regulatory requirements mandate that 60 % of variable remuneration is retained. Taking the target determination period together with the deferral and holding periods, the actual amount of variable remuneration for a given financial year is determined over an aggregate period of nine years. Given this very long period, which is prescribed by regulations, the Supervisory Board has refrained from imposing any further conditions or disbursement modalities.

There is no need for an agreement requiring Management Board members to enter into any proprietary investments in Aareal Bank shares, since the Supervisory Board believes that the existing system meets the purpose of such an investment.

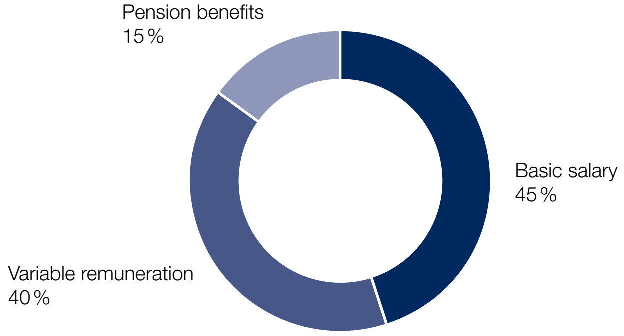
<table>
<tr><th>Remuneration element</th><th>Description</th><th>Reference to strategy and long-term development</th></tr>
<tr><td>Fixed remuneration elements</td><td></td><td></td></tr>
<tr><td>Fixed annual salary</td><td>– Fixed contractually agreed remuneration, paid monthly in the amount of 45 % of the target total remuneration of the Management Board members<br>– Chairman of the Management Board: € 1,425,000<br>– Ordinary Management Board members € 900,000<br>– Members of the Management Board for whom the so-called ”newcomer rule" applies: 80 % of an ordinary Management Board member's fixed annual salary</td><td rowspan="2">Guaranteeing the fixed income in the form of a fixed annual salary and ancillary benefits equivalent to scope and complexity of the business and the role and responsibility of the individual members of the Management Board, and competitive on the market.</td></tr>
<tr><td>Ancillary benefits</td><td>– Company car, which may also be used for private purposes or a flat rate payment if a company car is not opted for<br>– Group accident insurance<br>– Specific costs for security measures</td></tr>
<tr><td>Pension obligations</td><td>– Defined contribution commitment<br>– Annual contributions of 15 % of overall target remuneration of the Management Board members<br>– Members of the Management Board who were appointed prior to 1 January 2013 entitled to claim pension benefits as of the time at which they turn 60<br>– For members of the Management Board who were appointed after 1 January 2013: entitled to claim pension benefits as of the time at which they turn 62<br>– In the event of permanent disability, a Management Board member is entitled to claim benefits prior to turning 60 or 62, respectively</td><td>Granting of pension commitments for financial security in retirement and protection in case of death and disability that are in line with market requirements.</td></tr>
<tr><td>Variable remuneration elements</td><td></td><td></td></tr>
<tr><td></td><td>– 40 % of the Management Board members' total target remuneration<br>– The reference value for 100% target achievement amounts to € 1,250,000 for the CEO, and to € 780,000 for ordinary Management Board members<br>– Variable remuneration is determined via the achievement of targets strictly derived from the business and risk strategies (incl. ESG), and which are in line with Aareal Bank's corporate and risk culture<br>– Group (70 %), sectional (15 %) and individual (15 %) targets<br>– Performance measurement based on criteria whose performance is determined over a three-year period<br>– No discretionary components besides the targets derived from the strategy<br>– 80 % of the variable remuneration is paid out on a deferred basis (60 % must be retained for five years; 50 % each of deferred and non-deferred com-ponents are converted into virtual shares, to be held additionally for one year)<br>– Maximum overall target achievement level is capped at 150 % of the target value<br>– Maximum variable remuneration cannot exceed fixed remuneration</td><td>Provision of a variable remuneration on the basis of annual financial and non-financial performance criteria that are relevant for Aareal Bank AG's strategy.<br><br>Provides incentives to Management Board members for implementing the business priorities of Aareal Bank and to act in the interest of the long-term and sustainable positive business development. Group performance targets account for 70 % of overall target achievement, hence prioritising the entire Company's interest, including shareholder expectations.<br><br>By granting the variable remuneration, Aareal Bank meets the regulatory require-ments to which it is subject.</td></tr>
<tr><td>Other rules</td><td></td><td></td></tr>
<tr><td>Risk-bearing capacity</td><td>Before disbursing the variable remuneration, the Supervisory Board reviews it regarding its compatibility with the risk-bearing capacity.</td><td>Disbursing variable remuneration is not meant to threaten Aareal Bank's financial solidity.</td></tr>
<tr><td>Penalty and clawback</td><td>– All components of the variable remuneration are subject to penalty and clawback provisions.<br>– Admission of an adjustment to outstanding remuneration and/or clawback of remuneration already disbursed in case of clawback events.</td><td>Within the meaning of responsible and sustainable corporate governance, and for the purpose of implementing the regulatory requirements, penalty and clawback rules are a mandatory part of good corporate governance, which in turn is firmly enshrined in Aareal Bank's strategy.</td></tr>
</table>

By granting 50 % of variable remuneration in the form of virtual shares, together with the fact that variable remuneration – assuming a target achievement level of 100 % – is nearly equivalent to the fixed annual salary, Management Board members will have regularly earned virtual shares equivalent to a fixed annual salary level after three years. Given the long deferral periods and the holding periods, this is a value which they usually retain until the end of their term on the Management Board (cf. section "(Virtual) shareholdings of Management Board members **(share ownership)** and share-based remuneration").

Achievement of initial targets is regularly reviewed during the deferral period **(back-testing)**, and the level of target achievement originally agreed upon and, as a result, the amount of the variable remuneration is adjusted ex-post if necessary. Variable remuneration for a given financial year may be reduced in the event of inappropriate behaviour, or behaviour in breach of duties – in other words especially due to wilful breaches of internal or external rules, including Aareal Bank Group's Code of Conduct and the values determined therein. In the case of negative performance contributions, as defined in detail by the Supervisory Board, in the form of significant losses or material regulatory sanctions, variable remuneration must be reduced to zero **(penalty review)**. Where a portion of variable remuneration for such financial year has already been disbursed, this portion may be reclaimed on the basis of corresponding provisions in Management Board contracts **(clawback)**. Variable remuneration will no longer be paid in the event of any threats to the Bank's risk-bearing capacity, sufficient capitalisation or liquidity, or if certain minimum profitability indicators are not achieved.

**Management Board remuneration structure**

%




Pursuant to section 25a (5) of the German Banking Act (KWG), the variable remuneration must not exceed the fixed remuneration component for Management Board members, even in the event of maximum target achievement. The option of allowing the Annual General Meeting to approve higher variable remuneration corresponding to up to 200 % of the fixed remuneration component, as set out in section 25a (5) sentence 5 KWG, has not been used for the Management Board members.

The maximum overall target achievement level for determining performance-related, variable remuneration is additionally capped at 150 %. Hence, variable remuneration determined cannot exceed 150 % of the reference level.

The diagram below illustrates the ratio between the fixed and variable components of the remuneration of all members of the Management Board since the 2019 reporting year:

## Fixed remuneration component

The fixed remuneration component of a Management Board member consists of three components – the fixed annual salary, ancillary benefits, and contributions to retirement provisions.

### Fixed annual salary

Within Aareal Bank AG's corporate governance system, the members of the Bank's Management Board discharge operative functions in addition to their managerial duties. They prepare and implement strategic objectives in cooperation with their employees. Management Board members are remunerated in line with this comprehensive set of duties.

In order to prevent any motivation for Management Board members to enter into inappropriate risks, in accordance with Aareal Bank Group's risk culture, fixed remuneration accounts for a significant portion of the total remuneration package, which amounts to € 1,425,000 for the Chairman of the Management Board and to € 900,000 for ordinary Management Board members.

#### Ancillary benefits

Aareal Bank AG provides a company car to Management Board members, which may also be used for private purposes. Management Board members are covered by group accident insurance in case of death or invalidity. In addition, Aareal Bank AG bears the costs incurred for certain security expenses.

#### Pensions and retirement benefits

The benefit regulations as agreed in the service contract apply to the members of the Management Board. All members of the Management Board are granted a defined contribution commitment:

This amounts to € 464,000 p.a. for the Chairman of the Management Board, € 293,000 p.a. in general for ordinary members of the Management Board and thus accounts for 15 % of the target remuneration structure of the Management Board members.

Management Board members who were appointed prior to 1 January 2013 are entitled to claim pension benefits as of the time at which they turn 60. For members of the Management Board who were appointed on or after 1 January 2013, claims arise as of the time at which they turn 62. In the event of permanent disability, a Management Board member is entitled to claim benefits prior to turning 60 or 62, respectively.

The amounts are subject to a guarantee adjustment of 1 % p.a. The pension paid to widows amounts to 60 % of the pension of the member of the Management Board, while pensions to half-orphans and orphans amount to 10 % and not more than 25 %, respectively.

### Performance-related variable remuneration

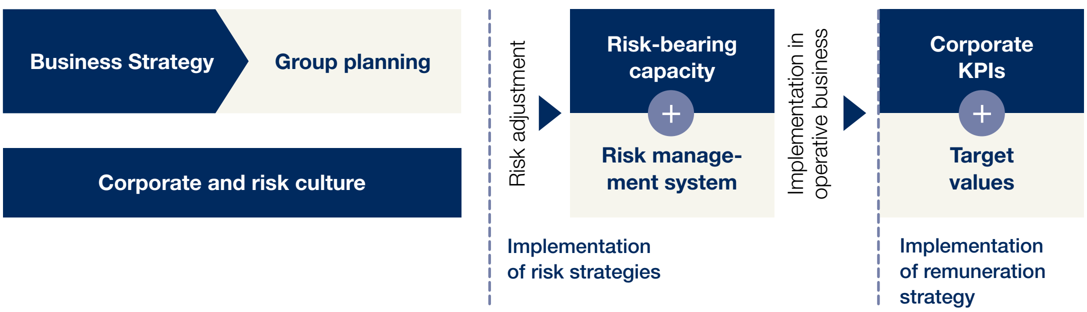
#### Remuneration and target derivation system

As a matter of principle, Aareal Bank derives remuneration targets from its strategic planning for the following years, which was already verified as to its compatibility with the corporate and risk culture, as well as with the Bank's risk strategies, and adjusted if necessary. Hence, the target parameters (KPIs) derived from the strategy are therefore geared towards the long-term and sustainable development of Aareal Bank Group – as opposed to short-term successes – and are thus aligned with the interests of shareholders, employees and other stakeholders.

#### Remuneration parameters (ex-ante risk adjustment)

A significant part of Aareal Bank's variable remuneration is governed by law: besides the general requirement – pursuant to the German Public

**Derivation of remuneration strategy, indicators, and target values**



Limited Companies Act (Aktiengesetz – "AktG") – that the remuneration system be focused on a sustainable company development, sections 19 and 20 of the German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – "InstVergV") require that target achievement be determined on the basis of at least three target levels, and over a minimum assessment period of three years. Accordingly, Aareal Bank AG's remuneration system for the Management Board provides for three target levels of:

- Group performance;
- sectional performance; and
- individual performance.

Target achievement for each target level is determined on the basis of a three-year assessment period.

All targets for Management Board members are geared towards achieving the long-term and sustainable objectives set out in the Bank's business and risk strategies **(pay-for-performance principle)**. To measure and monitor target achievement, KPIs are determined annually for the long-term and sustainable targets, and their degree of achievement is assessed at the end of the financial year. The target achievement level for each target level is thus determined by the respective KPI achievement of the past financial year and by the degrees of KPI achievement of the two previous financial years **(three-year assessment basis)**.

When setting targets, the Supervisory Board pays attention to defining ambitious yet realistic targets, which are in line with Aareal Bank's risk appetite as well as the corporate and risk culture. The targets comprise quantitative and qualitative components, which are also related to non-financial parameters. Annual target achievement is reported on an ex-post basis (cf. Remuneration of the Management Board, subsection Target achievement).

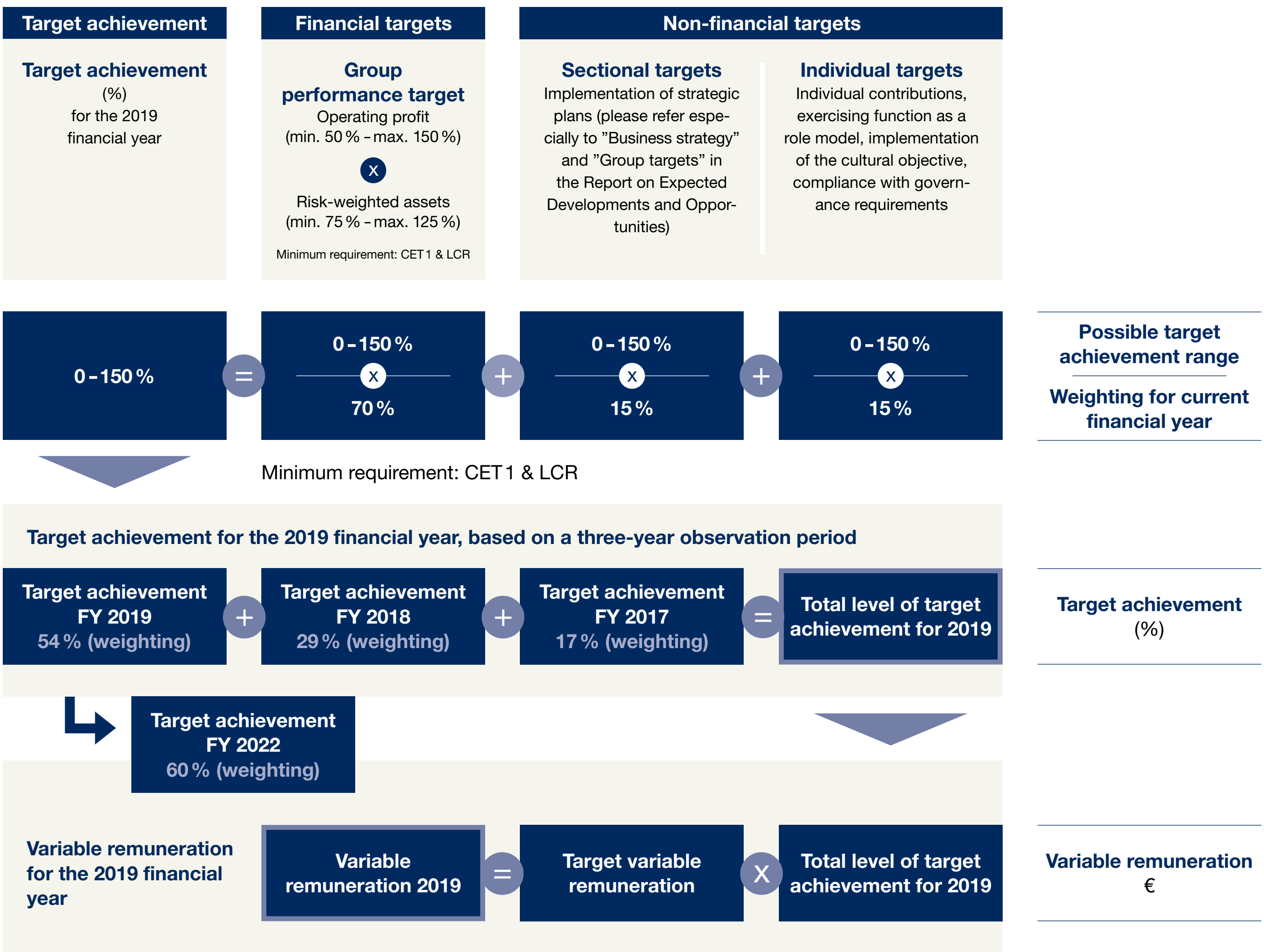
Amongst other things, the Company's interests are duly taken into account by the fact that **Group targets** are geared towards the KPIs used for corporate management purposes. Consolidated operating profit before taxes is generally chosen as an income target, whereas risk-weighted assets (RWAs) are used as a risk-adjusted target. Specific values are determined annually for both target components, which correspond to a 100 per cent target achievement. These targets at least complied with the corporate objectives communicated to the capital markets in the past, and will continue to do so in the future. The maximum achievement level for target consolidated operating profit is 150 %; for the RWA target, it is 125 %. The overall target achievement level is calculated by multiplying both target values; it is capped at a target achievement level of 150 %.

**Sectional targets** are related to the respective Management Board member's area of responsibility pursuant to the schedule of responsibilities. Accordingly, the Supervisory Board sets targets which the organisational units assigned to the respective Management Board members need to fulfil in order to achieve the strategic objectives of the Company as a whole. These targets may comprise income and budget targets, target values for specific risk indicators, or for implementation of key strategic projects. In line with Aareal Bank Group's management system, sectional targets for Management Board members responsible for Sales units comprise growth enhancement and development of main strategic fields of business and are measured, for example, by the level of specific property portfolio increases or the revenue generated with digital products. In accordance with Aareal Bank Group's risk management system, these income parameters must not exceed the risk appetite as determined by reference to certain limits; hence, there is no incentive to enter into inappropriate risks. Sectional targets for Management Board members responsible for central staff functions or control units are based on other indicators, such as the amount of the administrative expenses. Moreover, within the framework of sectional targets, all members of the Management Board are required to fulfil specific projects in order to implement the Company's strategy – such as projects for the digitalisation of processes and products, and other targets described in the (Group) Management Report (cf. Report on Expected Developments and Opportunities, chapters Business strategy and Group targets).

**Individual targets** refer to the Management Board members' individual performance; in this respect, Management Board members are required in particular to exercise their function as role models vis-à-vis staff and the general public (tone from the top). They also need to achieve material sustainability aspects, including organisational and cultural measures, contributing to more cooperation and thus to Aareal Bank's efficiency.

The business and risk strategies reflect the sustainability approach pursued by Aareal Bank with specific measures which the Supervisory Board requires the Management Board to implement. Hence, sectional as well as individual targets also include **ESG targets** (environmental, social, governance), which includes taking ESG opportunities, managing and reporting on corresponding risks, and developing specific ESG criteria to be considered in the core business. In its targets, Aareal Bank does not separately reflect compliance with statutory regulations, since adherence to internal and external provisions is deemed to be a necessary condition for confidential cooperation; as such, separate target-setting within the scope of variable remuneration is obsolete. Wilful breaches of internal

### Target achievement and variable remuneration for the 2019 financial year under review



and external rules may rather trigger a so-called penalty-triggering event which in turn can lead to variable remuneration no longer being paid at all, or even to an ex-post reduction or clawback of already granted deferred remuneration components.

### Performance measurement on individual target levels for the last financial year

The members of the Management Board are responsible – and epitomise – the Company's success. This is also reflected in the **weighting of the target levels.** Accordingly, achieving Group performance targets accounts for the clear majority (70 %) of target achievement. This target level is determined solely on a quantitative basis; performance is therefore calculated based on whether the target value specified by the Supervisory Board for the two components consolidated operating profit before taxes and risk-weighted assets has been achieved.

The other two target levels, the sectional and individual target levels, are weighted at 15% each. Three to four targets are determined per level. As previously described, they are mainly measured against qualitative KPIs, and additional quantitative KPIs only implemented for the Management Board member responsible for Sales units. When assessing the respective KPI, the Supervisory Board does not only simply evaluate whether the target has been achieved, but also whether the performance rendered is in line with the defined corporate and risk culture. In the event that this aspect has a positive or negative influence, the Supervisory Board would disclose it accordingly to the shareholders when talking about target achievement (cf. Remuneration of the Management Board › Target achievement). The following diagram gives a concise overview of performance measurement.

### Performance measurement on individual target levels

| Target | KPI (FY) | Actual achievement | Assessment | Target achievement level (FY) |
|---|---|---|---|---|
| **Group performance target level** | | | | |
| Cons. operating profit before taxes | quantitative | X % | | X % |
| Risk-weighted assets | quantitative | X % | | |
| **Divisional target level** (exemplary) | | | | |
| Growth target | quantitative | X % | Performance in line with the defined corporate and risk culture | X % |
| ESG target | qualitative | X % | | |
| Strategic project | qualitative | X % | | |
| **Individual target** (exemplary) | | | | |
| ESG target | qualitative | X % | Performance in line with the defined corporate and risk culture | X % |
| Efficiency target | qualitative | X % | | |

**Overall target achievement (3-year measurement)**

The principle of multiple-year assessment was applied only to the Group performance targets until 2018, and initially extended to remuneration determined at all target levels for the 2019 financial year. To set ambitious targets and a strong incentive for successful Management Board work, target achievement levels are incorporated at different levels over time. Following a transition period, the most recent reporting year will be weighted at 60 %, the preceding one at 30 %, and the oldest year in the assessment period at 10 %. The transition phase ends with the variable remuneration for the 2021 financial year. With regard to the variable remuneration for the year under review, reporting year 2019 is weighted at 54 %, financial year 2018 with 29 % and financial year 2017 with 17 %.

**Deferred disbursement, through retention of variable remuneration components and virtual shares**

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

- After confirmation of the total target achievement level by the Supervisory Board, 20 % of the variable remuneration are disbursed in cash **(cash bonus).**

- After confirmation of the total target achievement level by the Supervisory Board, a further 20 % of the variable remuneration is granted in the form of virtual shares **(share bonus with holding period)** and forms part of the share bonus plan.

- 30 % of the variable remuneration is retained **(cash deferral),** and disbursed in cash – pro rata temporis – over a five-year deferral period.

- The remaining 30 % of the variable remuneration is credited, as a cash amount, to a virtual account maintained on behalf of each Management Board member, and forms part of the Share Deferral Plan **(share deferral with holding period).**

This means that deferred disbursement applies to 80 % of variable remuneration determined, for up to six years.

**Five-year retention period**

For the portion of performance-related remuneration that is deferred initially as a cash deferral or a share deferral, the Supervisory Board makes a decision regarding the granting of one fifth of the amount in the five years following the determination of the performance-related remuneration (cf. "Ex-post review of target achievement and behaviour of the Management Board").

Until the end of each respective deferral period, there is no right to the relevant remuneration components. No interest or dividends will accrue. Once the deferred remuneration components for Management Board members are vested, the cash deferral is paid out in cash and the share deferral is converted into virtual shares, subject to a one-year holding period.

**Share bonus with holding period**

The portion of the performance-related remuneration which is subject to the share bonus plan will be converted into an equivalent number of virtual shares. The calculation of the number of virtual shares is based on the weighted average price on the basis of five (Xetra®) exchange trading days after publication of the preliminary results for the financial year for which the share bonus is granted (subscription price). The date of publication of the preliminary results is used as the reference date.

The virtual shares so determined are posted to a virtual account and are held for one year. They will be converted, automatically and without delay, into a cash amount and disbursed immediately after the Supervisory Board meeting which passes the resolution on the adoption of the annual financial statements for the first financial year following the financial year for which the virtual shares were granted ("holding period"). The conversion will be effected using the weighted average price calculated on the basis of the five (Xetra®) exchange trading days following the publication of the preliminary results for the year preceding the payout.

The payout amount of the share bonus of a given financial year may vary depending on the share price development and has been limited to a maximum of 300 % of the agreed initial value (ceiling).

**Share Deferral Plan**

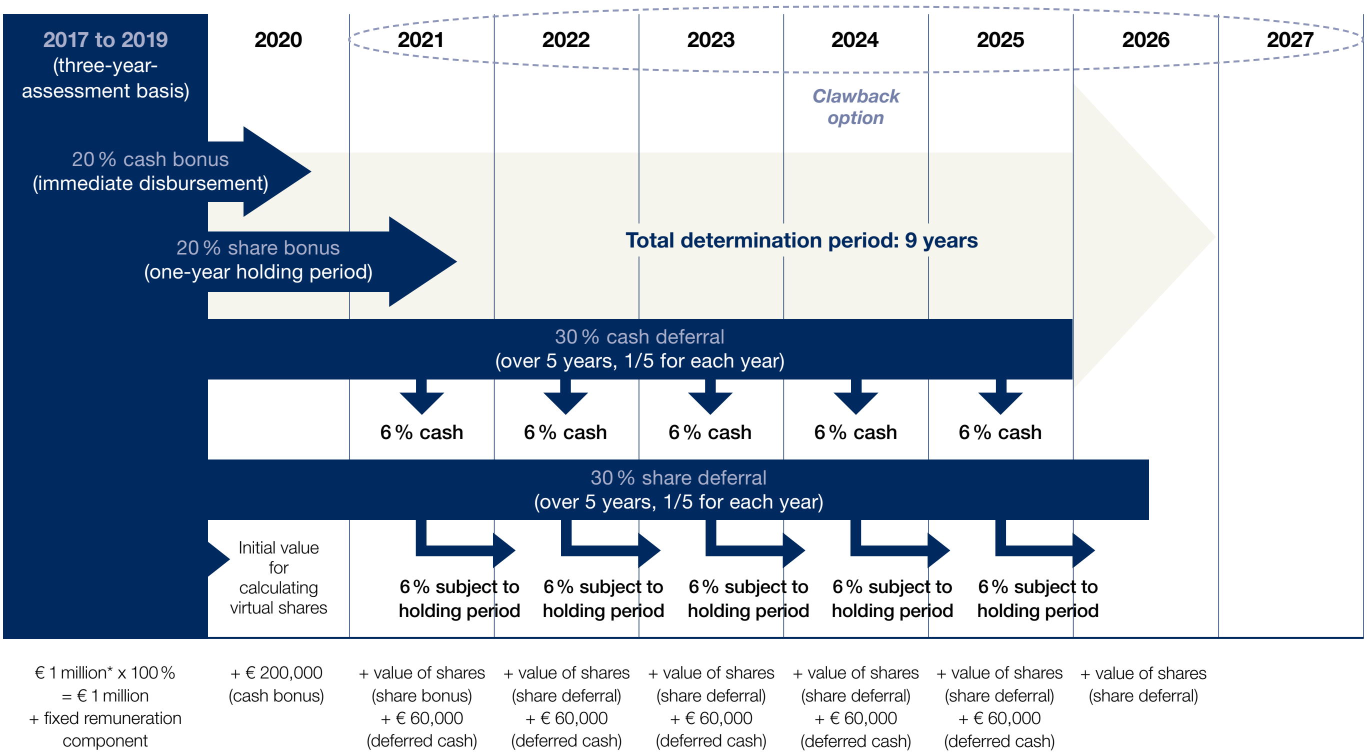
In the five years following determination of performance-related remuneration (deferral period), the Supervisory Board decides whether in each case a fifth of the share deferral should be converted into virtual shares.

The rules of the Share Bonus Plan are applicable to the calculation of the number of virtual shares, subject to the proviso that the weighted average price calculated on the basis of the five (Xetra®) exchange trading days following the publication of the preliminary results for the financial year in respect of which variable remuneration was determined. This is designed to preserve the reference to the original assessment period.

The ceiling value is applicable for the conversion of the virtual shares, with the proviso that the payout amount following the conversion of the virtual shares of a tranche into a cash payment must not exceed 300 % of the share deferral (30 % of the initial value of performance-related remuneration)

## Sample disbursement methodology, based on 100 % target achievement for the 2019 financial year

The Supervisory Board regularly examines, at the beginning of each year and prior to disbursement or conversion into virtual shares, whether the original target achievement still applies, and whether a penalty-triggering event has occurred which requires reduction or clawback of variable remuneration.




*For the sake of simplicity of this sample presentation, variable remuneration for a 100 % target achievement level was set to a notional value of € 1 million.

set for the financial year in question (which may have been reduced following the application of a penalty rule or as a result of an instruction by BaFin).

## Ex-post review of target achievement and behaviour of the Management Board

### Backtesting regarding retained remuneration components

Before the Supervisory Board decides on conversion or disbursement of retained remuneration components, it reviews whether the target achievement level originally agreed upon is still held to be correctly determined, based on current knowledge. For example, where an indicator used to determine remuneration needs to be adjusted ex-post, this can also reduce the variable remuneration determined – and hence, result in a reduction in the amount retained. If it turns out, at a later date, that a project did not achieve the objectives on which the original remuneration calculation was based, then the variable remuneration can also be reduced ex-post.

### Penalty review

When determining variable remuneration, as well as prior to every disbursement of cash components or conversion into virtual shares, the Supervisory Board verifies whether there are any reasons, besides the achievement of targets, for reducing variable remuneration, possibly to zero.

Such **penalty-triggering events** include inappropriate behaviour, behaviour in breach of duties, or negative performance contributions of Management Board members, which cannot be offset through positive performance contributions at other levels. For example, wilful breaches of the Code of Conduct, the corporate values determined therein and/or internal and/or external rules, conduct that damages the Bank's reputation, or other misconduct may give rise to a penalty. If any retained performance-related remuneration components are not awarded, or only in part, the remaining sum is forfeited, i.e. it is not carried forward into subsequent years. In the case of **negative performance** contributions in the form of significant losses or material regulatory sanctions, variable remuneration must be reduced to zero.

### Clawbacks

Starting with variable remuneration for the 2018 financial year, agreements with Management Board members ensure that any variable remuneration already disbursed must be reclaimed in the event of negative performance contributions (penalty review).

## Restrictions and additional provisions

### Impact of special external conditions (modifiers)

The Supervisory Board is entitled to increase or decrease the level of target achievement for the Group component by up to 20 percentage points (a so-called modifier) in the event of unforeseeable changes to the economic environment which are beyond the Management Board's influence or control (i.e. only on the basis of external conditions). This will not affect the restrictions set out below, especially the 150 % cap, which cannot be circumvented by the modifier.

### Hedging ban

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

### Additional constraints regarding target achievement

For the purpose of additional risk adjustment, for each financial year, the Supervisory Board sets lower thresholds in order to secure adherence of the regulatory capital adequacy and liquidity (Liquidity Coverage Ratio – LCR). For capital adequacy, this comprises a target ratio for Common Equity Tier 1 capital (CET 1 ratio), for liquidity the adherence to the statutory Liquidity Coverage Ratio (LCR). No variable remuneration will be determined for any financial year where any of these two targets has not been achieved.

### Risk-bearing capacity and parallel interest with shareholders

To preserve the Company's continued survival (and hence, shareholders' investment), variable remuneration is generally subject to a review performed by the Supervisory Board pursuant to section 7 of the InstVergV. This review is based on the Recovery Plan (which is mandatory for Aareal Bank as a significant institution) and the thresholds defined therein. These thresholds include achieving minimum profitability indicators such as the return on equity. In the event of these so-called "early warning thresholds" being reached, the Supervisory Board will decide, in its reasonable discretion, whether variable remuneration for the Management Board needs to be reduced. The total amount of variable remuneration is set to zero if Aareal Bank's risk-bearing capacity is no longer sufficiently ensured. In addition, pursuant to section 45 (2) sentence 1 no. 5a KWG, the German Federal Financial Supervisory Authority (BaFin) may impose further conditions or restrictions, or may instruct that the total amount of variable remuneration be cancelled.

### Rules governing severance pay

The agreements concluded with members of the Management Board do not include any obligation to make severance payments in cases involving the early termination of employment relationships **(rescission of the agreement without good cause).** However, severance payments may be included in individual termination agreements, provided that these are specified in accordance with regulatory requirements, in particular with the InstVergV. The agreements concluded with members of the Management Board state that, in the event of the premature termination of their term on the Management Board without good cause, payments, including ancillary benefits, made to the Management Board member in question must not exceed twice the annual remuneration (severance cap) and must not constitute remuneration for more than the remaining term of the employment contract.

In the case of a compulsory loss of a Management Board position **(change of control),** the Management Board members are to be paid the fixed remuneration component, the performance-based remuneration, as well as the contractually agreed benefits for the remainder of the term of the contract. The performance-related remuneration is subject to the above-mentioned conditions; that is, in particular the deferral periods, the holding periods and the penalty rules are applicable.

In addition, the extent to which sectional and individual targets were achieved on average during the last three years prior to the termination of the Management Board position will be used as a basis to determine the target achievement level for the remaining term of the contract. In the case of a voluntary termination of the Management Board position following a change of control, the members of the Management Board merely receive the fixed remuneration and the contractually agreed benefits for the remainder of the contractual term. In this case, there is no entitlement to the variable remuneration component.

The total amount of payments in the case of termination due to a change of control is limited to 150 % of the severance cap of an employment contract.

### Newcomer rule

The Supervisory Board intends to remunerate newly-appointed members who have not previously held a position on the Management Board of a comparable institution in line with an entry level of 80 % of fixed and variable remuneration for ordinary members of the Management Board, reflecting lack of experience. If the Management Board member is re-appointed, the Supervisory Board will also decide upon the potential increase of remuneration to the normal level. However, since the Supervisory Board decided upon the specific selection as well as remuneration of individual Management Board members, within its reasonable discretion, and taking the Company's specific needs into account, it is possible to diverge from this rule.

When implementing the InstVergV, as amended on 3 July 2017, the Supervisory Board decided to only gradually build up the three-year assessment period; in the Supervisory Board's view, newly-appointed members of the Management Board should not be held accountable for past developments. In accordance with the regulatory requirements pursuant to the InstVergV, the deferral period is extended for periods with a shortened assessment period. Hence, for the first year, the assessment period is only one year, with the deferral period extended from five to seven years. For the second year, the assessment period is extended to two years and the deferral period shortened to six years. The remuneration system for the Management Board will be applied, as provided, from the third year onwards.

#### Annual examination of appropriateness

The Supervisory Board regularly (at least annually) checks, whether Management Board and employee remuneration is appropriate (cf. remuneration governance). To evaluate whether the Management Board's specific total remuneration is in line with common practice/that of other companies, the Supervisory Board has set two comparison groups. The companies are selected based on Aareal Bank's market position (particularly sector, size, country). Therefore, the comparison groups are MDAX companies and banks of a similar size.

## Remuneration of the Management Board

### Measures in the 2019 financial year

#### Remuneration increase for two Management Board members

In the 2019 financial year, the two ordinary Management Board members Christiane Kunisch-Wolff and Christof Winkelmann began their second term of office as Management Board members. Since they had previously both been subject to the newcomers rule, their remuneration was correspondingly increased with effect from their second term of office.

#### Realignment of the total remuneration structure

As mentioned above, the Supervisory Board has decided to realign the remuneration structure for Management Board members as of 2019; as such, basic remuneration will account for 45 %, retirement benefits for 15 %, and variable remuneration for 40 % of total target remuneration. Within the scope of these changes, the fixed remuneration elements were increased for all members of the Management Board, whilst their target variable remuneration elements were lowered. No total target remuneration change was associated with these amendments.

### Target achievement in the 2019 financial year

#### Target achievement

The assessment of the single targets regarding variable remuneration in the year under review yielded the following results.

#### Group performance targets 2019

As mentioned, consolidated operating profit (as communicated to shareholders) and a target

| % | | Hermann J. Merkens | Marc Hess[1] | Dagmar Knopek | Christiane Kunisch-Wolff | Thomas Ortmanns | Christof Winkelmann |
|---|---|---|---|---|---|---|---|
| **2019** | **Overall Bank performance** | | | **100.0** | | | |
| | Sectional targets | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| | Individual targets | 110.0 | 110.0 | 100.0 | 100.0 | 100.0 | 110.0 |
| **Overall target achievement for 2019, based on a three-year observation period** | | **103.1** | **101.1** | **100.4** | **102.2** | **102.1** | **103.3** |
| **Amount of variable remuneration (€)** | | **1,289,126** | **788,190** | **783,354** | **768,770** | **796,224** | **733,882** |

[1] Given that Mr Hess joined the Bank in 2018, no target achievement levels for the year 2017 are considered in his case.

value for RWAs were chosen as income targets, both of which boasted 100 % target achievement.

### Sectional and individual targets 2019

Notwithstanding the Management Board's overall responsibility for the Bank's management, specific sectional and individual targets were agreed upon for each Management Board member. Whilst the individual targets reflect especially the individual contributions of each Management Board member, the sectional targets are meant to reflect the target achievement of the respective Management Board member's area of responsibility. Thus, the strategic initiatives and measures defined and implemented in the respective area of responsibility are the main basis for determining sectional targets. Furthermore, various ESG targets (derived from the business strategy) have been agreed upon on both levels.

Within the scope of their sectional and individual targets, all Management Board members were required to interlink the different processes in their areas of responsibility to an even greater extent (for Mr Merkens, e. g., the even more efficient interlinking of strategy and risk processes), to adhere to cost plans, and to promote the risk and corporate culture. The latter was reviewed within the course of a broad-based employee survey conducted in 2019, leading to measures aimed at promoting the Bank's risk and corporate culture. Implementation of these measures shall be reviewed within the scope of the individual targets 2020.

Apart from that, the following sectional and/or individual targets were defined for the individual Management Board members:

#### Hermann-Josef Merkens

Mr Merkens' targets include: increasing flexibility and efficiency of the Group organisation, improving the statement of financial position and strengthening equity, whilst expanding the business along the strategic benchmark, strengthening and developing the Aareal 2020 strategy, and preparing the strategic programme following Aareal 2020. The latter was achieved through "Aareal Next Level".

#### Marc Hess

Mr Hess' sectional and individual targets included integrating Düsseldorfer Hypothekenbank AG (now DHB Verwaltungs AG) – achieved during the year –, developing the concept for and implementing the process to select a new external auditor to be proposed to the Annual General Meeting (appointment to review, if applicable, the first-quarter interim financial information 2021), and adjusting the funding mix.

#### Christiane Kunisch-Wolff

Ms Kunisch-Wolff's targets comprised achieving closer links with supervisory authorities, optimising risk management-related management impulses relevant to the Group, and setting up Aareal Bank to anticipate (and plan in a timely manner) future and existing requirements, including the implementation of core regulatory projects.

#### Dagmar Knopek

Ms Knopek targeted the reduction of the NPL portfolio and the promotion of digitalisation initiatives in her area of responsibility.

#### Thomas Ortmanns

Mr Ortmanns' targets concerned, among other things, implementing the digitalisation strategy, measures to expand the commission-based business in the housing industry, improving Aareon's results, and managing the implementation of various IT projects.

#### Christof Winkelmann

Mr Winkelmann's sectional targets included implementing the business plan in the business division he is responsible for, and further improving the syndication process. These targets were measured, among other things, by considering specific country or property type portfolio volumes.

### No penalty-triggering events

In addition, compliance with governance provisions, i. e., with internal and external rules, as well as with the corporate values determined in Aareal Bank Group's Code of Conduct, is assessed within the scope of the annual penalty review. However, no such penalty-triggering events were found.

### Total remuneration

In accordance with German commercial law in conjunction with GAS 17, the following table shows fixed and other remuneration for members of the Management Board, variable remuneration determined for the respective financial year (total amount, plus a breakdown into its components), as well as the total target achievement levels, as determined by the Supervisory Board.

No benefits were granted to any member of the Management Board by third parties with respect to his/her Management Board activities during the year under review. Payments to former Management Board members of Aareal Bank AG and their surviving dependants totalled € 2 million (2018: € 3 million).

### (Virtual) shareholdings of Management Board members and share-based remuneration

Within Aareal Bank's remuneration system for Management Board members, the reference value for 100 % target achievement is slightly below the respective basic salary. Given that 50 % of variable remuneration is disbursed in the form of virtual shares, Management Board members typically earn virtual shares amounting to more than 100 % of their fixed annual salary at the latest after three years of service, provided that they also earn variable remuneration in subsequent years, the equivalent value of the virtual shares will not fall below this 100 % threshold until the end of their term on the Management Board.

The table on page 102 shows the portion of the variable component attributable to share-based payment arrangements as well as the corresponding number of virtual shares granted in 2019 and 2018, respectively – as well as the number of virtual shares already held as at the reporting date.

| € | Current year | Fixed remuneration | Variable remuneration: Cash component – Cash bonus | Cash-deferral[1] | Share-based component – Share bonus | Share deferral[1] | Target achievement level[2] | Total | Ancillary benefits | Total remuneration |
|---|---|---|---|---|---|---|---|---|---|---|
| Hermann J. Merkens | 2019 | 1,425,000 | 257,825 | 386,738 | 257,825 | 386,738 | 103.1 % | 1,289,126 | 36,079 | 2,750,205 |
| | 2018 | 1,300,000 | 304,248 | 456,372 | 304,248 | 456,372 | 108.7 % | 1,521,240 | 34,024 | 2,855,264 |
| Marc Hess[3] | 2019 | 900,000 | 157,638 | 236,457 | 157,638 | 236,457 | 101.1 % | 788,190 | 39,855 | 1,728,045 |
| | 2018 | 220,000 | 40,329 | 60,493 | 40,329 | 60,493 | 100.0 % | 201,644 | 3,244 | 424,888 |
| Dagmar Knopek | 2019 | 900,000 | 156,671 | 235,006 | 156,671 | 235,006 | 100.4 % | 783,354 | 56,012 | 1,739,366 |
| | 2018 | 880,000 | 164,256 | 246,384 | 164,256 | 246,384 | 102.7 % | 821,280 | 19,598 | 1,720,878 |
| Christiane Kunisch-Wolff | 2019 | 859,957 | 153,754 | 230,631 | 153,754 | 230,631 | 102.2 % | 768,770 | 34,797 | 1,663,524 |
| | 2018 | 704,000 | 139,085 | 208,627 | 139,085 | 208,627 | 108.7 % | 695,424 | 25,466 | 1,424,890 |
| Thomas Ortmanns | 2019 | 900,000 | 159,245 | 238,867 | 159,245 | 238,867 | 102.1 % | 796,224 | 40,678 | 1,736,902 |
| | 2018 | 880,000 | 173,856 | 260,784 | 173,856 | 260,784 | 108.7 % | 869,280 | 18,504 | 1,767,784 |
| Christof Winkelmann | 2019 | 802,000 | 146,776 | 220,165 | 146,776 | 220,165 | 103.3 % | 733,882 | 38,245 | 1,574,127 |
| | 2018 | 704,000 | 139,085 | 208,627 | 139,085 | 208,627 | 108.7 % | 695,424 | 70,329 | 1,469,753 |
| **Total** | **2019** | **5,786,957** | **1,031,909** | **1,547,864** | **1,031,909** | **1,547,864** | **102.1 %** | **5,159,546** | **245,666** | **11,192,169** |
| | **2018** | **4,688,000** | **960,859** | **1,441,287** | **960,859** | **1,441,287** | **107.2 %** | **4,804,292** | **171,165** | **9,663,457** |

[1] The deferrals shown are subject to the criteria on retention of variable remuneration components and penalty criteria, as set out above.
[2] 2018: excluding the positive non-recurring effect (negative goodwill) from the acquisition of former Düsselhyp
[3] Marc Hess was appointed to the Management Board on 1 October 2018.

| | Year | Share-based payment Value (€) | Share-based payment Quantity (number)[1] | Total quantity of virtual shares held (31 December) Quantity (number) |
|---|---|---|---|---|
| Hermann J. Merkens | 2019 | 644,563 | 21,308 | 58,753 |
| | 2018 | 760,620 | 28,182 | 55,340 |
| Mark Hess[2] | 2019 | 394,095 | 13,028 | 1,405 |
| | 2018 | 100,822 | 3,736 | – |
| Dagmar Knopek | 2019 | 391,677 | 12,948 | 35,689 |
| | 2018 | 410,640 | 15,215 | 36,772 |
| Christiane Kunisch-Wolff | 2019 | 384,385 | 12,707 | 18,504 |
| | 2018 | 347,712 | 12,883 | 9,726 |
| Thomas Ortmanns | 2019 | 398,112 | 13,161 | 35,942 |
| | 2018 | 434,640 | 16,104 | 38,112 |
| Christof Winkelmann | 2019 | 366,941 | 12,130 | 15,751 |
| | 2018 | 347,712 | 12,883 | 7,659 |
| **Gesamt** | **2019** | | | **166,044** |
| | **2018** | | | **147,609** |

[1] The stated number of virtual shares granted for 2019 is a preliminary figure, based on the price of Aareal Bank AG's share on 31 December 2019 (€ 30.25). The final conversion rate may only be determined after publication of preliminary results for 2019. The stated number of virtual shares granted for 2018 differs slightly from the previous year's figure since the former was calculated using a final conversion rate of € 28.71.
[2] Marc Hess was appointed to the Management Board on 1 October 2018.

## Target remuneration granted

The following table shows the target remuneration (fixed annual salary and variable remuneration based on a 100 % target achievement) for the year under review, in accordance with articles 4.2.4 and 4.2.5 of the German Corporate Governance Code:

| **Remuneration granted** | Hermann J. Merkens – Chairman of the Management Board | | | |
|---|---|---|---|---|
| | 2018 | 2019 | 2019 (min)[1] | 2019 (max)[2] |
| € | | | | |
| Fixed remuneration | 1,300,000 | 1,425,000 | 1,425,000 | 1,425,000 |
| Ancillary benefits | 34,024 | 36,079 | 36,079 | 36,079 |
| **Total** | **1,334,024** | **1,461,079** | **1,461,079** | **1,461,079** |
| One-year variable remuneration | 280,000 | 250,000 | – | 375,000 |
| Multi-year variable remuneration | | | | |
| Cash deferral 2018 (March 2024) | 420,000 | – | – | – |
| Share bonus 2018 (March 2019) | 280,000 | – | – | – |
| Share deferral 2018 (March 2024) | 420,000 | – | – | – |
| Cash deferral 2019 (March 2025) | – | 375,000 | – | 562,000 |
| Share bonus 2019 (March 2020) | – | 250,000 | – | 375,000 |
| Share deferral 2019 (March 2025) | – | 375,000 | – | 562,000 |
| **Total** | **1,400,000** | **1,250,000** | **–** | **1,874,000** |
| Benefit expense | 847,178 | 2,297,353 | 2,297,353 | 2,297,353 |
| **Total remuneration** | **3,581,202** | **5,008,432** | **3,758,432** | **5,632,432** |

[1] Minimum amount of the remuneration component granted in the year under review
[2] Maximum amount of the remuneration component granted in the year under review

| Remuneration granted | Mark Hess[3] | | | |
|---|---|---|---|---|
| € | 2018 | 2019 | 2019 (min)[1] | 2019 (max)[2] |
| Fixed remuneration | 220,000 | 900,000 | 900,000 | 900,000 |
| Ancillary benefits | 3,244 | 39,855 | 39,855 | 39,855 |
| **Total** | **223,244** | **939,855** | **939,855** | **939,855** |
| One-year variable remuneration | 40,329 | 156,000 | – | 234,000 |
| Multi-year variable remuneration | | | | – |
| Cash deferral 2018 (March 2026) | 60,493 | – | – | – |
| Share bonus 2018 (March 2019) | 40,329 | – | – | – |
| Share deferral 2018 (March 2026) | 60,493 | – | – | – |
| Cash deferral 2019 (March 2026) | – | 234,000 | – | 351,000 |
| Share bonus 2019 (March 2020) | – | 156,000 | – | 234,000 |
| Share deferral 2019 (March 2026) | – | 234,000 | – | 351,000 |
| **Total** | **201,644** | **780,000** | **–** | **1,170,000** |
| Benefit expense | 148,056 | 754,139 | 754,139 | 754,139 |
| **Total remuneration** | **572,944** | **2,473,994** | **1,693,994** | **2,863,994** |

| Remuneration granted | Dagmar Knopek | | | |
|---|---|---|---|---|
| € | 2018 | 2019 | 2019 (min)[1] | 2019 (max)[2] |
| Fixed remuneration | 880,000 | 900,000 | 900,000 | 900,000 |
| Ancillary benefits | 19,598 | 56,012 | 56,012 | 56,012 |
| **Total** | **899,598** | **956,012** | **956,012** | **956,012** |
| One-year variable remuneration | 160,000 | 156,000 | – | 234,000 |
| Multi-year variable remuneration | | | | |
| Cash deferral 2018 (March 2024) | 240,000 | – | – | – |
| Share bonus 2018 (March 2019) | 160,000 | – | – | – |
| Share deferral 2018 (March 2024) | 240,000 | – | – | – |
| Cash deferral 2019 (March 2025) | – | 234,000 | – | 351,000 |
| Share bonus 2019 (March 2020) | – | 156,000 | – | 234,000 |
| Share deferral 2019 (March 2025) | – | 234,000 | – | 351,000 |
| **Total** | **800,000** | **780,000** | **–** | **1,170,000** |
| Benefit expense | 488,691 | 780,217 | 780,217 | 780,217 |
| **Total remuneration** | **2,188,289** | **2,516,229** | **1,736,229** | **2,906,229** |

[1] Minimum amount of the remuneration component granted in the year under review
[2] Maximum amount of the remuneration component granted in the year under review
[3] Marc Hess was appointed to the Management Board on 1 October 2018.

| **Remuneration granted** | **Christiane Kunisch-Wolff** | | | |
|---|---|---|---|---|
| | **2018** | **2019** | **2019 (min)[1]** | **2019 (max)[2]** |
| € | | | | |
| Fixed remuneration | 704,000 | 859,957 | 859,957 | 859,957 |
| Ancillary benefits | 25,466 | 34,797 | 34,797 | 34,797 |
| **Total** | **729,466** | **894,754** | **894,754** | **894,754** |
| One-year variable remuneration | 128,000 | 150,400 | – | 225,600 |
| Multi-year variable remuneration | | | | |
| Cash deferral 2018 (March 2024) | 192,000 | – | – | – |
| Share bonus 2018 (March 2019) | 128,000 | – | – | – |
| Share deferral 2018 (March 2024) | 192,000 | – | – | – |
| Cash deferral 2019 (March 2025) | – | 225,600 | – | 338,400 |
| Share bonus 2019 (March 2020) | – | 150,400 | – | 225,600 |
| Share deferral 2019 (March 2025) | – | 225,600 | – | 338,400 |
| **Total** | **640,000** | **752,000** | **–** | **1,128,000** |
| Benefit expense | 422,142 | 826,324 | 826,324 | 826,324 |
| **Total remuneration** | **1,791,608** | **2,473,078** | **1,721,078** | **2,849,078** |

| **Remuneration granted** | **Thomas Ortmanns** | | | |
|---|---|---|---|---|
| | **2018** | **2019** | **2019 (min)[1]** | **2019 (max)[2]** |
| € | | | | |
| Fixed remuneration | 880,000 | 900,000 | 900,000 | 900,000 |
| Ancillary benefits | 18,504 | 40,678 | 40,678 | 40,678 |
| **Total** | **898,504** | **940,678** | **940,678** | **940,678** |
| One-year variable remuneration | 160,000 | 156,000 | – | 234,000 |
| Multi-year variable remuneration | | | | |
| Cash deferral 2018 (March 2024) | 240,000 | – | – | – |
| Share bonus 2018 (March 2019) | 160,000 | – | – | – |
| Share deferral 2018 (March 2024) | 240,000 | – | – | – |
| Cash deferral 2019 (March 2025) | – | 234,000 | – | 351,000 |
| Share bonus 2019 (March 2020) | – | 156,000 | – | 234,000 |
| Share deferral 2019 (March 2025) | – | 234,000 | – | 351,000 |
| **Total** | **800,000** | **780,000** | **–** | **1,170,000** |
| Benefit expense | 621,605 | 1,610,588 | 1,610,588 | 1,610,588 |
| **Total remuneration** | **2,320,109** | **3,331,266** | **2,551,266** | **3,721,266** |

[1] Minimum amount of the remuneration component granted in the year under review
[2] Maximum amount of the remuneration component granted in the year under review

| Remuneration granted | Christof Winkelmann | | | |
|---|---|---|---|---|
| | 2018 | 2019 | 2019 (min)[1] | 2019 (max)[2] |
| € | | | | |
| Fixed remuneration | 704,000 | 802,000 | 802,000 | 802,000 |
| Ancillary benefits | 70,329 | 38,245 | 38,245 | 38,245 |
| **Total** | **774,329** | **840,245** | **840,245** | **840,245** |
| One-year variable remuneration | 128,000 | 142,115 | – | 213,173 |
| Multi-year variable remuneration | | | | |
| Cash deferral 2018 (March 2024) | 192,000 | – | – | – |
| Share bonus 2018 (March 2019) | 128,000 | – | – | – |
| Share deferral 2018 (March 2024) | 192,000 | – | – | – |
| Cash deferral 2019 (March 2025) | – | 213,173 | – | 319,759 |
| Share bonus 2019 (March 2020) | – | 142,115 | – | 213,173 |
| Share deferral 2019 (March 2025) | – | 213,173 | – | 319,759 |
| **Total** | **640,000** | **710,576** | **–** | **1,065,864** |
| Benefit expense | 498,191 | 1,435,786 | 1,435,786 | 1,435,786 |
| **Total remuneration** | **1,912,520** | **2,986,607** | **2,276,031** | **3,341,895** |

[1] Minimum amount of the remuneration component granted in the year under review
[2] Maximum amount of the remuneration component granted in the year under review

## Remuneration paid

The following table shows the remuneration disbursed in the year under review, as defined in sections 4.2.4 and 4.2.5 of the German Corporate Governance Code. It also outlines disbursements under variable remuneration components related to multiple years which expired during the year under review:

| Remuneration paid | Hermann J. Merkens Chairman of the Management Board | | Marc Hess[1] | | Dagmar Knopek | | Christiane Kunisch-Wolff | |
|---|---|---|---|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 | 2019 | 2018 | 2019 | 2018 |
| € | | | | | | | | |
| Fixed remuneration | 1,425,000 | 1,300,000 | 900,000 | 220,000 | 900,000 | 880,000 | 859,957 | 704,000 |
| Ancillary benefits | 36,079 | 34,024 | 39,855 | 3,244 | 56,012 | 19,598 | 34,797 | 25,466 |
| **Total** | **1,461,079** | **1,334,024** | **939,855** | **223,244** | **956,012** | **899,598** | **894,754** | **729,466** |
| One-year variable remuneration | 304,248 | 343,994 | 40,329 | – | 164,256 | 196,568 | 139,085 | 157,254 |
| Multi-year variable remuneration | – | – | – | – | – | – | – | – |
| Cash deferral 2014 (April 2018) | – | 103,957 | – | – | – | 103,711 | – | – |
| Cash deferral 2015 (April 2018) | – | 151,605 | – | – | – | 107,621 | – | – |
| Cash deferral 2016 (April 2018) | – | 189,653 | – | – | – | 106,606 | – | 67,939 |
| Share bonus 2014 (April 2018) | – | 199,945 | – | – | – | 199,471 | – | – |
| Share deferral 2012 (April 2018) | – | 249,699 | – | – | – | – | – | – |
| Share deferral 2013 (April 2018) | – | 135,779 | – | – | – | 79,204 | – | – |
| Share deferral 2014 (April 2018) | – | 100,872 | – | – | – | 100,633 | – | – |
| Cash deferral 2015 (April 2019) | 152,530 | – | – | – | 108,278 | – | – | – |

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

| **Remuneration paid** | **Hermann J. Merkens Chairman of the Management Board** | | **Marc Hess[1]** | | **Dagmar Knopek** | | **Christiane Kunisch-Wolff** | |
|---|---|---|---|---|---|---|---|---|
| | **2019** | **2018** | **2019** | **2018** | **2019** | **2018** | **2019** | **2018** |
| € | | | | | | | | |
| Cash deferral 2016 (April 2019) | 190,450 | – | – | – | 107,054 | – | 68,224 | – |
| Cash deferral 2017 (April 2019) | 172,613 | – | – | – | 98,638 | – | 78,910 | – |
| Share bonus 2015 (April 2019) | 312,384 | – | – | – | 221,754 | – | – | – |
| Share deferral 2013 (April 2019) | 101,264 | – | – | – | 59,071 | – | – | – |
| Share deferral 2014 (April 2019) | 74,734 | – | – | – | 74,557 | – | – | – |
| Share deferral 2015 (April 2019) | 157,145 | – | – | – | 111,553 | – | – | – |
| Dividends | 128,964 | 138,349 | 2,950 | – | 78,046 | 91,929 | 41,361 | 24,316 |
| **Total** | **1,594,332** | **1,613,853** | **43,279** | **–** | **1,023,207** | **985,743** | **327,580** | **249,509** |
| Benefit expense | 2,297,353 | 847,178 | 754,139 | 148,056 | 780,217 | 488,691 | 826,324 | 422,142 |
| **Total remuneration** | **5,352,764** | **3,795,055** | **1,737,273** | **371,300** | **2,759,436** | **2,374,032** | **2,048,658** | **1,401,117** |

| **Remuneration paid** | **Thomas Ortmanns** | | **Christof Winkelmann** | | **Dr Wolf Schumacher[2]** | | **Dirk Große Wördemann[3]** | |
|---|---|---|---|---|---|---|---|---|
| | **2019** | **2018** | **2019** | **2018** | **2019** | **2018** | **2019** | **2018** |
| € | | | | | | | | |
| Fixed remuneration | 900,000 | 880,000 | 802,000 | 704,000 | – | – | – | – |
| Ancillary benefits | 40,678 | 18,504 | 38,245 | 70,329 | – | – | – | – |
| **Total** | **940,678** | **898,504** | **840,245** | **774,329** | **–** | **–** | **–** | **–** |
| One-year variable remuneration | 173,856 | 194,168 | 139,085 | 159,174 | – | – | – | – |
| Multi-year variable remuneration | – | – | – | – | – | – | – | – |
| Cash deferral 2014 (April 2018) | – | 103,135 | – | – | – | 181,493 | – | – |
| Cash deferral 2015 (April 2018) | – | 106,973 | – | – | – | 139,658 | – | – |
| Cash deferral 2016 (April 2018) | – | 107,249 | – | 42,739 | – | – | – | – |
| Share bonus 2014 (April 2018) | – | 198,365 | – | – | – | 349,075 | – | – |
| Share deferral 2012 (April 2018) | – | 249,699 | – | – | – | 421,271 | – | 202,720 |
| Share deferral 2013 (April 2018) | – | 135,779 | – | – | – | 229,075 | – | – |
| Share deferral 2014 (April 2018) | – | 100,075 | – | – | – | 176,108 | – | – |
| Cash deferral 2015 (April 2019) | 107,626 | – | – | – | 140,510 | – | – | – |
| Cash deferral 2016 (April 2019) | 107,669 | – | 42,918 | – | – | – | – | – |
| Cash deferral 2017 (April 2019) | 97,434 | – | 79,874 | – | – | – | – | – |
| Share bonus 2015 (April 2019) | 220,419 | – | – | – | 287,767 | – | – | – |
| Share deferral 2013 (April 2019) | 101,264 | – | – | – | 170,844 | – | – | – |
| Share deferral 2014 (April 2019) | 74,144 | – | – | – | 130,475 | – | – | – |
| Share deferral 2015 (April 2019) | 110,882 | – | – | – | 144,761 | – | – | – |
| Dividends | 78,565 | 95,279 | 35,240 | 19,149 | 31,001 | 88,048 | – | – |
| **Total** | **1,071,859** | **1,290,722** | **297,117** | **221,062** | **905,358** | **1,584,728** | **–** | **202,720** |
| Benefit expense | 1,610,588 | 621,605 | 1,435,786 | 498,191 | – | – | – | – |
| **Total remuneration** | **3,623,125** | **2,810,831** | **2,573,148** | **1,493,582** | **905,358** | **1,584,728** | **–** | **202,720** |

[1] Marc Hess was appointed to the Management Board on 1 October 2018.
[2] Dr Wolf Schumacher resigned with effect from 30 September 2015.
[3] Dirk Große Wördemann resigned with effect from 31 May 2013.

## Pensions

| € 000's | 2019 Pension claims p.a.[1] | 2019 Balance of pension obligations (IFRS) as at 31 Dec 2019 | 2019 Increase of pension obligations (IFRS) in 2019 | 2018 Pension claims p.a.[1] | 2018 Balance of pension obligations (IFRS) as at 31 Dec 2018 | 2018 Increase of pension obligations (IFRS) in 2018 |
|---|---|---|---|---|---|---|
| Hermann J. Merkens | 371 | 9,567 | 2,297 | 345 | 7,270 | 847 |
| Marc Hess[2] | 35 | 902 | 754 | 7 | 148 | 148 |
| Dagmar Knopek | 127 | 3,290 | 780 | 110 | 2,510 | 489 |
| Christiane Kunisch-Wolff | 75 | 1,998 | 826 | 54 | 1,172 | 422 |
| Thomas Ortmanns | 294 | 7,967 | 1,610 | 284 | 6,357 | 622 |
| Christof Winkelmann | 92 | 2,664 | 1,436 | 65 | 1,228 | 498 |
| **Total** | **994** | **26,388** | **7,703** | **865** | **18,685** | **3,026** |

[1] The pension claims mentioned refer to old-age pension earned as at 31 December of the year under review, based on the Company's contributions, if retired at the pertinent retirement age. To enhance comparability with other disclosures, the overview in the year under review and the previous-year figures were adjusted.
[2] Marc Hess was appointed to the Management Board on 1 October 2018.

Service cost (in accordance with IFRSs) incurred in the 2019 financial year in connection with the pension claims of members of the Management Board totalled € 3.6 million (2018: € 2.7 million). The pension obligations for current members of the Management Board as well as for former members of the Management Board and their surviving dependants increased by € 10.3 million in the year under review (2018: € 2.8 million). The stronger increase in pension obligations year-on-year is mainly due to the significantly lower imputed rate of interest. The total amount of pension obligations was € 61.8 million (2018: € 51.5 million). Of that amount, € 35.4 million related to former members of the Management Board and their surviving dependants (2018: € 32.8 million).

## Remuneration system for members of the Supervisory Board

Remuneration for the services of the Supervisory Board members is specified in Article 9 of the Memorandum and Articles of Association of Aareal Bank AG. Remuneration for the services of the Supervisory Board members comprises exclusively fixed remuneration, plus an attendance fee. Where membership in the Supervisory Board falls short of an entire financial year, said remuneration shall be paid on a pro rata temporis basis. Furthermore, the Supervisory Board members will be reimbursed for their expenses. Any value-added tax invoiced will also be deemed to be a refundable expense.

Remuneration of the Supervisory Board comprises the following (p. 108).

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

| Remuneration element | Description | Structure |
| --- | --- | --- |
| Fixed remuneration | Remuneration for activities in the Supervisory Board; Depending on the role of the respective Supervisory Board member (e.g. Chairman) | – € 50,000 p.a. per Supervisory Board member<br>– € 150,000 p.a. for the Chairman<br>– € 75,000 p.a. for the Deputy Chairman |
| Committee remuneration | Remuneration for activities and duties on the Supervisory Board committees also depends on the role of the respective Supervisory Board member in the respective committee (e.g. a committee chairman) | – € 20,000 p.a. each for membership in the Risk Committee and/or the Audit Committee<br>– € 40,000 p.a. each for the chairmanship in the two committees<br>– € 15,000 p.a. each for membership in other committees<br>– € 30,000 p.a. each for the chairmanship in other committees |
| Attendance fees | Remuneration for participation in Supervisory Board meetings and on the committees of the Supervisory Board | – € 1,000 per meeting |

## Supervisory Board remuneration

| € | Year | Fixed remuneration | Attendance fees | Total remuneration |
| --- | --- | --- | --- | --- |
| Marija Korsch<br>Chairman | 2019 | 265,000 | 37,000 | 302,000 |
| | 2018 | 265,000 | 36,000 | 301,000 |
| Prof. Dr Stephan Schüller<br>Deputy Chairman | 2019 | 125,000 | 23,000 | 148,000 |
| | 2018 | 125,000 | 27,000 | 152,000 |
| Klaus Novatius<br>Deputy Chairman (since 1 January 2019) | 2019 | 105,000 | 21,000 | 126,000 |
| | 2018 | – | – | – |
| Dieter Kirsch, Deputy Chairman<br>(31 March to 31 December 2018) | 2019 | – | – | – |
| | 2018 | 100,000 | 20,000 | 120,000 |
| York-Detlef Bülow<br>Deputy Chairman (until 31 March 2018) | 2019 | – | – | – |
| | 2018 | 31,250 | 9,000 | 40,250 |
| Thomas Hawel | 2019 | 65,000 | 13,000 | 78,000 |
| | 2018 | 65,000 | 12,000 | 77,000 |
| Petra Heinemann-Specht<br>(since 1 April 2018) | 2019 | 70,000 | 15,000 | 85,000 |
| | 2018 | 52,500 | 10,000 | 62,500 |
| Richard Peters | 2019 | 100,000 | 25,000 | 125,000 |
| | 2018 | 100,000 | 23,000 | 123,000 |
| Dr Hans-Werner Rhein | 2019 | 85,000 | 21,000 | 106,000 |
| | 2018 | 85,000 | 16,000 | 101,000 |
| Sylvia Seignette | 2019 | 90,000 | 15,000 | 105,000 |
| | 2018 | 90,000 | 13,000 | 103,000 |
| Elisabeth Stheeman[1)] | 2019 | 85,000 | 19,000 | 104,000 |
| | 2018 | 85,000 | 17,000 | 102,000 |
| Hans-Dietrich Voigtländer | 2019 | 115,000 | 25,000 | 140,000 |
| | 2018 | 115,000 | 26,000 | 141,000 |

[1)] Income tax plus solidarity surcharge for the Supervisory Board member subject to limited tax liability was declared pursuant to section 50a (1) no. 4 of the German Income Tax Act (Einkommensteuergesetz – "EStG"), and paid to the German Central Tax Offfice (Bundeszentralamt für Steuern, BZSt).

>

| € | Year | Fixed remuneration | Attendance fees | Total remuneration |
|---|---|---|---|---|
| Prof. Dr Hermann Wagner | 2019 | 110,000 | 21,000 | 131,000 |
| | 2018 | 110,000 | 19,000 | 129,000 |
| Beate Wollmann | 2019 | 70,000 | 15,000 | 85,000 |
| | 2018 | 65,000 | 12,000 | 77,000 |
| **Total** | **2019** | **1,285,000** | **250,000** | **1,535,000** |
| | **2018** | **1,288,750** | **240,000** | **1,528,750** |

## Remuneration system for employees

When it comes to the structure of the remuneration system for employees, a general distinction is made between three groups of employees. First of all, Aareal Bank has employees whose remuneration is governed by collective agreements. Then, there are employees whose remuneration is not governed by collective agreements. These employees who are not covered by collective agreements are then split into two further groups. First, there are those employees whose duties have a material impact on the overall risk profile of Aareal Bank (risk takers) or of Aareal Bank Group (Group risk takers). The variable remuneration paid to these "risk takers" is subject to very stringent regulatory requirements. The other employees who are not covered by collective agreements and are not risk takers either are not subject to these provisions and make up the third group.

The report below starts by explaining the remuneration system for risk takers and then addresses the differences compared with the other groups.

### Remuneration system for risk takers

In order to identify those employees who are classed as "risk takers", Aareal Bank carries out an annual independent risk analysis, identifying the employees in question based on a uniform set of criteria whilst taking regulatory requirements into account.

The remuneration system for risk takers is subject to the same basic conditions as the remuneration system for Management Board members, and is also aligned with the business and risk strategy of Aareal Bank AG and Aareal Bank Group respectively. As is the case with the Management Board remuneration, risk takers receive both fixed and variable remuneration. The fixed component comprises a fixed annual salary and ancillary benefits.

### Performance-related variable remuneration

**Remuneration parameters and target level weighting**

As with the Management Board members, the variable remuneration is measured based on targets derived from the corporate strategy. One difference compared with the Management Board system is that the assessment period for the target achievement is one year. The targets set for risk takers are split into three components that are added together, as is the case for the remuneration paid to the Management Board: a Group component, an organisational unit component (referring to the organisational unit that the risk taker works for) and an individual component (individual target achievement). The performance of the organisational unit for divisions allocated to Sales is measured using the Structured Property Financing segment operating result, as well as in terms of risk weighted assets. The performance of the Housing Industry division is measured by reference to the segment operating result of the Consulting/Services segment. The other organisational units, i. e. in particular central staff functions and control units, as well as the Treasury division, are measured based on their cost target. The remuneration system also takes account of the risk taker's position in the organisation's hierarchy, reflecting the influence that he/she can exert over the Group's/Bank's success. This results in differences in the weighting attached to the three additive components depending on an individual's responsibility within the Company: The Group component payable to risk takers assigned to the management level below the Management Board (Managing Directors) is 35 %. By contrast, it is 25 % for the other risk takers. For further information on the individual targets and possible resulting KPIs, we refer to the information on Management Board remuneration.

**Deferred disbursement, through retention of variable remuneration components and virtual shares**

To ensure that the remuneration system provides long-term incentives, the initial value for variable remuneration – as determined according to the principles set out above – is generally paid out on a deferred basis after the end of the financial year. The payout terms are based on those that apply to the Management Board remuneration system but once again vary depending on the risk taker's position within the organisational structure.

60 % of the variable remuneration paid to risk takers on the Managing Director level is subject to a five-year deferral period. As with the variable Management Board remuneration, 50 % each of deferred and non-deferred components are converted into virtual shares that are held for a minimum period of one year. Unlike with the Management Board remuneration system, risk takers can, however, opt to select when they want their virtual shares to be converted into cash after the end of the one-year holding period, selecting a conversion date that falls within a period of up to three years.

By contrast, 40 % of the variable remuneration paid to the other risk takers is subject to deferral over a period of three years.

All other aspects relating to the calculation of virtual shares are explained in the section on the Management Board remuneration system.

**Ex-post review of target achievement and behaviour of the risk takers**

As in the Management Board remuneration system, the original target achievement level is back-tested and, where appropriate, reduced before virtual shares are paid out/granted. Penalty-triggering events can also result in reductions or in the forfeiture of the variable remuneration entitlement in full and, as a result, also in variable remuneration that has already been paid out being clawed back. Details can be found in the information on the Management Board remuneration system.

### Remuneration system for employees who are not classed as risk takers

Aareal Bank AG is a member in Germany of the Arbeitgeberverband des privaten Bankgewerbes e. V. (association of employers in private banking) and bound by the collective agreements for private banks. As of the 2019 financial year, variable remuneration for employees not classified as risk takers has been split into two components, too: the Group component (25 % of target variable remuneration) and the individual component (75 % of target variable remuneration). As a result, the variable remuneration of all employees is directly linked to Aareal Bank Group's performance, and the employees are directly involved in reaching the communicated targets. The individual component paid to those employees whose remuneration is governed by a collective agreement is based on an annual appraisal. The initial value for measuring the variable remuneration corresponds to 0.75 gross monthly salaries for employees covered by a collective agreement. The individual component paid to those employees who are not covered by a collective agreement is based on contractually agreed target-variable remuneration and is measured based on an annual overall appraisal that also takes the target achievement level for the individual targets that have been set for the employee in question into account.

### Restrictions and link to risk-bearing capacity for all employee remuneration systems

All employee remuneration systems feature provisions corresponding to those found in the Management Board remuneration system regarding the impact of special external conditions (modifiers). In cases involving risk takers, the ban on hedging also applies. There are, however, differences with regard to the caps and the safeguarding of the risk-bearing capacity. The contracts of employment with those employees below Management Board level do not include contractual provisions on severance pay.

#### Caps and proportion of variable remuneration

The core components and – for risk takers – the organisational components are capped at 150 % in the target achievement level. The individual targets are capped at a target achievement level of 200 %. If the individual target achievement level is 0 %, no variable remuneration is paid at all. Performance of virtual shares is capped at 300 %.

In order to comply with the requirements set out in section 25a (5) KWG, the reference value for the variable remuneration in cases involving a target achievement level of 100 % generally corresponds to a maximum of 50 % of the fixed remuneration. This means that, even if an employee achieves the maximum target achievement level, the variable remuneration does not exceed the fixed remuneration. Consequently, if an employee receives fixed annual remuneration of € 80,000, for example, the reference value for the variable remuneration paid out if that employee achieves 100 % target achievement is limited to a maximum of € 40,000. It is very common, however, for variable remuneration to account for a smaller proportion of an employee's total remuneration. Furthermore, it has been ensured in line with regulatory requirements that the variable remuneration for control unit employees amounts to no more than one-third of total remuneration.

In 2014, the Annual General Meeting of Aareal Bank AG approved exemptions from this 1:1 rule for certain groups of employees. In order to ensure that the remuneration paid by Aareal Bank AG and its international subsidiaries is competitive in an international comparison, employees working in international sales at Aareal Bank AG, as well as executives and employees working for the subsidiaries Aareal Capital Corporation, New York, and Aareal Bank Asia Ltd., Singapore, have to be paid remuneration in line with local market standards. This applies to fewer than 25 positions.

### Material amendments to the remuneration systems last year

The material amendment to the remuneration systems for employees in the financial year under review concerned the aforementioned introduction of a Group component for the employees that were not identified as risk takers. In addition, this had the effect of reorganising the managing director level, whereby previously different positions were combined to create a uniform Managing Directors' level. This was accompanied by a standardisation in relation to the composition of the individual components of the target variable remuneration.

### Reporting on quantitative disclosure requirements

This report only covers the qualitative disclosure requirements regarding employee remuneration set out in Article 450 of the EU's Capital Requirements Regulation 2013/575 (CRR) and section 16 InstVergV. The quantitative disclosure requirements relating to the provisions set out above are published in a separate report entitled "Disclosure of Remuneration Indicators", which can be found on the website of Aareal Bank AG. This report will be made available within six months of the end of the financial year: www.aareal-bank.com/en/investors-portal/finance-information/regulatory-disclosures/archive/2019/

## Remuneration governance

### Governance of Supervisory Board remuneration

#### The role of the Annual General Meeting

Given the Supervisory Board's role as a supervisory body, remuneration for its members must not provide any incentives which would counter this surveillance function. The Annual General Meeting (AGM) determines the remuneration of the Supervisory Board, in Aareal Bank AG's Memorandum and Articles of Association; the AGM therefore also resolves on any adjustments to Supervisory Board remuneration (cf. Article 9 (4) and (5) of the Memorandum and Articles of Association).

In the implementation of the Second Shareholder Rights Directive in the German Public Limited Companies Act (AktG), as of the first ordinary Annual General Meeting following the 2020 financial year, the AGM will need to discuss Supervisory Board remuneration at least every four years, even without any concrete proposals for amendments, and will need to resolve whether it still approves it.

### The role of the Supervisory Board

The Supervisory Board shall review the appropriateness of remuneration for its members at least once a year. Every four years, it shall retain an external remuneration advisor to obtain an opinion as to the appropriateness of its remuneration – and especially, on whether remuneration is in line with common practice and comparable. The Supervisory Board shall present the results of this review as part of its report to the AGM. Where appropriate, the Supervisory Board will prepare recommendations for adjustments to its remuneration, and will submit them to shareholders at the next AGM.

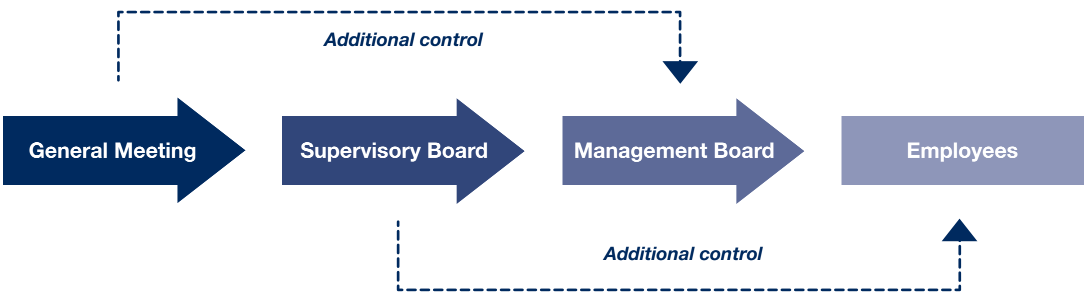
## Governance of Management Board remuneration

### The role of the Supervisory Board

The Supervisory Board shall act in the Company's interests; accordingly, it shall ensure that Management Board remuneration is geared towards the Company's sustainable development (cf. section 87 of the AktG). The Supervisory Board decides on Management Board remuneration, monitors appropriateness, defines targets for determining variable remuneration, and decides on target achievement. During the years following determination of variable remuneration], the Supervisory Board shall review, within the framework of backtesting/penalty reviews, whether variable remuneration determined originally must be adjusted or reclaimed (clawback).

As part of examining appropriateness of Management Board remuneration, the Supervisory Board shall review whether the remuneration system for the Management Board (as well as the corresponding targets for Management Board members derived therefrom) is consistent with the Company's business and risk strategies, the objectives derived from these strategies, the corresponding risk management, as well as with the defined risk appetite and the corporate values. As further elements of this examination of appropriateness, a vertical comparison with the average remuneration of relevant employees and the top management level below the Management Board is to be carried out, as well as a horizontal comparison with the remuneration of management board members of comparable enterprises. These components reflect the orientation of Management Board remuneration towards sustainable Company development, meaning that remuneration is aligned with the long-term interests of Aareal Bank's stakeholders.

### Determination and control of remuneration systems



When taking decisions concerning the structure of the remuneration system for the Management Board, the Supervisory Board shall take the views of Aareal Bank AG's relevant shareholders and of proxy advisors into account.

#### The role of the Remuneration Control Committee

The Remuneration Control Committee supports the Supervisory Board in its monitoring duties and prepares the plenary meeting's resolutions concerning remuneration. The Committee monitors the appropriateness of the structure of Management Board remuneration, proposes targets for variable remuneration and for target achievement at the end of the year, and also monitors the levels of target achievement during the course of each year. Moreover, the Committee assesses the effects of the remuneration systems on the Group's risk, capital and liquidity management. In the run-up to determining remuneration, in cooperation with the Audit Committee, it reviews whether there are any backtesting or penalty-triggering events which may result in a reduction of variable remuneration.

#### The role of the Risk Committee

The duties of the Risk Committee with regard to remuneration are unaffected by the assessment by the Remuneration Control Committee, as set out above. The Risk Committee verifies whether the incentives created by the remuneration system take the Company's risk, capital and liquidity structure into account, as well as the probability and timing of income.

#### The role of the Audit Committee

Circumstances where variable remuneration may be reduced may occur where Management Board members fail to fulfil any of their duties, or where they breach external or internal requirements. To the extent that any such events have occurred, these are identified in the reports prepared by Compliance, addressed to the Audit Committee as well as to the plenary meeting of the Supervisory Board. Internal conduct rules are also defined in a Code of Conduct which must be presented to the Audit Committee at least once a year.

#### The role of the Annual General Meeting

Under current legislation, Management Board remuneration may be submitted to the AGM for approval. Implementing the Second Shareholder Rights Directive in the German Public Limited Companies Act (AktG), as of the first ordinary Annual General Meeting following the 2020 financial year the AGM will address Management Board remuneration at least every four years as well as in the event of any material change to Management Board remuneration (say-on-pay).

### Governance of staff remuneration

#### The role of the Management Board

The Management Board is responsible for structuring the remuneration system for employees. As an element of appropriate and effective risk management, staff remuneration is monitored as to whether it is consistent with the corporate and risk culture, and with Aareal Bank's risk appetite. Especially with respect to the remuneration of material risk takers, the Management Board will take care to adjust remuneration parameters to such employees' influence on the Bank's risk exposure.

#### The role of the Supervisory Board / the Remuneration Control Committee / the Risk Committee

The Supervisory Board and its Remuneration Control Committee monitor the structure of staff remuneration. In this context, the Remuneration Control Committee also assesses the criteria for, and the actual selection of, Aareal Bank Group's material risk takers. Together with the Risk Committee, and in line with the rules for Management Board remuneration, the Remuneration Control Committee monitors whether the remuneration system for employees is consistent with the Company's business and risk strategies, the objectives derived from these strategies, its risk appetite and the risk management.

### Further information on the Supervisory Board and its committees

The composition and responsibilities of the Supervisory Board committees, and of the plenary meeting, are described in the Corporate Governance Statement/the Corporate Governance Report and in the Notes.

The Supervisory Board presents the remuneration-related activities of its plenary meetings and of its committees as part of its report to the AGM. This report also provides details regarding the number of meetings, and on the participation of the members of the committees and the Supervisory Board.

### The role of the Remuneration Officer

Following consultation of the Supervisory Board, the Management Board of Aareal Bank AG shall appoint a Remuneration Officer in order to ensure appropriate, sustained and effective monitoring of staff remuneration. Aareal Bank has appointed a Remuneration Officer, to carry out duties in accordance with section 24 of the InstVergV. These duties include supporting the Supervisory Board and the Remuneration Control Committee in structuring and monitoring the remuneration system. The Remuneration Officer is obliged to respond to queries of the Remuneration Control Committee's Chairman.

The Remuneration Officer reports on the appropriate structure of the remuneration systems for employees in the form of a Remuneration Report at least once a year. Due to the responsibility of monitoring the appropriateness of the remuneration systems on a continuing basis, the Remuneration Officer is being included in the conceptional new drafting (and future development), as well as in the application of the remuneration systems. In particular, the Remuneration Officer plays an active part in the process for the determination of the total amount available for variable remuneration, the annual review of penalty rules, the regular (at least spot checks) review of appropriate compliance structures, the monitoring of the hedging ban (and potential violations), the drafting of the annual remuneration report (pursuant to section 16 of the InstVergV in connection with Article 450 of the CRR) as well as the review of the risk taker analysis.

### Involvement of external remuneration advisors

As a matter of principle, the executive bodies of Aareal Bank decide upon remuneration themselves; they also come to an independent assessment of appropriateness. Especially for the purpose of examining whether remuneration is in line with common practice, compared with other companies, Aareal Bank retains external remuneration advisors.

## Takeover Disclosures in Accordance with Section 315a of the German Commercial Code (HGB)

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

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

### Restrictions affecting voting rights or the transfer of shares

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

## Shareholdings exceeding 10 % of voting rights

Details regarding any shareholdings exceeding 10 % of voting rights are provided in the Note "Disclosures pursuant to section 160 (1) no. 8 of the AktG".

## Shares with special rights granting the holder supervisory powers

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

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

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

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

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

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

## Authorisation of the Management Board to issue or repurchase shares

### Authorised capital

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

### Conditional capital

Based on a resolution passed by the Annual General Meeting on 22 May 2019, the Management Board was authorised to issue, on one or more occasions until 21 May 2024, profit-participation certificates with a limited or unlimited term for contribution in cash or in kind in a total nominal amount of up to € 900,000,000. The profit-participation certificates must be structured in such a way that the funds paid upon issuance are eligible as regulatory capital pursuant to the legal regulations applicable as at the time of issuance. Profit-participation certificates and other hybrid promissory note loans to be issued according to this authorisation shall be connected with conversion rights, entitling or compelling, in accordance with their respective conditions, the holder to purchase Company shares. Conversion rights or obligations may only be issued or created for no-par value bearer shares of the Company with a proportionate amount of the Company's share capital of up to € 71,828,664.00. The sum of shares to be issued so as to service conversion or option rights or conversion obligations from profit-participation certificates or hybrid promissory note loans issued pursuant to this authorisation, including shares issued during validity of this authorisation as a result of another authorisation (especially from the Authorised Capital 2017), may not exceed an amount of € 71,828,664.00 (which equals approx. 40 % of the current share capital). 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.

Accordingly, the Company's share capital is subject to a conditional capital increase not exceeding € 71,828,664.00 by issuance of up to 23,942,888 new no-par value bearer shares ("Conditional Capital 2019"). The purpose of the conditional capital increase is to grant shares to holders or creditors of convertible bonds issued in accordance with the aforementioned authorisation. The new no-par value bearer shares may only be issued at a conversion price in line with the resolution passed by the General Meeting on 22 May 2019. The conditional capital increase shall only be carried out insofar as conversion rights are exercised or as conversion obligations from such convertible bonds are fulfilled or as the Company makes use of alternative performance and insofar as no cash compensation is granted or treasury shares are used to service the rights. 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 Management Board is also authorised to determine the further contents of share rights and the terms governing the issuance of shares, subject to the approval of the Supervisory Board.

### Authorisation to purchase treasury shares

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

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

Subject to the approval of the Supervisory Board, the shares acquired under this or an earlier authorisation may be sold outside stock exchanges and without an offer to all shareholders, thereby excluding shareholders' pre-emptive rights, provided that the shares sold do not exceed the threshold value of 10 % of the Company's share capital and that the issue price is not significantly lower than the stock exchange price, or if the sale of such shares is made against contribution in kind, or if the shares are given to the holders of conversion or option rights, even if they had been issued by subsidiaries. The treasury shares may also be given to the holders of conversion or option rights in lieu of new shares from a contingent capital increase. The shares can 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. However, any and all share purchases involving the use of derivatives shall be limited to a maximum threshold value of 5 % of the Company's share capital. In addition, any acquisition of shares shall count towards the 10 % threshold for the authorisation to acquire treasury shares. Where treasury shares are acquired using equity derivatives, the shareholders' right to enter into any option transactions with the Company is excluded in analogous application of section 186 (3) sentence 4 of the AktG.

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

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

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

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

## Consolidated Non-Financial Report

The Combined Separate Non-Financial Report pursuant to sections 289b (3) and 315b (3) of the HGB has been published on the Company's website, on www.aareal-bank.com/en/responsibility/reporting-on-our-progress/.

## Corporate Governance Statement

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

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