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.

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. The strategic business segments are broken down into the three segments Structured Property Financing, Consulting/Services Bank and Aareon.

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 Bank segment, the Bank also generates bank 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 Bank

In the Consulting/Services Bank segment (formerly: Bank division Housing Industry, as of 1 January 2021: Banking & Digital Solutions), Aareal Bank Group offers its clients from the institutional housing industry, commercial property companies, as well as the energy and utilities industry, services for the management of properties used for residential purposes and the integrated processing of payment flows, as well as other services. With its BK 01 software, it operates a procedure for the automated settlement of mass payments, in the German property industry. The procedure is integrated in licensed bookkeeping systems. In conjunction with payment transactions processed via Aareal Bank's systems, deposits are generated that contribute significantly to Aareal Bank Group's refinancing base. Besides the German property industry, the German energy sector forms a second major client group of the segment 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. Aareal Bank is further strengthening its market position with its growing range of digital products and invoicing solutions within this segment. These products include mobile solutions for recording and processing meter readings, a platform solution for managing B2B payment processes and services, as well as a solution for simplifying invoice management of complex payment flows, whose first application was in e-mobility.

Aareon

In the Aareon segment, the Aareon sub-group offers its customers consulting, software and services solutions to optimise IT-supported business processes and to expand business models in the digital age. Aareon is present at 39 locations in Germany, Finland, France, the UK, the Netherlands, Norway, Austria, Romania (development business), Sweden and Switzerland. Aareon Smart World's portfolio of products, comprising ERP (enterprise resource planning systems) and digital solutions, networks property companies and their employees with clients, business partners as well as technical equipment in apartments and buildings. The ERP systems ensure recurring sales revenue and are a starting point for cross-selling activities for the digital solutions. The portfolio of digital solutions is being steadily expanded by the international research and development teams and through cooperations with PropTech enterprises. 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 the DACH region (Germany, Austria and Switzerland) 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.

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. As well as the designation of the Consulting/Services Bank segment, they were revised at the turn of the year as part of the strategic review. Given its relevance for management purposes, the Common Equity Tier I Capital Ratio is based on the so-called "phased-in" ratio pursuant to Basel IV:

- **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] (up to 31 December 2020) RoE after taxes[2] (from 1 January 2021)
- Consolidated net income allocated to ordinary shareholders of Aareal Bank[3] (up to 31 December 2020)
- Earnings per ordinary share (EpS)[4]
- Common Equity Tier 1 ratio (CET1 ratio) (%) – Basel IV (estimate) – (phased-in from 1 January 2021)

- **Structured Property Financing segment**
  - New business[5]
  - Credit portfolio of Aareal Bank Group

- **Consulting/Services Bank segment (as of 1 January 2021: Banking & Digital Solutions)**
  - Average deposit volume from the housing industry
  - Net commission income (in accordance with IFRSs)

- **Aareon segment**
  - Sales revenue (in accordance with IFRSs)
  - Adjusted EBITDA[6]

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.

The Consulting/Services Bank and Aareon segments also have specific management indicators typical for the respective business. The deposit volume from the housing industry and net commission income are key financial performance indicators for the Consulting/Services Bank segment. Aareon is managed on the basis of target figures commonly applied to software companies, such as sales revenue and adjusted EBITDA[6].

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

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

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

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

[5] New business = newly-originated loans plus renewals

[6] "Earnings before interest, taxes, depreciation and amortisation" excluding strategic investments (venture and M&A activities) and non-recurring effects

Report on the Economic Position

Macro-economic environment

The Covid-19 pandemic, which spread worldwide in the first quarter of 2020, and the measures taken in this context, resulted in a drastic collapse in economic output within a very short timeframe. Numerous economies faced enormous challenges in the first half of the year, some of which have not been seen since WWII. As a result of the measures taken to protect against the spread of the infection, which brought public life to a complete standstill in numerous countries and temporarily prohibited various services, as well as the collapse of various supply chains, the global economy plunged into a deep recession from March onwards. The second half of the year showed a marked recovery, which eased over time and ground to a halt as a result of renewed lockdowns imposed in many countries at the end of the year. State aid measures and a very loose monetary policy mitigated some of the negative effects this had on the economic players.

Economy

As a result of the Covid-19 pandemic, economic output in the euro zone in 2020 fell by 7.1 % compared with 2019. The year-on-year decline was still 15.0 % in the first half of 2020. In the third quarter of 2020, the economy improved by 12.5 % over the second quarter. New lockdowns in the fourth quarter of 2020 led to a renewed decline in individual euro zone countries. The services sector was hardest hit, while industrial production proved more stable. Governments implemented different aid and support measures – ranging from payment moratoriums to direct aid payments – to mitigate the consequences. While these measures varied from country to country, the aid provided totalled 4.5 % of gross domestic product in the euro zone. As a result, the government debt ratios in the euro zone increased.

The downturn was somewhat milder in some non-euro zone countries. The decline in Sweden's economic output, in particular, was less severe than in the rest of the EU. Economic output in Poland was down 2.9 % on the previous year. In contrast, the Czech Republic was harder hit by the pandemic than Poland or Sweden in 2020, with its economic output falling by 6.8 %.

In addition to the pandemic, Brexit also left its mark in the UK. The transition phase following the UK's exit from the EU on 31 January 2020 ended at the end of 2020. A trade deal was reached with the EU at the end of December 2020, thus avoiding a hard Brexit with numerous restrictions on trade. The deal also secures zero tariffs and unlimited movement of goods, albeit with greater bureaucratic hurdles to be overcome. Furthermore, the UK also ended the year 2020 with a hard lockdown, with the resultant negative effects. Overall, gross domestic product fell by 10.3 % during the course of 2020 compared with 2019.

Economic output in the US was 3.5 % lower in 2020 as a result of the Covid-19 pandemic, but made a marked recovery, especially in the third quarter of 2020. Several state aid programmes were rolled out during 2020, the last of which was launched towards the end of December. Uncertainty surrounding the presidential election also had a negative impact before easing at the end of 2020. In Canada, gross domestic product at the end of the year 2020 was down by 5.5 % on the same period of the previous year.

The pandemic had already started in China at the end of 2019, where it was brought under control much earlier than in the rest of the world. This meant that measures to ease restrictions took effect earlier, with positive knock-on effects for economic output, which showed no signs of a decline for the year as a whole. Exports, which are important for China, increased again in the second half of 2020.

In Australia, economic output in 2020 was 2.8 % lower than in the previous year, due to lower domestic consumption as a result of the Covid-19 pandemic.

The recession led to a sharp decline in employment across the globe. Whilst short-working programmes and other state measures tempered the rise in unemployment in many of the developed economies, large-scale redundancies have been seen in countries that did not have such programmes in place. In the US in particular, the number of people registering as unemployed for the first time rose dramatically within a short period. In April 2020, for example, the unemployment rate came to 14.7 % compared with 3.5 % at the end of 2019. However, the figure fell again to below 7.0 % by the end of 2020.

Annual rate of change in real gross domestic product

%	2020[1]	2019[2]
Europe		
Euro zone	-7.1	1.3
Austria	-7.5	1.4
Belgium	-7.1	1.7
Finland	-3.2	1.1
France	-9.1	1.5
Germany	-5.3	0.6
Italy	-9.0	0.3
Netherlands	-3.9	1.6
Spain	-11.1	2.0
Other European countries		
Poland	-2.9	4.6
Russia	-3.8	1.3
Sweden	-3.0	1.4
Switzerland	-3.1	1.1
United Kingdom	-10.3	1.4
North America		
Canada	-5.5	1.9
USA	-3.5	2.2
Asia/Pacific		
Australia	-2.8	1.9
China	2.1	6.0

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

Financial and capital markets, monetary policy and inflation

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

In 2020, the European Central Bank (ECB) adjusted its monetary policy several times to promote favourable financing conditions for the real economy in times of heightened uncertainty. While the key interest rate remained unchanged at zero per cent during the year, in March the Asset Purchase Programme (APP), which was launched back in September 2019 for an indefinite period, was ramped up by € 120 billion until the end of 2020. It will run from 2021 onwards on a monthly base level of € 20 billion. Additionally, a pandemic emergency purchase programme (PEPP) for public and private-sector issuers of securities was launched in March. This programme's volume was gradually increased during the year in several stages from € 750 billion originally to € 1.85 trillion. Its duration was also extended, most recently in December, to March 2022 at the earliest. The ECB will be maturing principal payments from securities purchased under the PEPP at least until the end of 2023. The terms for TLTRO 3 (Targeted Long-term Refinancing Operations 3) were also eased in March 2020 and extended in December, encouraging banks to maintain their lending policies. If the banks participating in these refinancing operations realise positive net lending to non-financial companies and private individuals in the euro zone in a reference period, this provides an attractive refinancing option with a negative interest rate that exceeds the ECB's deposit rate. There are also a number of other conditions attached to this programme.

The US Federal Reserve (FED) also took extensive measures in 2020 to support lending to households and the corporate sector, and to free up liquidity in the banking system. Two interest rate cuts implemented on 3 and 15 March lowered the key interest rate by a total of 150 basis points to a corridor of 0 – 0.25 %. As further stimulus, the FED made the decision on 15 March to increase its purchase programme for government bonds and mortgage-backed securities to an unlimited volume. Numerous lending programmes were also launched in the first half-year, to provide private and public-sector borrowers alike with liquidity and to help ensure that the credit markets could continue to function. As part of this programme only applies to 2020, it will be subsequently discontinued. On 27 August, the forward guidance was changed, whereby the current low interest rate policy is likely to remain in place in the medium term. This resets the inflation rate target at 2 % on average. The conversion to an average horizon suggests that exceeding the 2 % target slightly would be tolerated. Instead of taking deviations from the maximum employment level into account when setting monetary policy, a shortfall only will now be considered.

The Bank of England lowered the base rate to 0.1 % in two interest rate cuts in March 2020. The purchase programme for UK government and corporate bonds was also increased in several steps to a target value of GBP 895 billion.

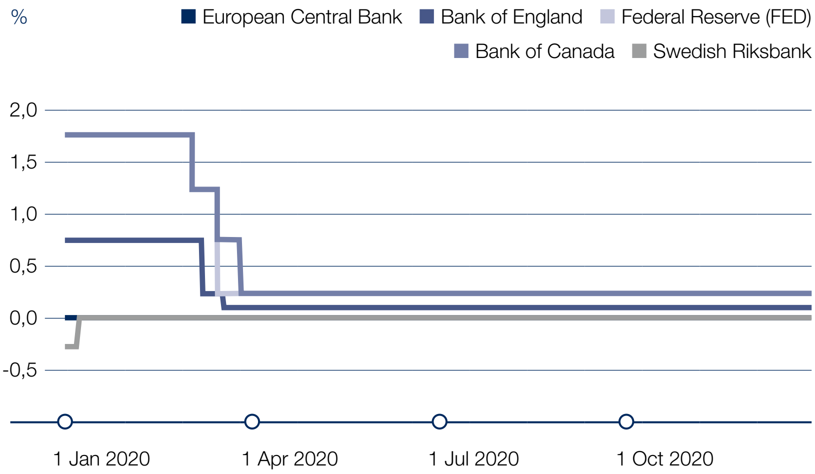
At year-end 2020, short-term interest rates[1)] were 15 basis points lower year-on-year in the euro zone and 25 basis points lower in Swedish krona. In US dollars and Canadian dollars, they fell by around 160 basis points. The decline was around 75 and 90 basis points respectively for pound sterling and Australian dollars.

Long-term interest rates[2)] fell initially at the start of the year in all of the currency areas that are relevant to Aareal Bank. As a direct consequence of the pandemic, they rose in April 2020 in all relevant currencies by around 40 to 50 basis points. Measured in euros, they then fell continuously to end roughly 50 basis points lower compared with the start of the year. Measured in USD, they fell up to mid-2020, before rising again by the end of the year. At the end of the year 2020, they were around 90 basis points below the 2019 year-end value. Long-term GBP interest rates developed in a similar manner; at the end of 2020 they remained around 60 basis points below the previous year's figure. They fell to a lesser extent in Swedish krona, at roughly 30 basis points less year-on-year at the end of 2020.

Government bonds with a ten-year maturity painted a mixed picture in the full-year 2020. While yields in the countries considered as safe havens fell in the course of the Covid-19 pandemic, they rose initially in Italy and Spain. Yields in the US, Sweden and the UK rose further in the second half of 2020, but declined again in Italy and Spain. At the end of 2020, yields in all the observed countries were down compared with the end of 2019.

Despite the current Covid-19 pandemic, the primary market in the euro zone's covered bond segment was defined by falling yields in 2020 due to the ECB's expansive monetary policy. Senior preferred bonds of many European banks were also trading at negative yields. Monetary policy taken, such as the ECB's TLTRO, also led to a significant reduction in the volume of new Pfandbriefe issued compared to 2019.

Key rate developments in 2020[3)]



[3)] The upper level of the corridor for Fed key rates is shown in the chart.

[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

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 II) at EU level as well as the EBA documents (Guidelines on PD and LGD estimation, treatment of defaulted exposures, and determination of downturn LGD), brought about further regulatory changes. The provisions put forward by the ECB, EBA and the EU Commission on the treatment of non-performing loans must also be taken into account. With regard to Covid-19, the IASB and relevant regulatory authorities such as the EBA, the ECB and ESMA formulated recommendations for implementation in the processes and for risk quantification, which we have taken into consideration accordingly. In addition, new reporting requirements were implemented, such as Covid-19 reporting, as well as relief measures such as the CRR Quick Fix, in which the date of application for selected topics, such as the SME Supporting Factor, were brought forward.

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

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. In the past year, ECB took a pragmatic SREP approach, which was mainly focused on the assessment of Covid-19-related risks. As a result, the score values and the requirements for additional capital and liquidity buffers remained unchanged except in justified individual cases. The assessment of Aareal Bank remained unchanged compared to the previous year.

Sector-specific and business developments

Structured Property Financing segment

Transaction volumes in 2020 declined substantially from the previous year, with notable difference in the regions. While volumes fell by around 40 % in North America, it was lower in Europe and the Asia/Pacific region at around 30 %. Transactions were delayed especially by measures taken to protect against the spread of the infection, while investor demand on the other hand remained intact. The latter can be assumed, given the virtually unchanged long and short positions of the investors. Property types varied; demand for logistics properties in particular remained strong, while fewer hotels and retail property changed hands, as a result of being directly affected by the government restrictions due to the measures taken to protect against the spread of the infection. The longer-term trend and radical changes brought about by online trading also impacted on retail property.

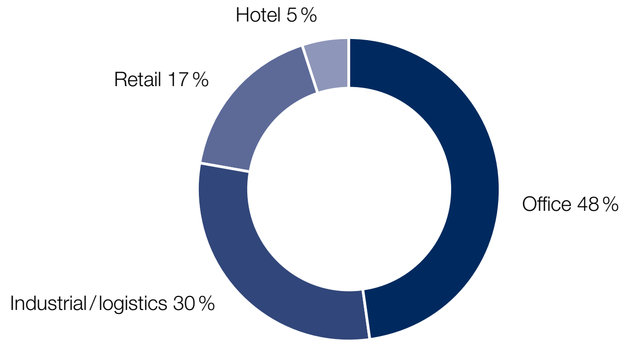
Measures imposed by various governments to protect against the spread of the infection in relation to the Covid-19 pandemic limited the operation of retail properties, hotels and student accommodation over a longer period of time in 2020 in many markets, resulting in lower revenues and rental income. Office properties were impacted rather indirectly by the measures, leading to greater uncertainty about future rental demand. Logistics properties, on the other hand, recorded higher rental demand.

In spite of the Covid-19 pandemic, market participants remained willing to provide financing for most types of property and locations in 2020. There were only partial restrictions, for example for retail properties in peripheral locations or some hotel properties. As a result, and with a smaller number of transactions, competition for commercial property financing remained intense. Margins increased in the course of the Covid-19 pandemic as refinancing rates rose. However, this trend reverted again as the situation eased in the course of the year. Refinancing costs and customer margins fell again, albeit not quite to the previous year's level. Loan-to-value ratios for new business declined.

In an environment influenced by the pandemic with high levels of uncertainty, Aareal Bank generated new business[1] of € 7.2 billion (2019: € 7.7 billion) and was therefore within the original target corridor of € 7 billion to € 8 billion, despite the adverse circumstances related to the pandemic. The estimated share of newly-originated loans was 75.6 % (2019: 80.1 %) or € 5.5 billion (2019: € 6.2 billion). Renewals amounted to € 1.7 billion (2019: € 1.5 billion). At 58.7 % (2019: 60.1 %), Europe accounted for the largest share of the financings, followed by North America with 36.6 % (2019: 35.1 %) and the Asia/Pacific region with 4.7 % (2019: 4.8 %).

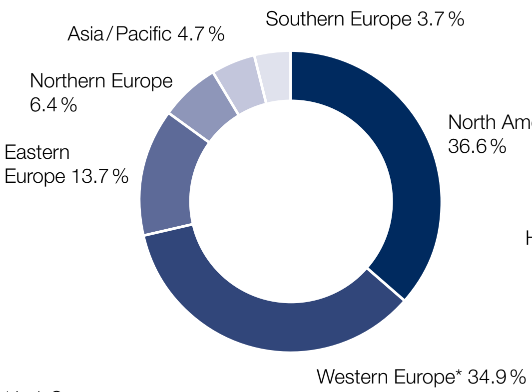
Share of transaction volume observed worldwide in 2020

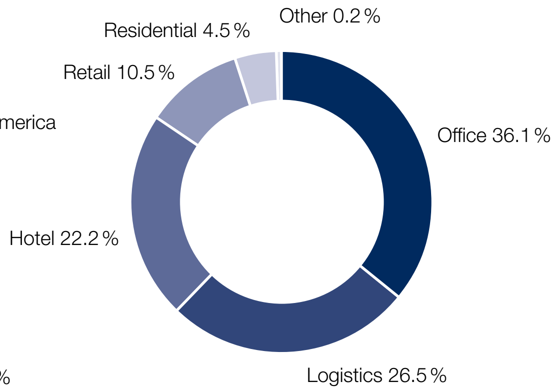
%



New business[1] 2020

by regions | by type of propert (%)





* Incl. Germany

[1] New business, excluding former WestImmo's private client business and local authority lending business.

With a share of 36.1 % (2019: 49.5 %), office property accounted for the largest share in new business in terms of property type, followed by logistics property at 26.5 % (2019: 9.9 %), whose share of new business increased appreciably, ahead of hotel property at 22.2 % (2019: 24.0 %) and retail property at 10.5 % (2019: 13.3 %). The share of residential property was 4.5 % (2019: 2.8 %), while other property and financings accounted for 0.2 % (2019: 0.5 %). Special attention was paid to the financing of modern, high-quality logistics properties in 2020.

Europe

Transaction volumes fell by around 30 % in Europe. The decline was lower in the UK and Poland. In Sweden, volumes even increased over the previous year. Investor positions changed only marginally compared with the previous year. Cross-border institutional investors were on the buy side for the most part, while REIT structures and private investors tended to be sellers.

Top yields[1] for office properties changed only marginally year-on-year and remained low. Top yields on European logistics properties decreased by 25 to 50 basis points. On contrast, top yields for retail and hotel properties rose between 50 and 125 basis points, especially in the UK. The development on the retail property market varied between shopping centres and retail parks, with the latter posting a lower rise of 25 to 50 basis points on average. In some markets, such as Germany and Sweden, they remained unchanged for retail parks.

The scenario during the year was similar for top rents. While they tended to remain rather stable for logistics properties, they fell by between 10 % and 20 % for retail property, whereby there were differences between shopping centres and retails parks. The latter were affected to a lesser extent by the measures taken to protect against the spread of the infection and remained open to a greater extent. Top rents for office properties fell by a few percentage points. With hotel properties, the lockdown led to a decline of around 50 % in average revenues per available hotel room, with income temporarily coming to a complete standstill. In contrast, occupancy improved significantly in part when measures taken to protect against the spread of the infection were eased. However, the higher levels of new infections at the end of the year and renewed lockdown measures had negative impact again.

The Bank originated new business of € 4.2 billion (2019: € 4.6 billion) in Europe during the year under review. As in the previous years, Western Europe accounted for the largest share of € 2.5 billion (2019: € 3.2 billion). This was followed by Eastern Europe, where new business of € 1.0 billion (2019: € 0.5 billion) was generated almost exclusively in Poland and the Czech Republic, Northern Europe with € 0.5 billion (2019: € 0.3 billion) and Southern Europe with € 0.2 billion (2019: € 0.6 billion).

North America

In North America, transaction volumes in 2020 were down by around 40 % year-on-year following an increase in the first quarter. The consequences of the Covid-19 pandemic were still being clearly felt at the end of the year. In terms of quantity, only half as many properties changed hands as in the previous year. This was particularly the case for retail and hotel property. Unlike in previous years, private investors were clearly on the seller side, whereas cross-border investors had almost balanced positions. Institutional investors were mainly on the buy side.

In 2020, rents offered for first-class offices in US metropolitan areas averaged 1.2 % lower compared with the end of the previous year. Developments did, however, vary from market to market. Rents in San Francisco fell by nearly 9 %. They were 4 % lower in New York, while remaining stable in Philadelphia. The development in rents for prime retail properties varied depending on the property subtype. Shopping malls, which were already under intense competitive pressure before the Covid-19 pandemic hit, reported a further

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

drop in rent and revenues, although this trend was also influenced by the pandemic. Local suppliers and retailers stocking everyday consumer goods, on the other hand, proved to be robust.

The pandemic impacted to a lesser extent on yields for first-class offices in the US in the year as a whole, thanks to high levels of liquidity and readiness to provide financing. Despite this, yields rose by just short of 20 basis points. Yields for malls also increased by around 20 basis points on average compared with the start of the year.

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

In North America, the Bank originated new business of € 2.7 billion (2019: € 2.7 billion) in 2020, almost all of which was attributable to the US.

Asia/Pacific region

Transaction volumes for commercial property in the Asia/Pacific region were roughly one third lower than in the same period of the previous year, owing to the Covid-19 pandemic. Fewer retail and hotel properties, in particular, changed hands in Asia/Pacific, too, while the number of logistics properties increased. Investor positions were similar to the previous year, with cross-border and institutional investors tending to be on the buy side, while REIT structures and private investors were more likely to be the sellers.

The development of top rents for office properties in Australia, China and Singapore showed a declining trend. Rents for logistics properties increased in Australia and China. However, rents for retail properties fell in all markets, due to the measures taken to protect against the spread of the infection, among other things. Rents for logistics properties rose.

Yields for top office properties rose by an average of 10 basis points in the Asia/Pacific region. While yields for shopping centres rose by up to 30 basis points, yields on logistics properties decreased by an average of 30 basis points.

Given that China represented the starting point for the pandemic, hotels there and in other Asian countries were impacted early in the year by the almost complete closure brought about by the measures taken to protect against the spread of the infection. This also meant, however, that relaxation measures were taken earlier than in other regions. While occupancy rates in China showed a rising trend thanks to domestic demand, they were still down noticeably year-on-year. Overall, average occupancy rates reached nearly 50 % in the Asia/Pacific region in 2020.

The Bank originated new business of € 0.3 billion in the Asia/Pacific region in 2020 (2019: € 0.4 billion).

Consulting/Services Bank segment

The residential and commercial property sectors in Germany are proving to be stable market segments, even in light of the Covid-19 pandemic. In general, steady rental income generated from a high occupancy status continues to guarantee a secure foundation. New-build rents rose by 3.7 % compared with the previous year (the third quarter is the comparative figure). Despite individual rent deferrals, no significant decline in rental income has therefore been witnessed on the housing market so far.

The shortage of residential space, which was the key driver of rental prices, eased. Construction in the most popular cities ("Schwarmstädte") is meanwhile nearly adequate, especially given that the trend to relocate here has eased off. Because of the high rents in city centres, people searching for accommodation have turned increasingly to the outskirts, with the resultant higher increase in rent prices there. This trend was reinforced by the Covid-19 pandemic, as the daily commute was no longer as important given the greater numbers working from home.

The 2020 financial year saw the Consulting/Services Bank segment strengthen its market position again via the acquisition of new clients. We also consistently intensified the cross-sector collaboration with our clients from the energy and waste disposal industry. This is accomplished especially through interface products such as BK01 eConnect and BK01 immoconnect, which extend across sectors and can be linked to housing industry products, such as the BK01 Invoice Data Processing, in order to facilitate for example accounting documentation and invoicing of energy supplies. This brought in more clients from the housing industry – managing more than 200,000 residential units between them – for the payments and deposit-taking businesses.

We once again strengthened our range of property industry services this year and at the same time extended the range of digital solutions for the housing industry and its clients.

With the Aareal Exchange & Payment Platform (AEPP), we offer a solution that enables companies to integrate alternative payment methods in the automatic administrative processes. AEPP also opens up the opportunity to implement new customer services and to invoice efficiently.

With Aareal Meter, we have developed a product together with pixolus GmbH that, based on mobile scanning of energy meters, automates and speeds up clients' meter reading processes.

Aareal Connected Payments acts as a new invoicing solution to support e-mobility. Aareal Bank co-operates here with the platform provider smartlab.

In collaboration with the Group company plusForta GmbH, we have extended our total offering in rental security deposits to include the tenant deposit guarantee alternative. All the variants for managing rental security deposits are digitally available and integrated in our processes.

The digital solutions also include the acquisition of joint control of the objego start-up, a joint venture with ista Deutsche GmbH, offering software to private landlords with up to 250 units, allowing them to manage their rented apartments in an efficient and straightforward manner.

At present, around 4,000 corporate clients throughout Germany are using our process-optimising products and banking services. The segment's volume of deposits averaged at € 11 billion in the 2020 financial year (2019: € 10.7 billion) and was thus in line with our expectations. All in all, this reflects the strong trust our clients continue to place in Aareal Bank. Additionally, despite the challenging environment we were able to increase net commission income in the Consulting/Services Bank segment as planned to € 26 million (2019: € 23 million).

Aareon segment

Aareon is a provider of ERP software and digital solutions for the European property sector and their partners in Europe. It pursues a growth strategy. Key factors to its success are client orientation, the growth in digital solutions, further strengthening of the ERP systems and exploration of new relevant markets and related sectors associated with the property industry. In the course of Aareon's forward-looking orientation and further intensification of research and development, the focus will be on digital solutions.

The 2020 financial year – in particular the second quarter – was dominated by the Covid-19 pandemic. Aareon supported its clients throughout the crisis – also by providing special product and service offerings, as well as numerous webinars – enabling them to continue their business operations in digital form. Clients with a high level of digitalisation were already at an advantage here. Client events were conducted successfully online, to the extent possible, while larger events, such as the Aareon Congress in particular, as a German industry event, were cancelled and adapted to digital formats. In September, Aareal held the online industry event Aareon Live in Germany, with more than 1,600 registered participants. Despite the Covid-19 pandemic, sales revenue including the CalCon Group was increased to € 258 million (2019:

€ 252 million). At € 62 million, an adjusted EBITDA[1] was achieved that was more or less on a par with the prior-year level (2019: € 64 million) The original forecast (which excluded Covid-19 effects and the consolidation of CalCon Group) had targeted revenue of € 272 million to € 276 million and an adjusted EBITDA of between € 68 million and € 71 million. Compared to the original fore-cast, the Consulting business in particular declined due to Covid-19, which could only partially be offset by sales revenues of acquired CalCon Group. Maintenance and Software as a Service (SaaS) businesses were material drivers of revenue growth. Revenue growth for digital solutions totalled 19 % compared to the previous year. This marked in-crease is due, among other things, to further market penetration and to the acquisition of CalCon Group as at 1 January 2020.

Additional clients were acquired in the Germany, Austria and Switzerland (DACH) region for the Wodis Sigma ERP solution and for the new Aareon Wodis Yuneo product generation, which was launched in September. This resulted in higher licence revenues, even though the favoured version continues to be the one that uses Wodis Sigma and Wodis Yuneo as a service from the exclusive Aareon Cloud. Additional licenses for SAP® solu-tions and Blue Eagle also led to high licence reve-nues. Migration projects were continued remotely during the Covid-19 pandemic. The last migration projects from GES to other ERP solutions were con-cluded on 1 July 2020. As at 31 December 2020, Aareon discontinued GES operations in the Aareon IT centre as planned. Additional commercial prop-erty clients were acquired for the RELion ERP solution, resulting in higher licence and consulting revenue. The business with Aareon Cloud Services continued on its positive trajectory. BauSecura's insurance business was up on the previous year's level. In the international ERP business, recurring revenues in particular from maintenance and Soft-ware-as-a-Service-(SaaS) increased further as a result of client rollouts. This is reflected especially in the Netherlands, where the transformation of the business model to an SaaS operation gained momentum. The Dutch REMS ERP solution for the commercial property business was stable in terms of sales revenue and an important new client was rolled out as scheduled. The new release of Prem'-Habitat was launched on the market in France, with clients – including one major client – having opted for it already. Many sales successes were reported in the UK with new and existing clients – including one major key client. Sales activities were stepped up in the Nordic countries to acquire new clients. Consulting revenue was down on the previous year due to the Covid-19 pandemic, despite the growing demand for the "green" online consulting offering.

Digitalisation is becoming increasingly important for the property industry. The Covid-19 pandemic acted as a catalyst in this respect, with a growing number of clients enhancing their ERP systems with the addition of integrated digital solutions, thus developing their own digital ecosystem, so that business volumes with digital solutions continued to rise in 2020.

Demand remains strong in the DACH region and in the international business for the WRM (Work-force Relationship Management), CRM (Customer Relationship Management) and SRM (Supplier Relationship Management) solutions. The market-ing of the Aareon Smart Platform, which was rolled out in the fourth quarter of 2019, continued. In the second quarter of 2020, Aareon announced the AI-based virtual assistant Neela (CRM solution) in Germany, and started marketing activities in the Netherlands, the UK and the Nordics. In a first stage, Neela was introduced as a chatbot. Neela facilitates an even more comfortable relationship between customers and property companies. In November 2019, Aareon had signed the contract to acquire CalCon with effect from 1 January 2020. The project for integrating the CalCon group was concluded in the first half of 2020.

With a view to potential inorganic growth, Aareon's management conducted a comprehensive screen-ing process looking at potential acquisition targets

[1] "Earnings before interest, taxes, depreciation and amortisation" excluding strategic investments (venture and M&A activities) and non-recurring effects

and identified opportunities that are being pursued systematically with the Value Creation Programme. On 23 December 2020, Aareon announced the acquisition of 100 % of the shares in Arthur Online Ltd., London (Arthur). Arthur offers a cloud-based software solution for property management focused on the UK, which brings together property managers, property owners, tenants and contractors on a single platform. The company was acquired with effect from 29 January 2021.

Financial Position and Financial Performance

Financial performance

Group

Consolidated operating profit for the 2020 financial year came to € -75 million due to the impact of the Covid-19 pandemic and was thus significantly below our original forecast and the previous year's level of € 248 million.

At € 512 million, net interest income was down on the previous year (€ 533 million) and our original forecast of a slightly declining net interest income, mainly due to a decline in the loan and securities portfolios in the course of the year. This was attributable to the previous year's accelerated de-risking involving defaulted loans, a larger exposure to a single borrower and securities in Italy, as well as to lower new business in the first half of the year on account of the Covid-19 pandemic. In parallel with the portfolio growth, net interest income rose again at the end of the year and also includes a pro rata interest benefit from the TLTRO programme in the amount of € 11 million.

Loss allowance amounted to € 344 million and was therefore significantly higher than the previous year's figure (€ 90 million) and our original forecast of a slightly declining loss allowance, largely because of the adverse economic effects related to the Covid-19 pandemic. Based on the extended and further tightened global lockdown measures, the Bank has generally classified all loans for which liquidity support measures (payment deferrals and liquidity facilities) were granted as stage 2 as at 31 December 2020 and recognised loss allowance in the amount of the losses expected for the entire remaining term. The assumption that no signifi-

Consolidated net income of Aareal Bank Group

€ mn	1 Jan - 31 Dec 2020	1 Jan - 31 Dec 2019
Net interest income	512	533
Loss allowance	344	90
Net commission income	234	229
Net derecognition gain or loss	28	64
Net gain or loss from financial instruments (fvpl)	-32	1
Net gain or loss from hedge accounting	6	-4
Net gain or loss from investments accounted for using the equity method	1	1
Administrative expenses	469	488
Net other operating income/expenses	-11	2
Operating profit	**-75**	**248**
Income taxes	-6	85
Consolidated net income	**-69**	**163**
Consolidated net income attributable to non-controlling interests	5	2
Consolidated net income attributable to shareholders of Aareal Bank AG	-74	161

cant decrease in credit quality within the meaning of IFRS 9 has occurred is only made in exceptional cases when this is justified based on supportable information. Stage 3 loss allowance increased due to new loan defaults; causes for increases with respect of existing exposures included a deterioration of market values, particularly affecting shopping centres in the UK and individual exposures in the US. The scope of current valuation reviews within the portfolio particularly affected by the Covid-19 pandemic (including property types such as retail, hotels, and student housing) for the purpose of year-end valuation covered this portfolio almost completely; external valuations accounted for approximately 85 % of the lending volume. Overall, the valuation reviews were in line with our expectations from the third quarter of 2020, except for a few NPL cases (non-performing loans). No management overlay was required by the year-end. Moreover, the accelerated de-risking burdened the loss allowance in the second quarter with € 9 million.

Net commission income increased to € 234 million (2019: € 229 million) on the back of higher sales revenue at Aareon and in the Consulting/Services Bank segment. However, due to the Covid-19 pandemic, the increase was below our original forecast.

The net derecognition gain of € 28 million (2019: € 64 million) was attributable to market-driven effects from early loan repayments, and to repurchases in the Treasury business within the scope of market support. The higher figure for the previous year reflected structural adjustments to our securities portfolio following the acquisition of former Düsseldorfer Hypothekenbank AG (Düsselhyp).

At € -26 million (2019: € -3 million), the net result from financial instruments (fvpl) and from hedge accounting was also burdened by Covid-19. The decline was largely due to credit-risk induced measurement losses of defaulted property loans, which are reflected in the net gain or loss from financial instruments (fvpl).

In spite of rising expenses in connection with Aareon's growth, administrative expenses declined to € 469 million (2019: € 488 million), also due to cost savings incurred in connection with the Covid-19 pandemic, meaning that it came in below our original forecast of slightly increasing administrative expenses. The previous year's figure still included running costs and integration expenses in the amount of € 11 million incurred in conjunction with the integration of Düsselhyp.

Net other operating income/expenses of € -11 million (2019: € 2 million) was burdened by write-downs on properties held by the Bank in the amount of € -33 million, as a result of Covid-19.

All in all, the consolidated operating loss for the 2020 financial year totalled € 75 million, after a profit of € 248 million in 2019. Taking into consideration income from income taxes of € -6 million (positively influenced by the capitalisation of deferred taxes) and non-controlling interest income of € 5 million, consolidated net income attributable to shareholders of Aareal Bank AG amounted to € -74 million (2019: € 161 million). Assuming the pro rata temporis accrual of net interest payments on the AT1 bond, consolidated net income allocated to ordinary shareholders stood at € -90 million (2019: € 145 million). Earnings per ordinary share (EpS) amounted to € -1.50 (2019: € 2.42), and RoE before taxes -4.1 % (2019: 8.9 %). In our original forecast, we had assumed stable consolidated net income allocated to ordinary shareholders and EpS as well as RoE before taxes more or less on the same level as in the previous year.

Structured Property Financing segment

Operating profit in the Structured Property Financing segment amounted to € -99 million, due to the effects of the Covid-19 pandemic (2019: € 276 million).

Net interest income in the segment of € 474 million was down on the previous year (€ 549 million), mainly due to a year-on-year decline in the loan and securities portfolios. This was attributable to the previous year's accelerated de-risking involving defaulted loans, a larger exposure to a single borrower and securities in Italy, as well as to lower new business in the first half of the year on account of the Covid-19 pandemic. In parallel with the portfolio growth, net interest income rose again at the end of the year and also includes a pro rata interest benefit from the TLTRO programme in the amount of € 11 million. The adjusted transfer pricing and the increased interest rate on residual deposits of the Consulting/Services Bank segment from 1 January 2020 onwards led to a decline in net interest income in the Structured Property Financing segment (see Note 71 of the consolidated financial statements).

Loss allowance of € 344 million (2019: € 90 million) was recognised, largely due to the adverse economic effects related to the Covid-19 pandemic. Based on the extended and further tightened global lockdown measures, the Bank has generally classified all loans for which liquidity support measures (payment deferrals and liquidity facilities) were granted as stage 2 as at 31 December 2020 and recognised loss allowance in the amount of the losses expected for the entire remaining term. The assumption that no significant decrease in credit quality within the meaning of IFRS 9 has occurred is only made in exceptional cases when this is justified based on supportable information. Stage 3 loss allowance increased due to new loan defaults; causes for increases with respect of existing exposures included a deterioration of market values, particularly affecting shopping centres in the UK and individual exposures in the US. The scope of current valuation reviews within the portfolio particularly affected by the Covid-19 pandemic (including property types such as retail, hotels, and student housing) for the purpose of year-end valuation covered this portfolio almost completely; external valuations accounted for approximately 85 % of the lending volume. Overall, the valuation reviews were in line with our expectations from the third quarter of 2020, except for a few NPL cases. No management overlay was required by the year-end. Moreover, the accelerated de-risking burdened loss allowance in the second quarter with € 9 million.

The net derecognition gain of € 28 million (2019: € 64 million) was attributable to market-driven effects from early loan repayments, and to repurchases in the Treasury business within the scope of market support. The higher figure for the previous year reflected structural adjustments to our securities portfolio following the acquisition of former Düsseldorfer Hypothekenbank AG (Düsselhyp).

Structured Property Financing segment result

€ mn	1 Jan - 31 Dec 2020	1 Jan - 31 Dec 2019
Net interest income	474	549
Loss allowance	344	90
Net commission income	8	10
Net derecognition gain or loss	28	64
Net gain or loss from financial instruments (fvpl)	-32	1
Net gain or loss from hedge accounting	6	-4
Net gain or loss from investments accounted for using the equity method	2	1
Administrative expenses	227	254
Net other operating income/expenses	-14	-1
Operating profit	**-99**	**276**
Income taxes	-14	95
Segment result	**-85**	**181**

At € -26 million (2019: €- 3 million), the net result from financial instruments (fvpl) and from hedge accounting was also burdened by Covid-19. The decline was largely due to credit-risk induced measurement losses of defaulted property loans, which are reflected in the net gain or loss from financial instruments (fvpl).

Administrative expenses declined to € 227 million (2019: € 254 million), due to cost savings in connection with the Covid-19 pandemic. The previous year's figure still included running costs and integration expenses in the amount of € 11 million incurred in conjunction with the integration of Düsselhyp.

Net other operating income/expenses of € -14 million (2019: € -1 million) was burdened by write-downs on properties held by the Bank in the amount of € -33 million, as a result of Covid-19.

Overall, operating profit for the Structured Property Financing segment was € -99 million (2019: € 276 million). Taking into consideration income from income taxes of € -14 million (2019: € 95 million), which were positively impacted by the capitalisation of deferred taxes, the segment result amounted to € -85 million (2019: € 181 million).

Consulting/Services Bank segment

The year-on-year improvement in net interest income to € 39 million (2019: € -15 million) for the Consulting/Services Bank segment was due primarily to adjusted transfer pricing and the increased interest rate on residual deposits from 1 January 2020 onwards (see Note 71 of the consolidated financial statements). Net interest income continues to be burdened by the negative margins from the deposit-taking business due to the persistently low level of interest rates.

As planned, net commission income of € 26 million showed positive development (2019: € 23 million).

As a result of Covid-19, administrative expenses fell slightly to € 68 million (2019: € 73 million).

Overall, segment operating profit was € -3 million (2019: € -65 million). Taking income taxes into consideration, the segment result amounted to € -2 million (2019: € -44 million).

Aareon segment

Net commission income in the Aareon segment was € 213 million and increased slightly (including CalCon Group) despite the Covid-19 pandemic (2019: € 208 million).

Administrative expenses rose to € 188 million (2019: € 173 million), due to business expansion (including the CalCon Group) and strategic investments.

Consulting/Services Bank segment result

€ mn	1 Jan - 31 Dec 2020	1 Jan - 31 Dec 2019
Net interest income	39	-15
Loss allowance	0	0
Net commission income	26	23
Administrative expenses	68	73
Net other operating income/expenses	0	0
Operating profit	**-3**	**-65**
Income taxes	-1	-21
Segment result	**-2**	**-44**

Aareon segment result

€ mn	1 Jan - 31 Dec 2020	1 Jan - 31 Dec 2019
Net interest income	-1	-1
Loss allowance	0	0
Net commission income	213	208
Net gain or loss from financial instruments (fvpl)	0	0
Net gain or loss from investments accounted for using the equity method	-1	0
Administrative expenses	188	173
Net other operating income/expenses	4	3
Operating profit	**27**	**37**
Income taxes	9	11
Segment result	**18**	**26**

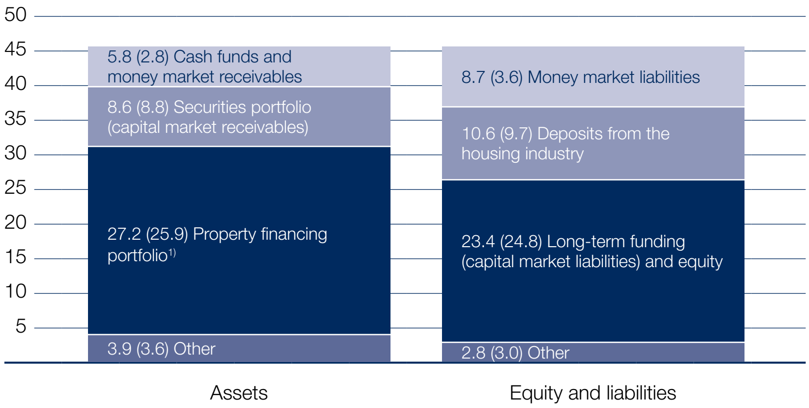
Overall, segment operating profit was € 27 million (2019: € 37 million). Taking income taxes into consideration, the segment result amounted to € 18 million (2019: € 26 million).

Financial position

Consolidated total assets of Aareal Bank Group increased to € 45.5 billion as at 31 December 2020 (31 December 2019: € 41.1 billion), especially reflecting the use of targeted longer-term refinancing operations (TLTROs): this led to increases in cash funds and money-market liabilities.

Statement of financial position – structure as at 31 Dec 2020 (31 Dec 2019)

€ bn



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

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 2020, this comprised predominantly cash funds and deposits with central banks and money-market receivables from banks.

Property financing portfolio

As at 31 December 2020, the volume of Aareal Bank Group's property financing portfolio[2] stood at € 27.2 billion (2019: € 25.9 billion). Including former WestImmo's private client and local authority lending businesses, it amounted to € 27.8 billion. After a marked increase in the second half of the year, the volume was thus at the upper end of our target corridor of € 26 billion to € 28 billion.

Portfolio allocation by region and continent did not change significantly compared with the end of the previous year. Whilst the portfolio share of exposures in Eastern Europe rose by around 1.9 percentage points, it was down by around

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

1.6 percentage points for Southern Europe, due to accelerated de-risking in Italy. It remained relatively stable for all other regions. The Covid-19 pandemic led to higher LtVs in most regions, especially in North America.

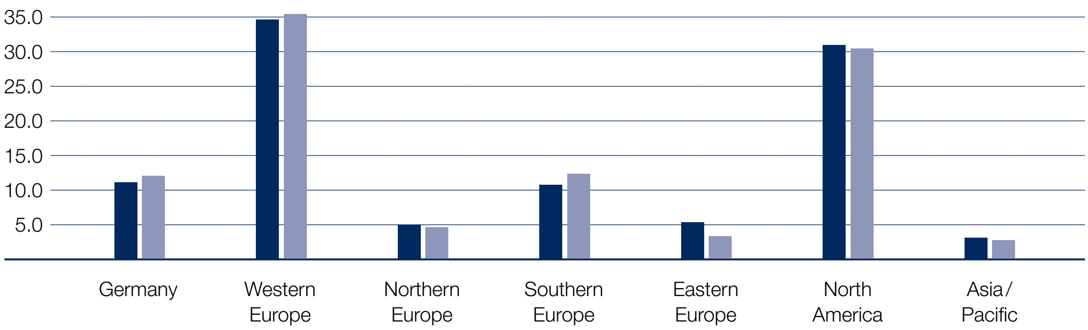
The breakdown of the portfolio by property type did not change significantly during the reporting period. The share of logistics properties increased by 3.3 percentage points compared to year-end 2019, whilst the share of retail properties was reduced by 2.7 percentage points. The share of office, hotel and residential properties, as well as other financings in the overall portfolio remained almost unchanged compared to year-end 2019. The Covid-19 pandemic led to higher LtVs, especially for hotel and retail property.

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.

Property financing volume[1] (amounts drawn)

by region (%)

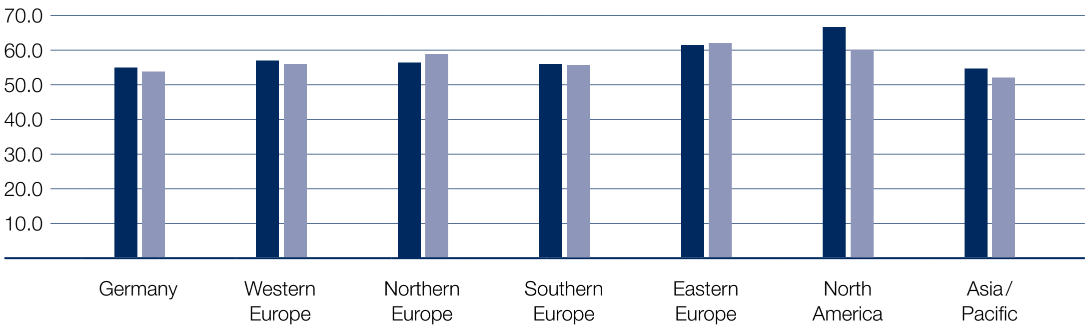
■ 31 Dec 2020 (100 % = € 27.2 bn) ■ 31 Dec 2019 (100 % = € 25.9 bn)



Average LTV of property financing[1]

by region (%)

■ 31 Dec 2020 ■ 31 Dec 2019

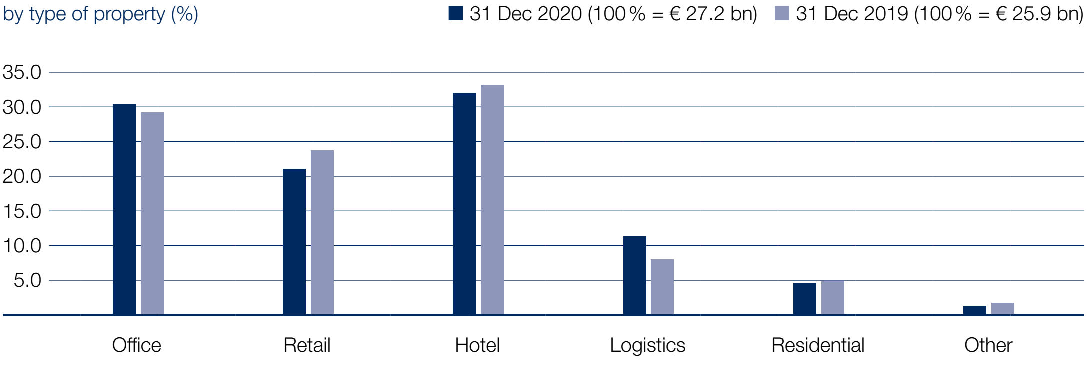


Note that the loan-to-value ratios are calculated on the basis of drawdowns and market values, including supplementary collateral with sustainable value, excluding defaulted property financings.

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

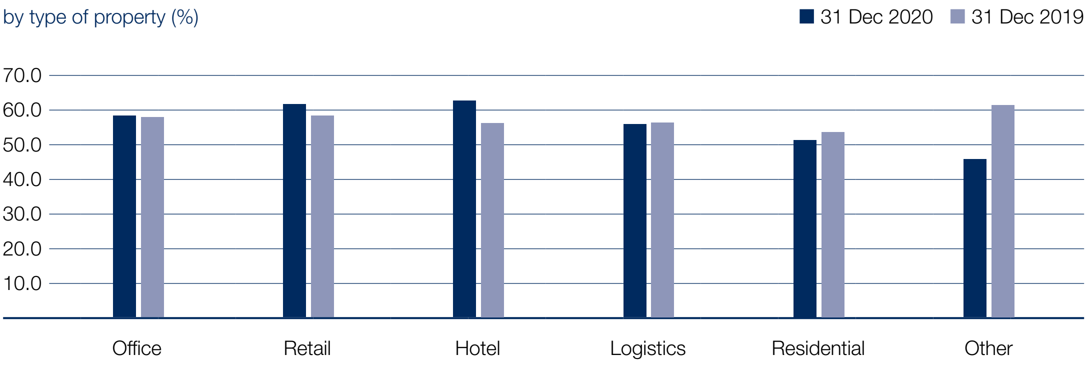
Property financing volume[1] (amounts drawn)

by type of property (%)



Average LTV of property financing[1]

by type of property (%)



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

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

Treasury-Portfolio

As explained below, Aareal Bank holds a high-quality 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 2020, the total nominal volume of the Treasury portfolio[2] was € 7.2 billion (31 December 2019: € 7.3 billion).

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

[2] As at 31 December 2020, the securities portfolio was carried at € 8.6 billion (31 December 2019: € 8.8 billion).

The high creditworthiness requirements are also reflected in the rating breakdown in the portfolio. 99.9 % of the portfolio has an investment grade rating[1], and 83 % of the positions have an AAA to AA- rating (2019: 78 %).

The portfolio currently comprises almost exclusively (98 %) securities denominated in euros and its average remaining term on the reporting date was 6.2 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 2020, Aareal Bank had € 10.6 billion at its disposal in deposits generated from the business with the housing industry (31 December 2019: € 9.7 billion). Money market liabilities, including targeted longer-term refinancing operations (TLTROs) of Deutsche Bundesbank, amounted to € 8.7 billion (31 December 2019: € 3.6 billion).

Long-term funding and equity

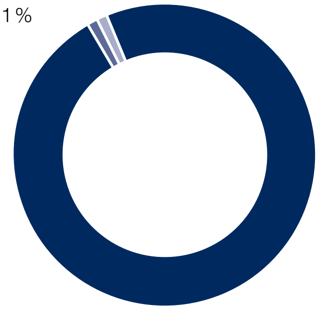
Funding structure

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 (AT 1) bond.

Treasury portfolio as at 31 December 2020

%

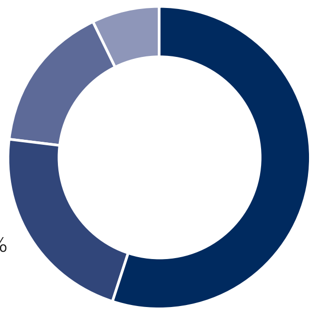
Total volume (nominal): € 7.2 bn



Money market funding mix as at 31 December 2020

%

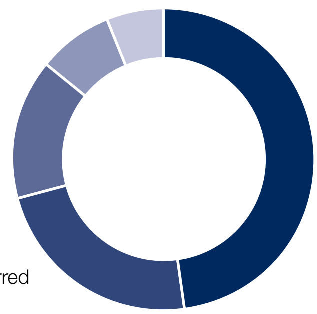
Total volume: € 19.3 bn



Capital market funding mix as at 31 December 2020

%

Total volume: € 19.1 bn

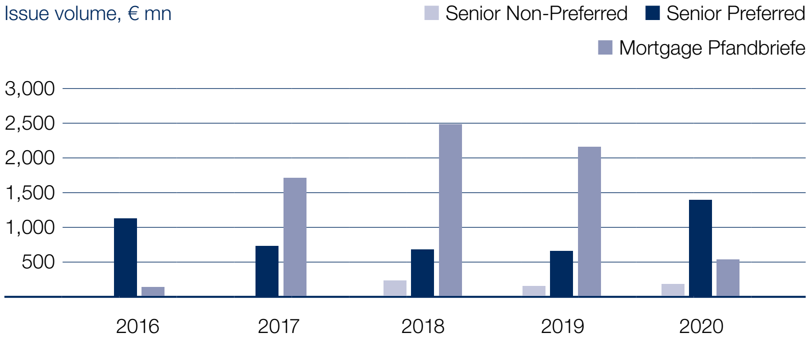


[1] The rating details are based on the composite ratings.

As at 31 December 2020, the notional volume of the long-term refinancing portfolio was € 19.1 billion. The book values of the long-term refinancing portfolio totalled € 20.7 billion.

Issuing activities – 2016 to 2020

Issue volume, € mn



Refinancing activities

Throughout the financial year 2020, Aareal Bank Group was able to place € 2.1 billion on the capital market, comprising € 0.5 billion of Pfandbrief, € 1.4 billion of senior preferred and € 0.2 billion of senior non-preferred issues. In addition, the bank issued Pfandbriefe in the amount of € 0.9 billion which it took onto its own books. Aareal Bank Group raised € 4.3 billion as part of TLTRO 3.

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

Equity

Aareal Bank Group's total equity as disclosed in the statement of financial position amounted to € 2,967 million as at 31 December 2020

Regulatory indicators[1)]

	31 Dec 2020[2)]	31 Dec 2019
€ mn		
Common Equity Tier 1 (CET 1)	2,286	2,191
Tier 1 (T1)	2,586	2,491
Total capital (TC)	3,395	3,343
%		
Common Equity Tier 1 ratio (CET 1 ratio)	18.8	19.6
Tier 1 ratio (T1 ratio)	21.3	22.3
Total capital ratio (TC ratio)	28.0	29.9
Common Equity Tier 1 ratio (CET 1 ratio) – Basel IV (fully phased-in) –[3)]	13.1	13.5
Common Equity Tier 1 ratio (CET 1 ratio) – Basel IV (phased-in) –[3)]	17.3	17.1

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

2) 31 December 2019: excluding dividend for 2019 from initial proposal on the appropriation of net retained profit and including a pro-rata temporis deferral of net interest on the AT1 bond
31 December 2020: including dividend for 2019 from initial proposal on the appropriation of net retained profit and less a proposed dividend of € 1.50 per share in 2021 and pro-rata temporis deferral of net interest on the AT1 bond. The 2021 dividend payment of € 1.50 for 2020 would need to be made in two steps. In compliance with the requirements published by the European Central Bank (ECB) on 15 December 2020, the distributable amount is calculated at € 0.40 per share. The Management Board plans to submit a corresponding proposal for the appropriation of profits to the ordinary Annual General Meeting in May 2021. Depending on further economic developments, regulatory requirements, the Bank's capital position and its risk situation, a subsequent Annual General Meeting, which could possibly take place during the fourth quarter of 2021, could then decide on the intended remaining payout of € 1.10 per share.
The SREP recommendations concerning the NPL inventory and the ECB's NPL guidelines for exposures newly classified as NPLs, as well as the "CRR Quick fix" as of 30 September 2020, were taken into account.

3) Underlying RWA estimate, incorporating the higher figure determined using the revised AIRBA or the revised CRSA (phased-in), 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.).

(31 December 2019: € 2,861 million), comprising € 300 million for the Additional Tier 1 (AT 1) bond. Retained earnings increased especially due to the sale of a minority stake in Aareon and the fact that no dividend was paid for the previous year. Please also refer to the statement of changes in equity, and to our explanations in Note 58 of the consolidated financial statements.

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.

Our Employees

The year under review brought major changes for our employees too. As a part of the Business Continuity Management, the pandemic led to the announcement of a mandatory working-from-home order at all German locations in March 2020 as part of the emergency planning due to the Covid-19 pandemic. Following a first working-from-home test phase in mid-March 2020, almost all employees were able to continue working seamlessly from home, thus maintaining operations in this way throughout the entire lockdown. Since the end of the first lockdown, we introduced a rolling attendance system. Implemented together with a strict hygiene concept, this allowed employees to work partially at the office again. Where appropriate and compatible with the local regulations, the emergency planning was implemented at our international locations correspondingly. At the start of the first lockdown, our employees quickly organised themselves with digital tools to facilitate cooperation. These experiences have shown us that we can successfully make it through the crisis using new ways of cooperation.

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 Bank's training and education programme was restructured in the year under review. The result of this restructuring is Learning@Aareal – a learning provision of which 50 % the content is available in digital format, therefore facilitating permanent learning regardless of time or location. Learning@Aareal supports employees in performing their current tasks through targeted offers that are focused on the company and personal strategy, Aareal Bank's USP (unique selling point) and a consistent skill matrix. Learning@Aareal also helps to improve the balance between work and family life, which is one of Aareal Bank's core concerns. Learning@Aareal is integrated in Aareal Bank's strategic development approach, which uses a skill matrix as the basis

Employee data as at 31 December 2020

	31 Dec 2020	31 Dec 2019	Change
Number of employees at Aareal Bank Group	2,982	2,788	7.0 %
Years of service	10.8 years	11.6 years	-0.8 years
Staff turnover rate	4.5 %	4.6 %	-2.2 %

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.

for talent development at an organisational level. By linking skill matrix, Learning@Aareal, clear selection procedures and management and expert career paths, we are facilitating the sustainable development of our employees. Networking knowledge contributes to the permanent development of the organisation and guarantees that specialist knowledge is secured to sustainable succession planning. Besides the conceptual new approach, tried and tested formats for specific and generic training measures – for example, in the form of qualification programmes for (agile as well as traditional) project management, were pursued as well as supporting measures related to organisational and team development. A programme for newly appointed executive staff was also launched for the first time.

Personnel development at Aareon continued in digital format during the Covid-19 pandemic. An e-learning management system was introduced, which offered training on housing industry topics from EBZ Bochum and on management, agile project management, soft skills, communication and health. Other training measures included an IT security boot camp and special consulting training sessions.

A digital language learning portal helped to further build language and communications skills on both Aareal Bank and Aareon, within the scope of internationalisation. This learning portal allows all employees throughout the Group to improve their language skills, anywhere (even at home) and at any time.

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. For the first time, Aareal Bank offered vocational training in IT application development in 2020, in cooperation with other companies in the region. Aareal Bank closely collaborates with universities in the region through various initiatives. In addition to the successful transfer of specialist knowledge and the gathering of new perspectives, the specific measures taken at Aareal Bank to empower young professionals have already reduced the average age.

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.

In the course of the measures for promoting the next generation, Aareon supported the JOBLINGE initiative aimed at socially deprived young citizens. First participants of this programme have meanwhile embarked on their training. Aareon also held two applicant training courses for participants of the JOBLINGE initiative. To promote trainees and science, Aareon is cooperating with several universities, offers placements and supports 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 close relatives. 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), as well as the option of participating in various training courses in the Bank 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 numerous measures as part of the "work4future" project concluded in 2020. The works agreement on mobile working was implemented in 2019, increasing our employees' work flexibility. A digital collaboration tool was introduced for internal communications, which brought employees even closer together in the Covid-19 pandemic, despite social distancing. This was supported through various campaigns and regular posts by members of the Management Board. The room concepts were developed further in line with the requirements of day-to-day cooperation, to become even more innovative and successful in this context.

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. Despite the restrictions imposed by the pandemic in the reporting year, successful formats continued to be applied in the Bank. These included preventative, individual health consultations on various topics, consultations with the company doctor including screenings, flu vaccinations, skin screenings, colorectal cancer screening and ergonomics advice at the work place, massages (until the lockdown), as well as business yoga that was continued digitally. In company health management, Aareon implemented numerous measures for supporting employees in the digital working worlds in 2020 – this was particularly relevant against the background of the Covid-19 pandemic.

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.

Aareal Bank regularly reviews the appropriateness and effectiveness of its corporate governance systems (including risk governance systems).

Given the Covid-19 pandemic, the various processes and systems affected were reviewed right at the start of the pandemic. Management has thus responded to the Covid-19 crisis in a comprehensive manner. The Pandemic Committee established continuously ascertained (IT) operations, including required hygiene and distancing rules. Technical equipment has proven to be effective during the crisis, which involved longer periods of working from home. Specific Covid-19 scenarios were developed at an early stage, in order to simulate the potential impact applying different parameters. Besides an event-driven review of the Risk Appetite Framework and the credit risk strategies, methods used to determine scenario assumptions for risk management of the property finance portfolio were extended. Reporting frequencies were adjusted as required. The prevailing situation was discussed continuously with all affected stakeholders in the respective bodies.

Aareal Bank also includes sustainability risks – so-called ESG risks (environmental, social and governance) – in its risk management. Fundamentally, Aareal Bank considers sustainability risks to include cross-species risks and risk drivers that are influenced directly or indirectly by environmental or social issues, or by monitoring processes. All material sustainability risks were able to be classified as a form of existing financial and non-financial risks. In line with this, they are managed implicitly as part of the risk types under which they are classified.

Risk management – scope of application and areas of responsibility

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 is carried out at Group level via the relevant control bodies of the respective entity, and equity investment risk controlling.

Overall responsibility for risk management and risk monitoring remains with the Management Board and – in its function of monitoring the Management Board – the Supervisory Board of Aareal Bank AG. The diagram below 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. Risk Controlling is responsible for monitoring financial risks at portfolio level, whilst the Non-Financial Risk division exercises this function for non-financial risks. Both divisons report directly to the Group Chief Risk Officer (GCRO).

On top of this, Group Internal Audit (as the "Third Line of Defence") reviews the organisational structure and procedures, as well as risk processes

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 Credit Risk Project & Credit Portfolio Management Credit Transaction Management Workout	Risk Controlling Second Line of Defence (NPL)
Treasury business	Treasury	Risk Controlling
Country risks	Treasury Credit Risk Credit Transaction Management	Risk Controlling
Interest rate risk in the banking book (IRRBB)	Treasury, Asset-Liability Committee	Risk Controlling Finance & Controlling
Market risks	Treasury, Asset-Liability Committee	Risk Controlling
Operational risks	Process owners	Non-Financial Risks
Investment risks	Group Strategy	Risk Controlling Finance & Controlling Controlling bodies
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		

– 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 function, 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. The Risk Appetite Framework, which also outlines the key elements of the risk culture put in place, is defined consistently with the business strategy and building on the defined risk appetite. Taking the Risk Appetite Framework as a basis, and strictly considering the Bank's risk-bearing capacity, we have formulated detailed strategies for managing the material types of risk, in terms of capital as well as liquidity. 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, the Risk Appetite Framework and the risk strategies are subject to review on an ongoing basis, and are updated if necessary. In the wake of the pandemic and the associated macroeconomic impact, an extraordinary review of risk strategies was carried out in 2020. Besides the regular review (and, if appropriate, adjustment) of the business strategy (and consequently, the Group risk strategy), the Bank's risk-bearing capacity and its material risk models are 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.

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 framework of the Internal Capital Adequacy Assessment Process (ICAAP)) is a core determining factor governing the structure of its risk management system. To ensure its uninterrupted risk-bearing capacity, Aareal Bank Group has adopted a dual management approach comprising two complementary perspectives: the normative and the economic perspective.

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

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

Besides the planning process itself, intra-year computation adjustments to Aareal Bank Group's planning process also included the ongoing monitoring of management indicators as well as checking whether limits in the normative perspective were 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, hidden encumbrances, or a management buffer.

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

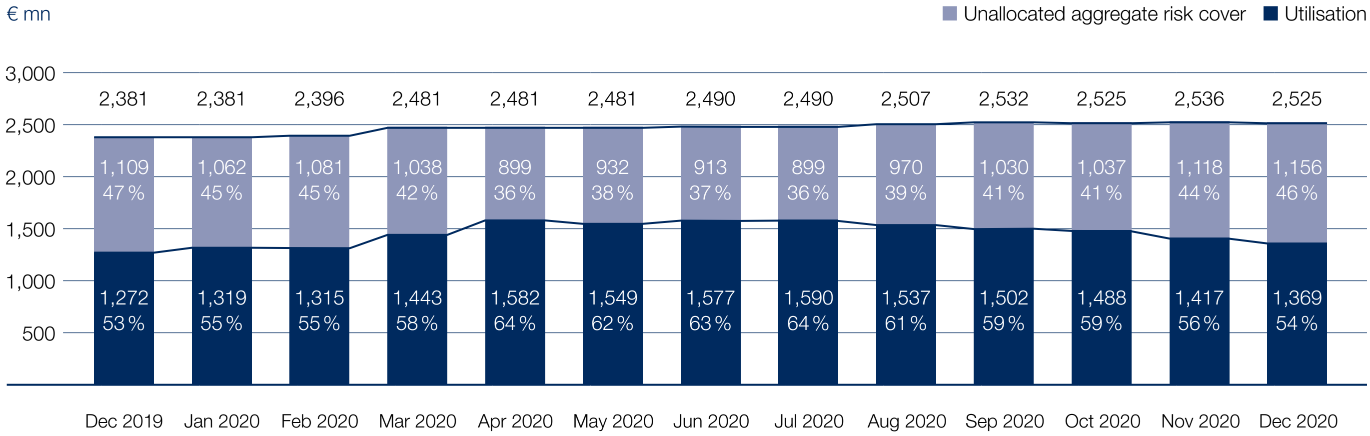
Looking at correlation effects between material types of risk within the framework of the economic ICAAP perspective, Aareal Bank Group has prudently opted for aggregation of risk levels; accordingly, no risk-mitigating correlation effects are being taken into account. Where we measure risks on the basis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

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

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

€ mn	31 Dec 2020	31 Dec 2019
Tier 1 (T1) capital	2,586	2,491
Economic adjustments	-61	-110
Aggregate risk cover	**2,525**	**2,381**
Utilisation of aggregate risk cover		
Loan loss risks	637	525
Interest rate risk in the banking book (IRRBB)	68	93
Market risks	415	360
Operational risks	102	123
Investment risks	35	30
Property risks	76	60
Business and strategic risks	36	81
Total utilisation	**1,369**	**1,272**
Utilisation (% of aggregate risk cover)	**54 %**	**53 %**

Utilisation of aggregate risk cover during the course of 2020



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. Higher market volatility caused by the Covid-19 pandemic triggered isolated transgressions of early warning thresholds: this indicates that the limit system is adequately calibrated and shows its steering effect, in the sense of being responsive to significant changes in overall conditions. Corresponding countermeasures have been taken; the overall utilisation of risk cover shows that capitalisation is adequate.

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

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

Stress testing

Within the scope of ICAAP and ILAAP, scenario analyses are carried out in all perspectives, as a core element 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 macro-economic 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.

The Management Board and the Supervisory Board are informed of the results issued by the stress analyses 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.

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, Credit Transaction Management and Credit Portfolio Management (organisational units 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. Contractual measures related to Covid-19 – such as the waiver of certain agreements, deferrals of repayments, or the provision of liquidity facilities – are being reported to the Management Board on a regular basis, and closely monitored.

Extensive IT resources are deployed to identify risk positions, and to monitor and assess risks. Overall, the existing set of tools and methods enables the Bank to adopt 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. 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 which are independent from each other.

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.

In this context, PD and LGD procedures are also applied for accounting purposes, for determining model-based loss allowance. Concerning the scenario analyses to be taken into account when determining individual LGDs, we applied an updated scenario mix, going beyond the customary process. This probability-weighted scenario mix reflects the uncertainties as to how the Covid-19 pandemic will develop further and supplements our baseline scenario (swoosh) with the addition of divergent developments over an observation period of three years.

The expected loss (EL) in the event of default of an exposure is determined as the product of PD, LGD and EAD. 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 Group 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 Credit Transaction Management 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 an Asset-Liability Committee (ALCO), to develop strategies for the Bank's asset/liability management and proposals for their implementation. The ALCO, 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.

Credit Transaction Management 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, Credit Transaction Management 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 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 Bank also includes sustainability risks, to the extent that they are relevant for the assessment. 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 credit risk strategy adopted is subsequently discussed by the Supervisory Board.

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. Given the changed economic conditions due to the Covid-19 pandemic, we have thus completed an event-driven review and update, which included stricter requirements for new business involving those types of property particularly affected by the Covid-19 pandemic.

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 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.

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

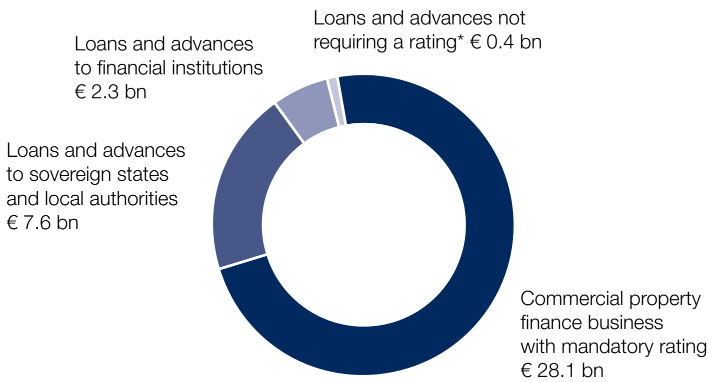
Methods used to measure, control and monitor concentration and diversification effects on a portfolio level include two different credit risk models. Based on these models, the Bank's decision-makers are regularly informed of the performance and risk content of property financing exposures, and of business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

Within the process-oriented monitoring of individual exposures, the Bank uses various tools to monitor exposures on an ongoing basis: besides the tools already described, this includes rating reviews, the monitoring of payment arrears, and the regular, individual analysis of the largest exposures. The intensity of loan coverage is oriented upon the credit risk exposure.

Against the background of the Covid-19 pandemic, Aareal Bank was in close contact with most property financing clients with mandatory rating, and has amended contractual arrangements to clients' updated business plans to the extent necessary and possible. Given the lockdown, this primarily affected financings of hotels and shopping centres, as well as involving waivers of certain contractual agreements without impact on payments (covenants). Our clients and sponsors have provided a significant portion of the required liquidity from their own resources. In addition, funds obtained from government assistance were used and a few

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

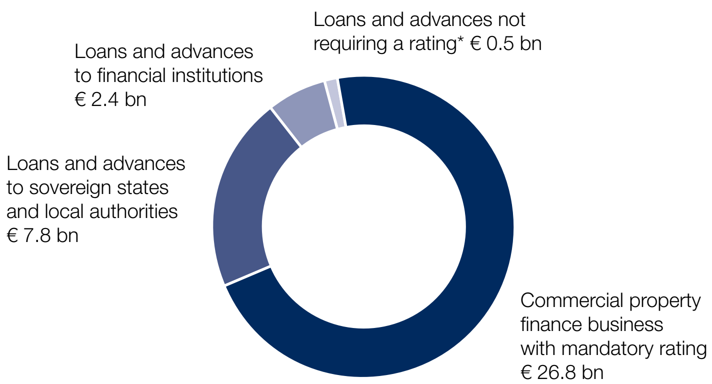
by rating procedure, € bn — 31 Dec 2020



* Including the private client business of former WestImmo

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

clients reduced their exposures. Aareal Bank supported clients through deferrals of repayments totalling € 120 million as well as liquidity facilities of € 146 million. The gross carrying amount of the on-balance-sheet lending business under government moratoria amounted to € 49 million, whilst the gross carrying amount of on-balance sheet lending business subject to Covid-19-related forbearance measures amounted to € 6.5 billion. Measures related to Covid-19 – such as deferrals of repayments, or the provision of liquidity facilities – are being reported to the Management Board on a regular basis, and closely monitored.

On top of existing processes, additional measures were implemented during the year under review for those portfolios particularly affected by the Covid-19 pandemic, such as retail, hotels, and student housing. These portfolios were subject to particular monitoring (regardless of whether liquidity facilities were provided), including ad-hoc valuation reviews of the financed properties, which were increasingly backed by external appraisals. The frequency for periodic monitoring and internal rating (which also comprise a detailed target/actual comparison of the business plan) was adjusted to a semi-annual cycle. The CRE Credit Risk Committee was closely involved in evaluating and assessing all credit or monitoring decisions. A separate reporting system was established for the affected portfolios, enabling follow-ups of individual exposures and providing credit-relevant information, in order to be able to derive suitable measures at portfolio level, at an early stage.

When accounting for these measures, we have taken the recommendations made by the IASB, and by relevant regulatory authorities such as the EBA, the ECB and ESMA, into consideration – with the objective of providing a realistic assessment of expected losses. Intensified handling triggers recognition of loss allowance, in the amount of lifetime expected credit loss for the financial instrument concerned (Stage 2). The same applies for financings for which a forbearance measure has been granted. As at 31 December 2020, we assume recovery to kick in later (compared to expectations in the third quarter of 2020) due to the pandemic developments. These prospective changes in estimates result in such Covid-19-related liquidity measures no longer being of a temporary nature, but lead to a significant deterioration of credit quality in general. The assumption that no significant decrease in credit quality has occurred is only made in exceptional cases when this is justified based on supportable information.

The following tables provide a breakdown of gross carrying amounts of on-balance sheet as well as off-balance sheet credit business, money-market business, and capital markets business, by rating classes and loss allowance stages, in line with credit risk management at Group level. The impact of the Covid-19 pandemic has led to an increase in Stage 2 loss allowance. Figures are based on Aareal Bank Group's internal default risk rating classes. The default definition follows the definition pursuant to Article 178 of the CRR, which is decisive for management purposes.

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.

On-balance sheet commercial property finance business with mandatory rating

	31 Dec 2020					31 Dec 2019				
	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
€ mn										
Class 1										
Class 2	73				**73**	62				**62**
Class 3	249	4			**253**	430			2	**432**
Class 4	1,142				**1,142**	1,368				**1,368**
Class 5	3,684	9		249	**3,942**	3,447			495	**3,942**
Class 6	3,920	426		184	**4,530**	4,300	20		64	**4,384**
Class 7	2,991	297		253	**3,541**	3,872			75	**3,947**
Class 8	3,140	574		38	**3,752**	6,051	35		209	**6,295**
Class 9	2,565	1,271		14	**3,850**	2,936			56	**2,992**
Class 10	707	2,961		17	**3,685**	860	344			**1,204**
Class 11	453	514			**967**	174				**174**
Class 12	1	16			**17**	1	16			**17**
Class 13							60			**60**
Class 14										
Class 15										
Defaulted			1,547	95	**1,642**			935	149	**1,084**
Total	**18,925**	**6,072**	**1,547**	**850**	**27,394**	**23,501**	**475**	**935**	**1,050**	**25,961**

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

Off-balance sheet commercial property finance business with mandatory rating

	31 Dec 2020					31 Dec 2019				
	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
€ mn										
Classes 1-2										
Class 3						22				**22**
Class 4	29				**29**	25				**25**
Class 5	69			10	**79**	63			17	**80**
Class 6	168				**168**	117				**117**
Class 7	87	0		14	**101**	141			25	**166**
Class 8	123	9			**132**	271	4			**275**
Class 9	158	41			**199**	101				**101**
Class 10	12	80			**92**	34				**34**
Class 11	30	11			**41**	1				**1**
Classes 12-15										
Defaulted			1	5	**6**			2		**2**
Total	**676**	**141**	**1**	**29**	**847**	**775**	**4**	**2**	**42**	**823**

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

On-balance sheet loans and advances to financial institutions

€ mn	31 Dec 2020 Stage 1	Stage 2	Stage 3	fvpl [1]	Total	31 Dec 2019 Stage 1	Stage 2	Stage 3	fvpl [1]	Total
Class 1	853				**853**	815				**815**
Class 2	213				**213**					
Class 3	26				**26**	172				**172**
Class 4	108				**108**	82				**82**
Class 5	48				**48**	49				**49**
Class 6	26				**26**					
Class 7	677				**677**	836				**836**
Class 8	320				**320**	417				**417**
Class 9						35				**35**
Class 10	33				**33**	26				**26**
Classes 11-18										
Defaulted										
Total	**2,304**	**–**	**–**	**–**	**2,304**	**2,432**	**–**	**–**	**–**	**2,432**

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

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

€ mn	31 Dec 2020 Stage 1	Stage 2	Stage 3	fvpl [1]	Total	31 Dec 2019 Stage 1	Stage 2	Stage 3	fvpl [1]	Total
Class 1	3,622				**3,622**	2,505				**2,505**
Class 2	1,674			26	**1,700**	2,680			65	**2,745**
Class 3	778			62	**840**	739			67	**806**
Class 4	76				**76**	100				**100**
Class 5	36				**36**	176				**176**
Class 6	177				**177**	262				**262**
Class 7	151				**151**	189				**189**
Class 8	1				**1**	6				**6**
Class 9	404	556			**960**	925	125			**1,050**
Classes 10-20										
Defaulted										
Total	**6,919**	**556**	**–**	**88**	**7,563**	**7,582**	**125**	**–**	**132**	**7,839**

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

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

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.

Due to Covid-19, the associated lockdowns, and the increased number of enquiries, there were delays in obtaining external appraisals for properties which showed evidence of fluctuations in value. During the reporting year, Aareal Bank accounted for this by means of internal appraisals and management overlays. The scope of current valuation reviews within the portfolio particularly affected by the Covid-19 pandemic (including property types such as retail, hotels, and student housing) for the purpose of year-end valuation covered this portfolio almost completely. External valuations accounted for approximately 85 % of the lending volume. Overall, the valuation reviews were in line with our expectations from the third quarter of 2020, except for a few NPL cases. No management overlay was required by the year-end.

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)]

[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").

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.

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. Credit Transaction Management is responsible for the daily valuation of the Bank’s trades, including collateral accepted or pledged, and using validated valuation procedures.

Collateral for derivative transactions is usually provided in cash. 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

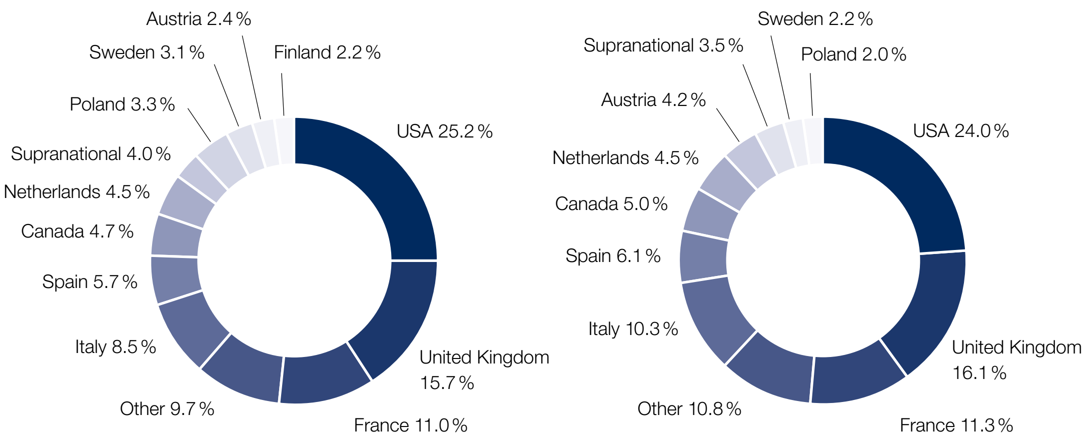
Our comprehensive approach to risk management also includes measuring and monitoring country risk exposure. When defining country risk, in addition to the risk of sovereign default or default of state entities, Aareal Bank also considers the risk that a counterparty could become unable to meet its payment 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 below illustrates the risk exposure by country (comprising receivables and off-balance sheet obligations) in the Bank’s international busi-

Breakdown of country exposure in the international business

%

31 Dec 2020 | 31 Dec 2019



ness, 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, 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 our goal to pursue a 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 following tables 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 1 capital shown) for six early-warning indicators, applying the prescribed scenarios. The ratio of the aggregate result

Changes in present value

	31 Dec 2020		31 Dec 2019	
	-200 bp	+200 bp	-200 bp	+200 bp
€ mn				
EUR	9	49	5	37
GBP	19	-21	21	-20
USD	62	-39	18	-28
Sonstige	8	-18	8	-13
Total	**98**	**-29**	**52**	**-24**
Percentage ratio to regulatory capital	**2.9**	**0.9**	**1.6**	**0.7**

€ mn	31 Dec 2020	31 Dec 2019
Parallel shock up	-32	-30
Interest rate coefficient for parallel shock up (%)	1.2	1.2
Parallel shock down	98	52
Interest rate coefficient for parallel shock down (%)	3.8	2.1
Steepener shock	50	38
Interest rate coefficient for steepener shock (%)	1.9	1.5
Flattener shock	2	-44
Interest rate coefficient for flattener shock (%)	0.1	1.8
Short rates shock up	-39	-40
Interest rate coefficient for short rates shock up (%)	1.5	1.6
Short rates shock down	92	51
Interest rate coefficient for short rates shock down (%)	3.6	2.0
Tier 1 (T1) capital	**2,586**	**2,491**

to Aareal Bank Group's Tier I capital is clearly below the prescribed threshold of 15 %.

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.

Additional elements of market risk are:

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

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

Risk measurement and monitoring

Risk Controlling informs the members of the Management Board responsible for Treasury and risk monitoring about the risk position and 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, the VaR figure takes into account the correlation between individual risk types. Statistical parameters used in the VaR model are calculated directly from a historical data pool maintained within the Bank, which covers at least 250 days.[1] The loss potential is determined applying a 99.9 % confidence interval.

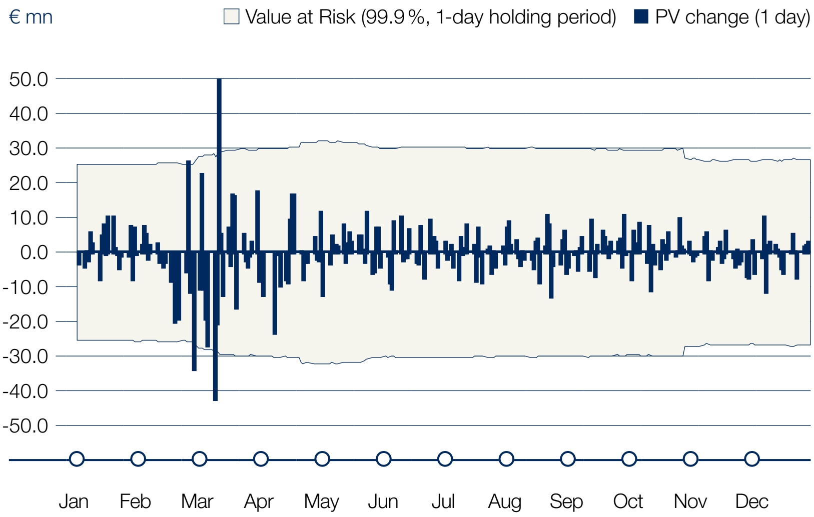
Backtesting

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 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.

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

Two negative outliers were observed at Group level during the past 250 trading days, also as a result of volatility induced by Covid-19 in March; this does not refute the long-term forecasting quality of the VaR model we use.

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



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:

[1] Historical data covering two years is used for the sub-risk type of credit spread risk.

- 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.

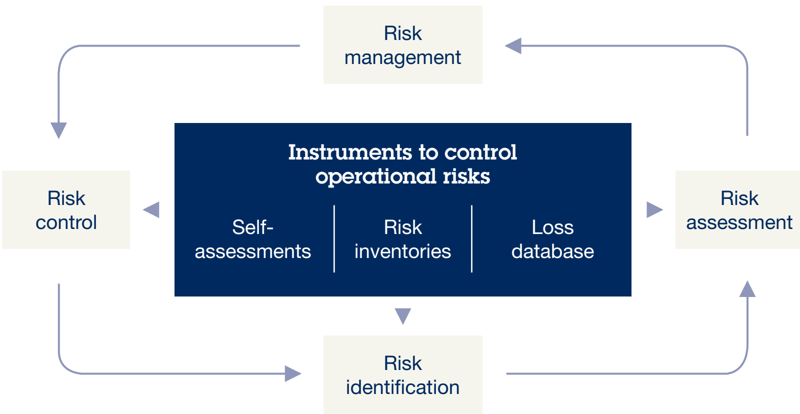
The three tools described above are used to prepare the regular risk reporting to the Bank's senior management. The responsibility for implementing operative risk-reducing measures rests with those responsible for the Bank's risk management. The utilisation of freely available funds for operational risks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

Management of operational risks



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 are recorded in the loss database on an ongoing basis, the aggregate impact of such losses during the year under review 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.

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. The effects of the Covid-19 pandemic required a valuation review for some properties. This required write-downs to be recognised for properties held by the Bank. Property risks increased during the period under review, as a result of the acquisition of a property SPV from an Italian credit exposure.

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. A property's risk contribution 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 macro-economic 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. All elements have been integrated in an overarching ILAAP, which maps liquidity risks in both the normative and the economic perspective. Within the framework of Group planning, in addition to ICAAP risk parameters taken into account for capital planning purposes, ILAAP risk parameters for a three-year horizon are also considered.

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

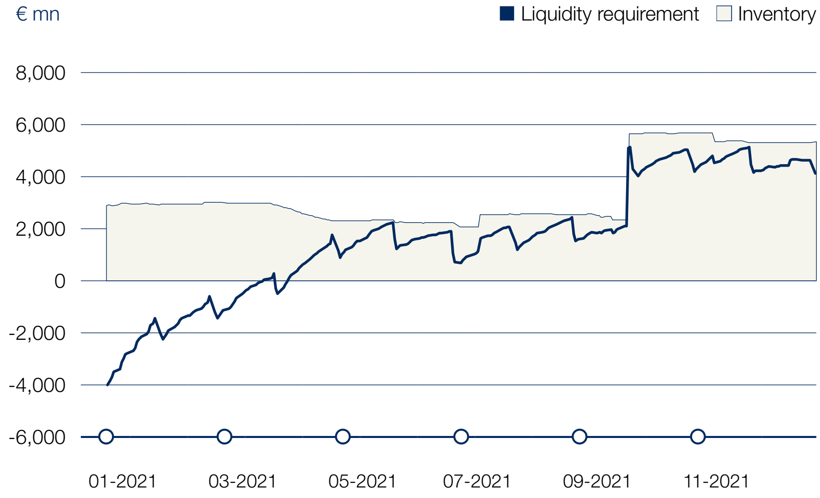
Moreover, we employ stress tests and scenario analyses to assess the impact of sudden stress events onto the Bank's liquidity situation. The various standardised scenarios used are evaluated on the basis of the liquidity run-off profile.

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

Liquidity development



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 2021. The chart demonstrates that the liquidity stock will always exceed liquidity requirements, even under adverse conditions. The increase in the liquidity stock from September 2021 onwards reflects the maturity of Targeted Longer-Term Refinancing Operations (TLTROs), together with related collateral.

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 eserves 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 provisions of 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 and IT requirements.

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 due to new legal requirements. The Covid-19 pandemic has not required any material adjustments to the accounting-related Internal Control System.

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

The economy, financial markets and commercial properties are subject to a series of risks, whereby some downside risks – such as the risk of a no-deal Brexit or uncertainties in the course of the US presidential election – were not triggered until the end of 2020. Nonetheless, 2021 will continue to be exposed to other risks that could have negative implications. These include the ongoing Covid-19 pandemic and its economic burdens, protectionist tendencies, doubt about the cohesion of the European Union, higher public and private borrowing and other geopolitical risks.

An ongoing Covid-19 pandemic due to further new infections or the failure of the vaccines to deliver the anticipated success could halt or even stop the recovery of the global economy. An extension or reintroduction of protective measures against the infection – also due to newly emerging Covid strains – could have negative consequences for demand and for the services sector.

A resurgence of the European sovereign debt crisis also has to be considered a threat. Sovereign debt is rising in many places, whilst the legal situation in the euro zone materially increases the risk of a crisis, which could resurge, for example, due to higher debt levels resulting from the Covid-19 pandemic or because of doubts as to solidarity within the euro zone. Political uncertainty in Spain also needs to be mentioned in this context. A separation of the Autonomous Community of Catalunya from the Kingdom of Spain might have negative economic consequences, which are as yet difficult to assess. Spain and Italy, among others, pose another risk with their high number of Covid-19 infections. Although the EU's rescue package announced in July 2020 is aimed in particular at supporting these countries, there is still a risk that the measures will not be quite enough to stem the negative consequences.

The reform backlog and structural economic problems in some euro zone countries, in particular following the government crisis in Italy, geopolitical risks (e.g. armed conflicts, terrorism) represent further uncertainties, risks and stress factors.

Non-financial enterprises in many of the developed countries have increased their borrowings significantly, especially by issuing bonds. In many instances, these bonds are just about rated in investment grade territory. An ongoing pandemic or other risks could be a reason for downgrading the rating of these bonds. The ending of special regulations and state aid represents a risk for higher insolvency rates among non-financial enterprises.

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

There are several risks for commercial property resulting from the Covid-19 pandemic: bans on contact, travel restrictions and business closures of a temporary nature to begin with are likely to have a marked negative impact on cash flows in 2021 too, particularly for hotel and retail properties. They are exposed to the risk of continuing constraints and the resulting follow-on risks, which might reduce cash flows over the longer term. Furthermore, the Bank cannot exclude that the pandemic's economic impact – particularly due to new protective measures against the spread of the infection – will continue to have a negative effect upon property values.

The Bank expects competition in the commercial property financing markets to remain intense, particularly in regions and for property types that were less adversely affected by the pandemic. While loan-to-value ratios for new business look set to remain virtually stable, changes in the market environment could put direct pressure on margins, or result in higher loan-to-value ratios.

Economy

The rapid development and approval of Covid-19 vaccines support the assumption that the global economy will recover by a strong 5.0 % on 2021. As pre-crisis levels will not be reached everywhere, even at the end of the year, the recovery is therefore expected to be largely gradual. Various measures taken at the end of 2020 to protect against the spread of the infection are likely to dampen the recovery.

Gross domestic product in the euro zone is expected to increase by 4.2 % in 2021. This is based on expectations that retail sales will remain solid, exports increase and investments recover at a slower pace. The funds from the EU support packages are also likely to provide support in the second half of the year. Given that the respective member states have formulated different support packages, the recovery with definitely be heterogeneous.

With gross domestic product forecast to grow by 4.5 % in 2021, the UK is expected to recover. The trade agreement reached with the EU is likely to support the recovery and reduce uncertainty, albeit not entirely.

We expect economic growth of 4.2 % for the US in 2021, especially due to fiscal support towards mid-year. Despite high Covid-19 numbers, the economic situation should gradually return to normal. The economy in Canada is expected to grow by 4.4 % in 2021, with accelerating growth anticipated from mid-year onwards.

China was already showing signs of recovery at the end 2020, which should continue into 2021. However, we will see a shift in the growth drivers from infrastructure investment and exports to consumption and corporate investments.

Based on consumption and a positive trend on the labour market, Australia's economy is expected to grow by 3.1 % in 2021. The pre-crisis level should therefore be reached in the second half of the year.

Financial and capital markets, monetary policy and inflation

The risks and uncertainties referred to above are also significant for the financial and capital markets and could continue to create considerable disruption. Given these circumstances, we can expect sharply rising or falling equity and bond prices overall in 2021.

Due to the uncertainty, especially regarding the impact of the Covid-19 pandemic on the economy, we expect to see strongly expansionary monetary and fiscal policy measures and continued low interest rates in 2021. However, the persistent low interest rate environment might impair the effect of central banks' traditional policy.

Several factors are likely to drive up inflation in 2021 over the levels seen in 2020. On the one hand, energy prices have increased year-on-year, while the pandemic-induced tax relief will be abolished in part on the other. All in all, weaker demand in the services sector will probably curb core inflation.

Regulatory environment

The Covid-19 pandemic impacted on the regulatory environment as well. Various regulatory initiatives were deferred and temporary relief resolved for financial institutions. Nonetheless, the trend towards a tighter regulatory framework is set to persist in the years ahead, too. For instance, the finalisation of the Basel III framework, adopted by the Basel Committee's Group of Governors and Heads of Supervision (GHOS), will bring about extensive changes to the approaches used for determining risk-weighted capital requirements (a concept known as "Basel IV"). In the course of the Covid-19 pandemic, the Basel Committee has deferred the date of application by one year to 1 January 2023. A second consultation on implementing Basel IV at a European level, taking into account the experience gathered from the Covid-19 pandemic, is anticipated and likely to start during the first half of 2021.

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. ongoing monitoring of the credit terms).

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

Sector-specific and business developments

Structured Property Financing segment

Demand for commercial properties will vary in 2021, depending on the region and property type. This is an area in which developments surrounding the Covid-19 pandemic and the form of economic recovery will be decisive, especially given that some regions and types of property were more severely affected by the pandemic than others.

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

It is expected that various factors will have an impact on how commercial property values develop this year. While historically low interest rates support property values, political uncertainty, economic downturns or restraint among investors can have an adverse impact on property values.

With regard to commercial property, we expect stable to rising average market values over the next few years. All in all, commercial properties should have reached or overcome the performance low. Considering the assumed recovery, most commercial properties should return to their pre-crisis values in the years to come. With a view to retail properties, we expect the situation to ease more slowly, as the structural change in buying behaviour is having a dampening effect on the outlook of value-driving rental revenues, depending on location and segment. Also depending on location and segment, we see hotel properties recovering in the years to come. As travel activities gradually increase, we expect a recovery at least to pre-crisis levels. We expect a similar development for student housing activities, where demand by international students should recover. We expect the values of office properties to rise slower compared to the previous year, due to the Covid-19 pandemic. Logistics properties continue to be assessed positively, as we expect the trend of rising market values of these properties to prevail. Individual properties may generally deviate from this estimate, depending on the different regional economic impacts of the Covid-19 pandemic.

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

%	2020	2021	2022	2023
"Swoosh" scenario				
Gross domestic product (year-on-year change in %)				
Euro zone	-7.1	4.2	4.9	2.2
US	-3.5	4.2	3.4	2.0
UK	-10.3	4.5	6.4	2.3
Unemployment (%)				
Euro zone	8.0	9.1	8.4	7.9
US	8.1	6.2	5.2	4.7
UK	6.1	7.4	5.5	4.6
Portfolio-weighted property price development (2020 basis = 100 %)		104.2	107.5	108.2

>

%	2020	2021	2022	2023
"Bad case" scenario				
Gross domestic product (year-on-year change in %)				
Euro zone	-7.1	-0.9	5.6	2.3
US	-3.5	0.0	4.2	1.7
UK	-10.3	-1.1	6.0	2.4
Unemployment (%)				
Euro zone	8.0	11.0	10.2	9.4
US	8.1	6.9	5.8	5.3
UK	6.1	10.8	9.2	7.8
Portfolio-weighted property price development (2020 basis = 100 %)		97.6	102.3	103.4

history. Data and experience are therefore both lacking. Against this background, the impact of worsening macro-economic factors (compared to the "swoosh" scenario underlying our forecast) was examined. In the so-called "bad case" scenario, loss allowance for the overall portfolio increases by approximately 20 basis points compared to our "swoosh" scenario in 2021. The scenarios are based on the macro-economic factors shown above.

In the Structured Property Financing segment, we aim to originate new business of between € 7 billion and € 8 billion for the 2021 financial year, so that Aareal Bank Group's property financing portfolio is expected to be at € 29 billion at the end of the 2021 financial year, subject to exchange rate fluctuations. To manage our portfolio and risk exposure, we also use syndications.

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.

Banking & Digital Solutions segment

The segment description Consulting/Services Bank was changed to Banking & Digital Solutions at the turn of the year as part of the strategic review.

The German housing and commercial property industries are expected to remain solid in 2021, in spite of the Covid-19 pandemic. We expect property values to be very stable and rental income to remain largely steady. Following a long growth phase, rental income is expected to stagnate at average levels in the long term, due to regulatory requirements such as the caps on rent levels and also against the background of the Covid-19 pandemic. Further rent deferrals or defaults due to rising unemployment are also to be expected, especially among freelancers and the self-employed. At present, it is impossible to seriously forecast just how serious the impact is going to be – this will largely depend upon the further development of the Covid-19 pandemic.

The companies will continue to optimise and develop existing portfolios, driven especially by socio-political consideration, such as refurbishing buildings to make them suitable for the elderly, district development or new-build projects. The demands of climate protection targets for Germany, and the decisive pressure on the property industry to achieve them, is putting serious demands on resources.

Even though the Bank's market share in the institutional housing industry is already high based on the number of residential units, we see good opportunities in the 2021 financial year to acquire new clients and to intensify the business relationships with our existing client base. We plan to achieve this through the expansion of the "Housing Industry Ecosystem", the cross-sector development of interface products, and the expansion to adjacent ecosystems, such as companies from the utilities and waste disposal industries. The focus here remains 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 methods in existing accounting systems, is available since 2020 with an interface to barzahlen/viacash, with further payment methods such as PayPal and credit cards being added in 2021. We also see potential in technical solutions for automating billing processes as part of electromobility in the network of charging stations. The corresponding Aareal Connected Payments product was launched successfully on the market in 2020. Further growth should be generated by the integrated rental security product Aareal Aval and Aareal Meter, a solution that uses mobile meter reading to provide a digital solution to a labour-intensive analogous product.

Against this background, we are aiming for renewed net commission income growth over the previous year (2020: € 26 million) and expect the average deposit volume from the housing industry to remain around € 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, stable and alternative source of funding for Aareal Bank.

Aareon segment

Aareon will continue to implement and accelerate its growth strategy in the 2021 financial year. In this context, Aareon Flight Plan 2021 was developed and launched on the fourth quarter of 2020. This plan integrates measures from a Value Creation Programme, including inorganic growth projects, as well as investments in existing and new products.

The Covid-19 pandemic will continue to have an impact on Aareon in 2021 – especially on the consultancy business. The Covid-19 pandemic is expected to result in greater digitalisation needs in the medium term and therefore to an increase in the demand for digital solutions and advisory services. In this context, Aareon expects double-digit growth rates of over 20 % in digital solutions in the 2021 financial year (2020: 19 %). Sales revenue generated from ERP products is expected to grow in the lower single-digit range. Overall, a marked increase in consolidated sales revenue is expected for 2021. As a result of the aforementioned expenses for investments (including the Value Creation Programme), we anticipate an increase in adjusted EBITDA[1]. Aareon will become a "Rule of 40" entity in the medium term. This indicator is widely used in the software industry to identify efficient growth companies whose revenue growth and EBITDA margin add up to at least 40 %.

Demand for the new product generation Aareon Wodis Yuneo, which was introduced in 2020, will be important for the ERP business in the DACH region. Market response has been very positive up to now, so that Aareon expects revenues to increase further in 2021. Aareon also anticipates growth for the ERP solution RELion, which is focused on the commercial property market. The business volume generated from Aareon Cloud Services and BauSecura insurance management will be up slightly on the previous year. The acquisition of Arthur Online Ltd., London, which complements

[1] "Earnings before interest, taxes, depreciation and amortisation" excluding strategic investments (venture and M&A activities) and non-recurring effects

Aareon's product portfolio from 1 February 2021 onwards, will also contribute to this growth. Arthur offers a cloud-based software solution for property management focused on the UK, which brings together property managers, property owners, tenants and contractors on a single platform. On the other hand, the number of client projects migrating to the new ERP product generation will rise significantly for the Tobias solution. It is expected that 2020 sales revenue levels will be reached again in France. On the UK market, client acquisitions in 2020 in particular are expected to have a positive impact on recurring revenues in 2021. The acquisition of new ERP clients should also lead to growing licence revenues. Aareon also expects to generate higher revenues from licenses and SaaS with new and existing clients in the Nordic countries.

The digital solutions will make a decisive contribution towards realising the growth potential in the DACH region and in the international business. Aareon anticipates strong licence business from the BRM solution of the CalCon company acquired at the beginning of the year under review. SaaS revenues are expected to increase for the WRM and CRM products due to additional products being rolled out. Higher sales revenues with SRM products should be achieved thanks to a greater number of tradesmen' orders that are settled via Mareon.

Looking at the Consulting business, Aareon expects demand for green consulting services in particular to remain strong against the backdrop of the Covid-19 pandemic. Traditional consulting offerings are also expected to be used increasingly during the year; nonetheless, renewed lockdowns will also impact on consulting revenue in 2021.

Aareon will continue in 2021 with the development drive in new products and services that was launched in 2019. The virtual assistant Neela and the Aareon Smart Platform and Smart Partner solutions will be developed further and new functional features added. Further product developments are planned in preventive maintenance and in networking clients, public offices and utilities, among others, on a digital platform and for mobile solutions. Aareon is also investing in developing new lines of business by co-founding start-ups. Capacities were also extended to drive Aareon's inorganic growth.

Based on the explanations outlined above, Aareon envisages a marked overall increase in sales revenue to between € 276 million and € 280 million in the year ahead (2020: € 258 million). Adjusted EBITDA[1] is likely to further increase to between € 63 million and € 65 million (2020: € 62 million). The forecast does not include any effects from future M&A transactions.

Business strategy

Aareal Bank Group's strategy focuses on sustainable business success. Environmental, social and governance aspects are therefore key elements of its business strategy. The medium-term strategic development is therefore being pursued under the guiding principle 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, but also to exploit growth opportunities while adhering to our risk standards. To do so, Aareal Bank makes systematic use of the flexibility gained in recent years regarding regions, asset classes, structures, and exit channels, as well as expanding the activities along the value creation chain. The Consulting/Services Bank and Aareon segments are expected to continue to grow in the years ahead. The objective is to gradually reduce

[1] "Earnings before interest, taxes, depreciation and amortisation" excluding strategic investments (venture and M&A activities) and non-recurring effects

the overlaps and cross-dependencies, while strengthening the independence of the individual brands and business models – whilst securing existing synergies at the same time.

Within the scope of strategic initiatives and measures implemented within "Aareal Next Level", Aareal Bank agreed on a long-term partnership with financial investor Advent International ("Advent") on 14 August 2020, to significantly further strengthen the growth momentum of its subsidiary Aareon. The agreement was concluded following anti-trust approvals on 31 October 2020, with the sale of a 30 % minority stake in Aareon to Advent. The financial terms and conditions of the disposal are based on an enterprise value for Aareon of approximately € 960 million. This corresponds to an equity value of approximately € 860 million, leading to a purchase price for the 30 per cent stake of € 258 million, which was paid in cash. With the new partnership agreed with Advent, Aareal Bank has swiftly brought the structured process for the sale of a significant minority stake in Aareon to a successful conclusion, benefiting from the currently very favourable market environment for resilient software-centric businesses.

Within the scope of a strategic review, Aareal Bank also examined whether Aareal Bank Group's business model remains viable in a normalised environment, once the pandemic has been overcome. Some adjustments will be made within the existing "Aareal Next Level" strategic framework in order to be able to fully exploit the opportunities arising from changes induced by Covid-19, and to retain the Bank's successful performance in the future. The Bank will continue to pursue its risk-conscious, organic expansion of the financing business in its Structured Property Financing segment. Furthermore, the inherent profitability in this business is set to be further enhanced, including through the optimisation of the funding mix and capital structure. In the Consulting/Services Bank segment, the opportunities should be used for expanding the product range, and for entering into further partnerships, with a particular focus on strengthening commission-based business. We envisage even stronger profit momentum through the implementation of the Value Creation Programme for Aareon, which was prepared together with partner Advent. Measures are also being implemented to enhance the efficiency in the organisation, of processes and infrastructure.

Given the general market environment, regulatory dividend restrictions and the perspectives that the results of our strategic review process, including the Value Creation Programme for Aareon, have opened up, our shareholder group and its expectations have already changed, with further changes possibly arising in this respect. One indicator of this is the significant interest that financial investors have been showing in companies operating in the financial sector for some time now. Should new investors acquire substantial stakes in Aareal Bank, further strategic options could arise.

Group targets

Besides the strategic measures and initiatives within the framework of "Aareal Next Level", Aareal Bank Group's focus in the 2021 financial year will be on coping with the impact of the Covid-19 pandemic in the best way possible – together with its clients. In this context, it will be crucial how quickly the emerging recovery of the real economy will gain momentum. With a view to the economic development, Aareal Bank Group continues to anticipate a "swoosh-shaped" trend and expects a marked recovery during this year and 2022[1)].

Based on this assumption and current insights, Aareal Bank Group expects a clearly positive consolidated operating profit in a range of between € 100 million and € 175 million for 2021 as a whole (2020: € -75 million), despite high loss allowance. Earnings per share (EpS) are therefore expected to be in the region of € 0.70 to € 1.50 (2020: € -1.50) and the RoE after taxes between 1.5 % and 4 % (2020: -3.6 %). Naturally, in the

[1)] For details please refer to our explanations and the description of the macro-economic influencing factors in the Report on Expected Developments and Opportunities of the Structured Property Financing segment.

current environment, this forecast is subject to significant uncertainty, especially with regard to the assumed duration and intensity of the crisis, the pace of recovery and the associated effects on our clients, as well as prevailing uncertainty concerning regulatory and accounting provisions, and the possibility that individual loan defaults cannot be reliably predicted. Effects from a potential, selective continuation of accelerated de-risking activities are not included either.

Income is expected to rise significantly over the previous year. Net interest income should rise to between € 550 million and € 580 million (2020: € 512 million), reflecting the higher (and further growing) loan portfolio. Net commission income should rise further, thanks in particular to Aareon's growth, to between € 250 million and € 270 million (2020: € 234 million). Based on our "swoosh" scenario, we estimate the allowance for credit losses to be in a range to between € 125 million to € 200 million (2020: € 344 million). However, this item is subject to considerably higher uncertainty than usual, due to the Covid-19 pandemic. Administrative expenses should amount to between € 520 million and € 540 million (2020: € 469 million). Besides the non-recurrence of the previous year's cost savings due to Covid-19, this reflects the planned growth of Aareon and the initiatives launched on the basis of the strategic review.

In the Structured Property Financing segment, a portfolio size of around € 29 billion is envisaged by the end of the year, market conditions permitting and subject to exchange rate fluctuations. Aareal Bank plans new business volume of € 7 billion to € 8 billion on this basis.

For the Banking & Digital Solutions segment, we are aiming at further slight net commission income growth (2020: € 26 million) and expect an average deposit volume from the housing industry of around € 11 billion.

It is expected that Aareon will see a marked increase in sales revenue in the region of € 276 million to € 280 million for the current year (2020: € 258 million). Adjusted EBITDA[1)] is likely to further increase to between € 63 million and € 65 million (2020: € 62 million). The forecast does not include any effects from future M&A transactions.

Aareal Bank envisages to achieve consolidated operating profit in an amount of approximately € 300 million already in 2023. This is of course provided the pandemic has been fully overcome by then.

With regard to capitalisation, Aareal Bank expects a CET1 ratio (Basel IV (phased-in)) of more than 16 % by the end of the year, despite the planned portfolio growth and subject to further regulatory changes.

Remuneration Report

Review

Aareal Bank AG's Management Board remuneration system proved to be balanced in the exceptional environment created by the Covid-19 pandemic. One key component of the Management Board remuneration system is the definition of ambitious quantitative and qualitative targets and corresponding robust measurement criteria in advance. The calculation of the variable remuneration is then based on the established target achievement level, which largely prevents any leeway for purely discretionary decisions in accordance with the regulatory requirements

In the Supervisory Board's opinion, the Management Board achieved excellent performance in the reporting year and steered Aareal Bank safely through the Covid-19 pandemic. From the Supervisory Board's perspective, the Bank did not lose sight of its strategic objectives at any point in time, key objectives of the Bank were met despite the challenging overall environment, and the sale of a

[1)] "Earnings before interest, taxes, depreciation and amortisation" excluding strategic investments (venture and M&A activities) and non-recurring effects minority stake in Aareon also served to significantly strengthen Aareal Bank's equity resources.

Notwithstanding these achievements, however, the effects that the pandemic has had on the Bank's operating profit have a significant impact on the variable remuneration payable to Management Board members and employees, due to the close links between the overall target achievement level of the Management Board members and the overall performance of Aareal Bank Group.

The operating profit for 2020, which was impacted to a considerable degree by the Covid-19 pandemic, means, in terms of remuneration for Management Board members and employees, that the target achievement level for the Group component in 2020, which accounts for what is by far the largest share of the overall target achievement level, was set at only 20 %. As a result, the annual target achievement level of each individual Management Board member, which also comprises the achievement levels for the sectional and individual targets, is approx. 50 % for the 2020 financial year. Since the previous years are included in the Management Board remuneration due to the three-year observation period, this leads to an overall target achievement level of around 70 % for each Management Board member in 2020. What proves to be a positive aspect for the overall target achievement level in 2020 will turn into a negative one in the years that follow, as the significantly reduced annual target achievement level for 2020 will also have a negative impact on any variable remuneration for 2021 and 2022.

In addition, the large proportion of share-based remuneration means that the Management Board members have been affected by the drop in the share price during the Covid-19 crisis. Specifically, the value of more than 250,000 virtual shares held by the members of the Management Board which are subject to deferral/holding periods, was down year-on-year in line with share price performance.

Outlook

Various adjustments to the remuneration system were adopted by the Supervisory Board in 2020 following intensive discussions with Aareal Bank's shareholders in order to achieve an increased focus on the sustainable development of Aareal Bank Group in the long run. For the variable remuneration from the 2021 financial year onwards, this will, in particular, include establishing the systematic requirement for at least 15 % of the targets set to be based on quantifiable ESG criteria in the future. In addition, the proportion of share-based remuneration was already increased to 55 % for the 2020 variable remuneration (with the exception of the Chairman of the Management Board, Hermann Merkens, who was released from his duties at the end of the reporting year). There is still no need for any agreement requiring Management Board members to enter into any proprietary investments in Aareal Bank shares, since the existing system meets the purpose of such an investment. By granting 55 % 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 and share-based remuneration").

The enhanced Management Board remuneration system will be put to the vote at this year's Annual General Meeting, the aim being for it to apply as of the 2021 reporting year.

Remuneration system for the Management Board

<table>
<tr><th>Remuneration element</th><th>Description</th><th>Reference to strategy and long-term development</th></tr>
<tr><td colspan="3">Fixed remuneration elements</td></tr>
<tr><td>Fixed annual salary
+ ancillary benefits
= basic remuneration</td><td>– Fixed contractually agreed remuneration in line with standard market conditions, paid monthly
– Ancillary benefits in line with standard market conditions, in particular a company car that can also be used for private purposes or a lump-sum payment for members who decide against a company car; certain costs for security expenses, including the taxes and social security contributions payable on these amounts; (substitute) social security contribution corresponding to 50 % of the contributions due under the statutory social security scheme
– The resulting basic remuneration accounts for around 45 % of the total target remuneration for Management Board members</td><td>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>Pension obligations</td><td>– Defined contribution commitment with guaranteed interest
– Annual contributions of around 15 % of the total target remuneration for Management Board members
– Management Board members are entitled to pension payments when they reach a defined age
– In the event of permanent disability, Management Board members are entitled to invalidity benefits even before they reach this defined age</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 colspan="3">Variable remuneration elements</td></tr>
<tr><td></td><td>– The target variable remuneration corresponds to around 40 % of the Management Board members' total target remuneration
– Variable remuneration is determined via the achievement of targets derived from the business and risk strategies, and which are in line with Aareal Bank's corporate and risk culture
– Group (70 %), sectional (15 %) and individual (15 %) targets
– Group targets usually correspond to the financial KPIs used in the management system, while sectional and individual targets can include both financial and non-financial KPIs. At least 15 % of the target achievement will be based on quantitative ESG targets from the 2021 financial year onwards.
– Performance measurement based on criteria whose achievement is determined over a three-year period
– No discretionary components besides the targets derived from the strategy
– Breakdown of variable remuneration via four components (as per regulatory requirements)
– At least 55 % of variable remuneration is share-based
– At least 80 % of the variable remuneration is paid out on a deferred basis (20 % as a share bonus with one-year retention period, plus 60 % cash and share deferral)
– Maximum overall target achievement level is capped at 150 % of the target value
– Maximum variable remuneration cannot exceed fixed remuneration
– No compensation is granted in the form of special bonuses extending over and above the components referred to above.</td><td>Calculation of variable remuneration on the basis of annual financial and non-financial performance criteria that promote the achievement of the strategic objectives.

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.

By granting the variable remuneration, Aareal Bank meets the regulatory requirements to which it is subject.</td></tr>
</table>

Remuneration element	Description	Reference to strategy and long-term development
Other rules		
Risk-bearing capacity	– Before disbursing the variable remuneration, the Supervisory Board reviews it regarding its compatibility with the risk-bearing capacity.	Disbursing variable remuneration is not meant to threaten Aareal Bank's financial solidity.
Penalty and clawback	– All components of the variable remuneration are subject to penalty and clawback provisions. – Admission of an adjustment to outstanding remuneration and/or clawback of remuneration already disbursed in case of clawback events.	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.
Consideration of extraordinary developments	– (Modifier) adjustment of Group target achievement level by 20 percentage points possible in cases involving exogenous circumstances. – In principle, no subsequent adjustments to remuneration targets, unless extraordinary developments result in the business strategy being adjusted during the year.	In order to ensure that the remuneration system provides incentives for the actual performance of the Management Board member with regard to the sustainable and long-term development of Aareal Bank Group, adjustments can be made subject to pre-defined and very restrictive conditions.
From the 2021 reporting year onwards: Maximum remuneration of € 5.5 million per Management Board member (within the meaning of section 87a of the German Public Limited Companies Act (Aktiengesetz – "AktG")	– Maximum expense amount for the financial year which includes the fixed annual salary, variable remuneration elements (incl. the development of the virtual shares over the next six years), ancillary benefits and pension obligations (service cost). Severance payments are excluded from this amount as a non-standard remuneration component. – The maximum remuneration is stated individually for each member of the Management Board and applies until the next proposal is made to the Annual General Meeting. It is calculated based on the maximum possible values for the abovementioned remuneration components, plus a buffer for fluctuations in the share price, for example.	In order to define absolute values to ensure the proportionality of the amount of Management Board remuneration, the maximum remuneration sets a specific upper limit. This theoretical maximum value is based on a maximum possible target achievement level over the entire three-year assessment period and maximum share price performance. This means that the maximum remuneration can be clearly distinguished from the total target remuneration.

Remuneration structure

Total target remuneration comprises a fixed component (fixed annual salary plus ancillary benefits (= "basic remuneration") and annual retirement benefits) and a variable component, the structure of which is subject to regulatory requirements.

The fixed annual salary plus ancillary benefits accounts for approximately 45 % of the total target remuneration, with the fixed annual salary determining the vast majority. The ancillary benefits generally amount to a share of between one and two percentage points. In order to be able to report a proportion of retirement benefits that is as stable as possible, the information presented is based on the annual pension contributions, which, unlike the IAS 19 disclosures, do not differ depending on the member's age and length of service on the Management Board. The maximum remuneration is still based on the expenses according to IAS 19, which are also shown in the corresponding remuneration tables. The target variable, performance-related remuneration comprises approx. 40 % of the total target remuneration.

In line with the "1:1 rule" that applies to credit institutions, the maximum variable remuneration must not exceed the fixed remuneration component. In order to allow target overfilling in the first place, the share of total target remuneration attributable to the target variable remuneration must be below the fixed remuneration share. In order not to motivate Management Board members to take inappropriate risks in line with Aareal Bank Group's risk culture, no use was made of the option to adjust the 1:1 rule via the Annual General Meeting.

The relative shares referred to above can shift by a few percentage points due to fluctuating ancillary benefits.

The Supervisory Board can adjust the reference values for the fixed and variable remuneration components in the context of the defined maximum remuneration while maintaining the relative proportions of fixed and variable components provided for in this remuneration system. Until further notice, however, the reference values for fixed and variable, performance-related remuneration components set out below apply.

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.

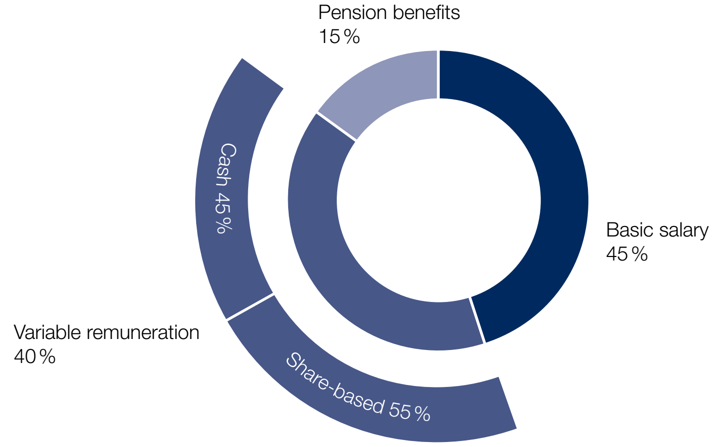
Fixed annual salary

Within Aareal Bank'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.

The fixed annual salary currently amounts to € 1,425,000 for the Chairman of the Management Board and to € 900,000 for ordinary Management Board members.

Management Board remuneration structure

%



Ancillary benefits

As well as paying a fixed annual salary, Aareal Bank grants the members of the Management Board ancillary benefits in line with standard market conditions.

For example, Aareal Bank provides a company car to Management Board members, which may also be used for private purposes. If Management Board members decide against a company car, they receive a lump-sum compensation payment instead.

Management Board members also receive an amount equivalent to up to 50 % of the contributions to the statutory social security system.

They also receive certain insurance benefits/insurance compensation benefits. In addition, Aareal Bank bears the costs incurred for certain security expenses.

The members of the Management Board are also granted insurance cover in line with standard market conditions, such as D&O insurance (subject to the statutory deductible), group accident insurance or health insurance for travel abroad.

The Supervisory Board can grant other or additional ancillary benefits that are customary on the market, such as the assumption of costs for trips home to see family.

In principle, all members of the Management Board are equally entitled to the ancillary benefits. The benefits can, however, vary in terms of their type and amount depending on the member's personal situation. They can also fluctuate considerably from year to year. This is particularly true with regard to security expenses, which are not usually incurred in similar amounts every year.

Pensions and retirement benefits

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

This currently amounts to a total of € 464,000 p.a. for the Chairman of the Management Board and € 293,000 p.a. for ordinary members of the Management Board, and thus accounts for around 15 % of the target remuneration structure of the Management Board members. The contributions bear interest at a guaranteed rate of 4 %. In addition, members of the Management Board can make use of a deferred compensation system.

Members of the Management Board are entitled to pension payments when they reach a defined age. This is age 60 for members appointed before 1 January 2013 and currently age 62 for all other members. In the event of permanent disability, Management Board members are entitled to invalidity benefits even before they reach this defined age.

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

Long-term and sustainable focus of the targets

The structure of the variable remuneration system is subject to detailed requirements set out in the bank regulatory provisions. The calculation of the variable remuneration is generally split into two phases. In the first phase, the achievement of targets derived from the strategy is determined over a period of three years at three levels: Group, sectional and individual. The target achievement level is multiplied by the reference value and produces the amount calculated (e.g. for an ordinary member of the Management Board: 780,000 x 90% = € 702,000). The amount calculated is then paid out in the second phase in four different components, including 80 % that is paid out on a deferred basis and at least 55 % paid out in virtual shares over a period spanning several years (see "Deferred disbursement, through retention of variable remuneration components and virtual shares (phase 2)").

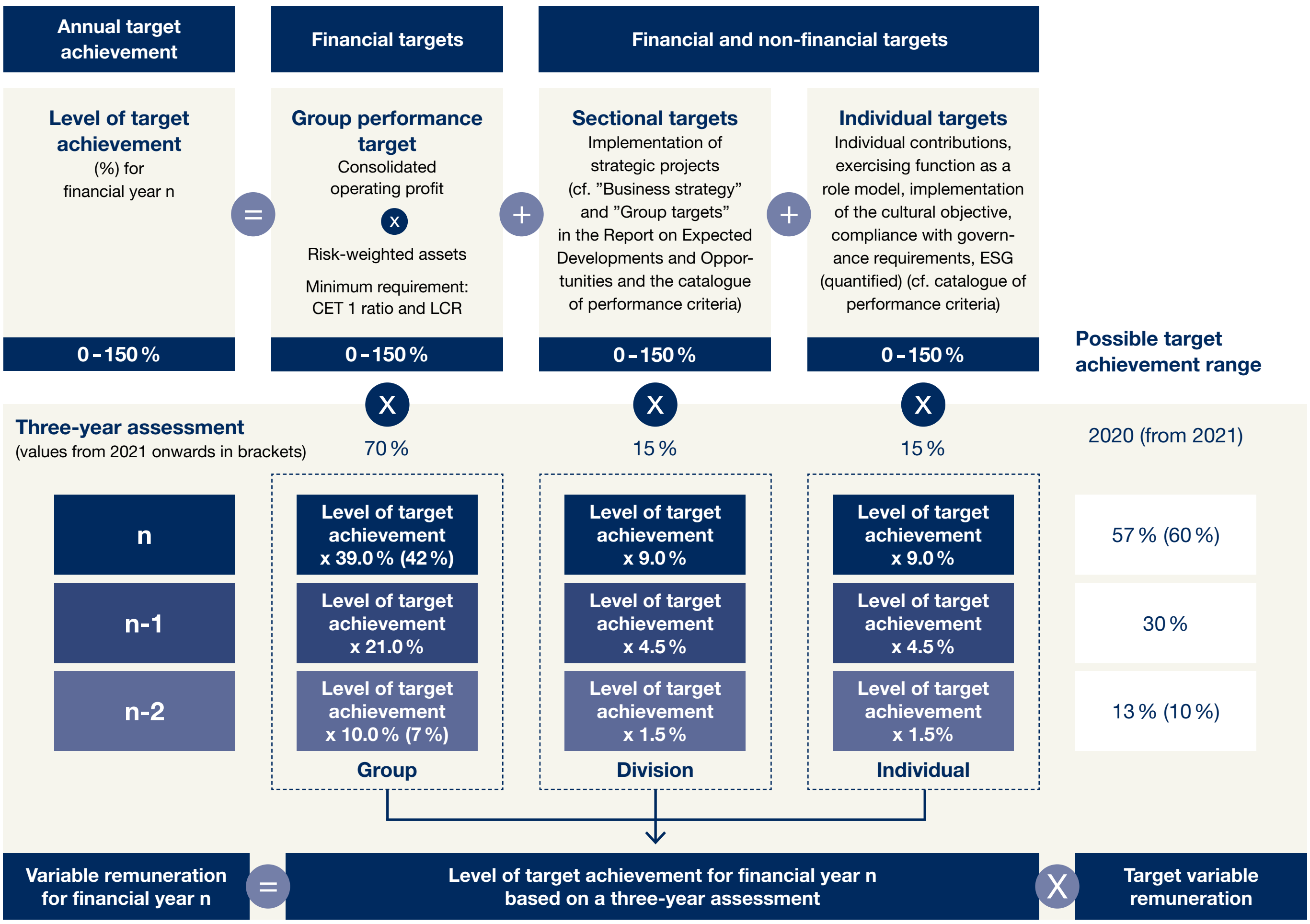
Among other things, the fact that the targets are geared towards the strategy and the subsequent adjustment based on share price performance over the next six years promotes sustainable and long-term company development while at the same time taking the interests of the shareholders into account. This is also achieved through the penalty, clawback, modifier rules and the check to ensure compatibility with sufficient risk-bearing capacity.

Multi-year performance measurement across different target levels (phase 1)

A significant part of Aareal Bank's variable remuneration is governed by law: besides the general requirement – pursuant to theAktG – 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's remuneration system for the Management Board provides for three target levels of:

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

Target achievement and variable remuneration for financial year n

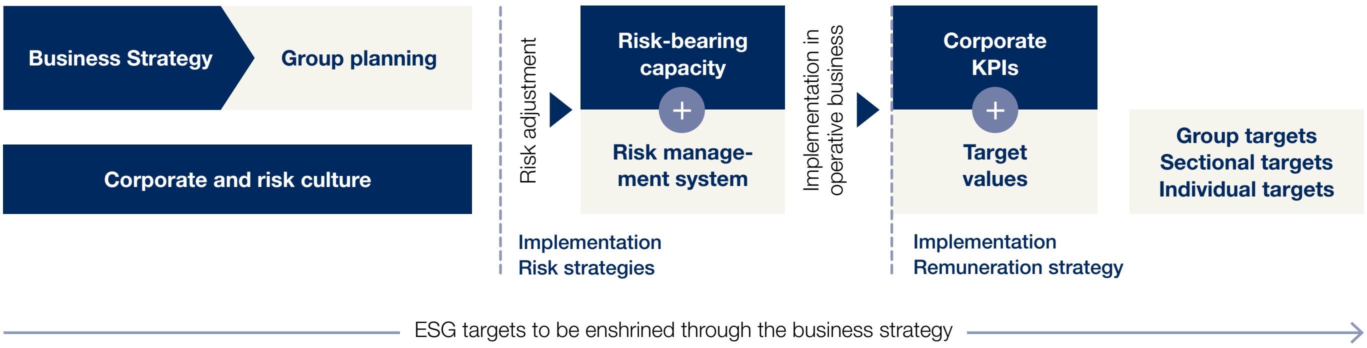


Target achievement for each target level is determined on the basis of a three-year assessment period.

The targets set at all three levels are focused on sustainable and long-term growth and are designed to be forward-looking. To measure and monitor target achievement, various KPIs are determined annually for 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).**

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 (generally 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 components consolidated operating profit and RWA, or for other corporate financial indicators defined annually by the Supervisory Board, has been achieved. The other two target levels, the sectional and individual target levels, are generally weighted at 15 % each. The Supervisory Board

System for defining targets



reserves the right to adjust the weightings attached to the performance levels annually.

To set ambitious targets and a strong incentive for successful Management Board work, target achievement levels are incorporated at different levels over time. The target achievement level is calculated by looking at performance in more than one year at all target levels. This means that, generally speaking, the most recent reporting year is weighted at 60 %, the preceding one at 30 %, and the oldest year in the assessment period at 10 %. A transitional rule applies for the 2020 reporting period, whereby the reporting years 2020, 2019 and 2018 are weighted at 57 %, 30 % and 13 %, respectively.

Pursuant to section 25c (4a) of the German Banking Act (Kreditwesengesetz – "KWG"), the strategy is to be geared towards the Bank's sustainable development. As early on as during the development process, the business strategy is reviewed as to its compatibility with the corporate and risk culture, the risk strategies and the Bank's sustainability approach, and is adjusted if necessary. This means that the remuneration targets and KPIs derived from the strategy do not promote short-term successes, but rather support the Company in its long-term and sustainable development **(pay-for-performance principle).** As a result, they serve the interests of the shareholders, employees and other stakeholders of Aareal Bank Group.

Remuneration parameters (ex-ante risk adjustment)

The targets are made up of quantitative and qualitative components. A target value for 100 per cent target achievement, a minimum ambition level and a maximum achievable value are set for quantitative criteria. Qualitative values are measured using different formats that suit the corresponding target parameters. These can include comparisons with project targets, internal and external studies, section-specific reports, as well as statistics on how the Bank is perceived by its employees or clients. Specific target achievement is reported on an ex-post basis (cf. "Target achievement" section).

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. These KPIs are generally based directly on the Group's performance indicators, which are defined in the Group Management Report. In order to reduce the influence of one-off effects and to ensure that the KPIs fulfil their purpose in terms of measuring the actual performance of Management Board members, certain effects are already excluded from target achievement when the targets are set, e.g. changes due to external regulatory requirements, M&A transactions, or comparable effects. The Supervisory Board sets target values for the Group on the basis of the consolidated operating profit, risk-weighted assets (RWAs) and/or other indicators that it defines based on the performance indicators (cf. the "Management system" section of the Group Management Report), and determines the result that constitutes achievement of each target. Consolidated operating profit is chosen as the income target, whereas RWA is used as a risk-adjusted target. The 100 % targets set for the target parameters complied with the corporate objectives communicated to the capital markets in the past, and will continue to do so in the future, too. 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 all 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. Between two and four targets are determined for each Management Board member. The Supervisory Board uses the sectional component to measure the contribution to the implementation of the strategy made by the units for which the individual Management Board member is responsible. Based on the strategic framework (currently "Aareal Next Level"), the Supervisory Board selects certain initiatives and assigns those initiatives to the individual members of the Management Board. The KPIs used by the Supervisory Board typically include qualitative and quantitative criteria, as shown in the catalogue of performance criteria. In line with Aareal Bank Group's management system, sectional targets for Management Board members responsible for Sales units comprise growth 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.

Individual targets refer to the Management Board members' individual performance as role models for the organisation ("tone from the top"). A maximum of two individual targets are determined for each Management Board member. As with the other targets, the individual Management Board member is set targets that promote the implementation of Aareal Bank Group's strategic objectives, but are primarily to be fulfilled by him/her.

Catalogue of possible performance criteria (financial/non-financial, quantitative as well as qualitative)

Key performance indicators used in the Group management system	Strategic project (Aareal Next Level)
Increasing flexibility	Sustainability of the organisation
Increase in growth	Establishing sustainability in the core business
Capital market target	Expansion of sustainable products
Market expansion	Innovative power
Budget target	Client satisfaction
Efficiency enhancement	Dialogue with employees
Liquidity planning	Empowering the next generation
Targets for risk indicators	Safeguarding expertise
Effectiveness of the organisation	Transparency
Scaling client relationships	

ESG targets can be established at both sectional and individual level. The specific ESG target parameters are disclosed as part of the reporting process (annual report for the year concerned) together with the other parameters used. In order to ensure that the increased importance of ESG aspects in Aareal Bank's strategy are adequately reflected in the remuneration system, quantifiable ESG targets will be included in the overall target calculation with a minimum weighting of 15 % from the 2021 financial year onwards, and are covered, in particular, by the individual component. The use of quantitative ESG targets allows for a high level of transparency regarding Aareal Bank AG's ESG focal areas and at the same time creates targeted incentives for a long-term sustainable strategy. In addition to the individual level, the sectional level can also include ESG targets to add more weight to ESG aspects.

In its ESG 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 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 to retained remuneration components being reduced ex post, and can even result in the **clawback** of remuneration components that have already been granted.

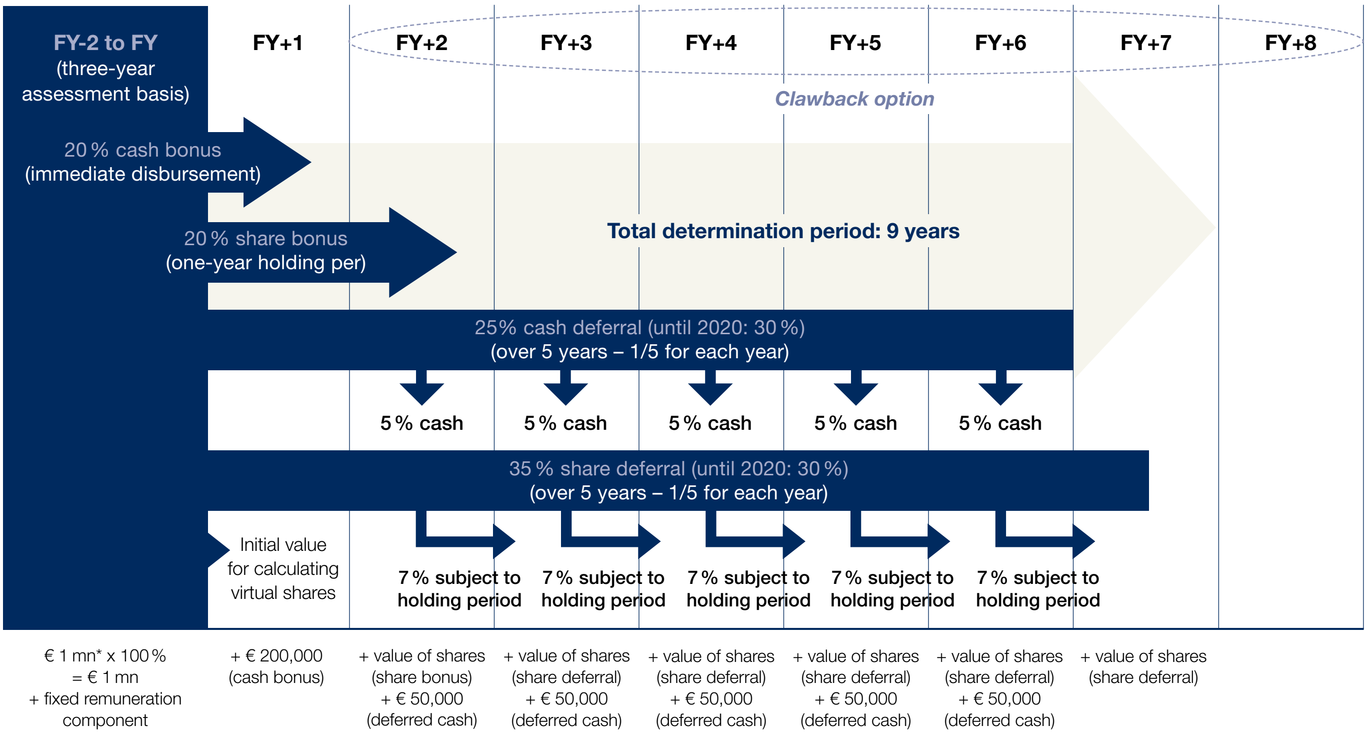
Deferred disbursement, through retention of variable remuneration components and virtual shares (phase 2)

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.
- 25 % of the variable remuneration is retained **(cash deferral),** and disbursed in cash – pro rata temporis – over a five-year deferral period.
- The remaining 35 % of the variable remuneration forms part of the Share Deferral Plan **(share deferral with holding period).**

Sample disbursement methodology, based on 100% target achievement for the 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.

Consequently, 60 % of the variable remuneration is granted on a deferred basis, supporting the long-term focus of the variable remuneration system. This means that deferred disbursement applies to a total of 80 % of variable remuneration determined, for up to six years. 55 % of the variable remuneration is granted as share-based remuneration and has a holding period of one year, which applies to both the share bonus and the individual tranches of the share deferral. The fact that the variable component is predominantly share-based helps to ensure the sustainability, as well as the long-term focus, of the remuneration system and promotes alignment with shareholder interests.

Five-year retention period

For the portion of performance-related remuneration that is deferred initially as a cash deferral or a share deferral (60 %), 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. the sub-section ”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, in line with regulatory requirements.

Share bonus with holding period (20 %)

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 (35 %)

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 (35 % of the initial value of performance-related remuneration) 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).

With regard to the deviation from the recommendation set out in the German Corporate Governance Code regarding the four-year holding period that we have declared as a precaution,

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we refer to our Declaration of Compliance with the German Corporate Governance Code at www.aareal-bank.com/en/about-us/corporate-overnance/declaration-of-compliance/

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 target was not achieved or if the assessment of qualitative targets shows a negative deviation when the target achievement measurement is repeated as part of a retrospective review, 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, justifying a reduction in, or even the loss of, variable remuneration.

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. They include, for example, wilful breaches of the Code of Conduct and/or internal and/or external rules, conduct that damages the Bank's reputation, or other misconduct. 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. The variable remuneration must be reduced to zero in the event of **negative performance** contributions. In accordance with the regulatory requirements governing remuneration, negative performance contributions refer to a scenario in which the Management Board member was significantly involved in, or responsible for, any behaviour which led to considerable losses, or material regulatory sanctions, for the Bank.

Clawback

Agreements reached with the Management Board members ensure that variable remuneration already paid out has to be clawed back in the event of negative performance contributions (see Penalty review). The amounts can be clawed back until two years have expired since the end of the last retention period for the variable remuneration paid for the financial year in question.

Allocation to appropriate periods

The penalty review and backtesting processes are applied to the appropriate periods. Missed targets/penalty-triggering events defined as part of the penalty review are allocated to a particular assessment period. They are allocated to the year in which the target was missed/the penalty-triggering event occurred, meaning that the variable remuneration is also adjusted for the corresponding year.

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 150 % cap, which cannot be circumvented by the modifier.

Subsequent adjustments to targets and target values (KPIs) are generally not permitted. Such adjustments may be made as an exception if extraordinary developments require adjustments to be made to the business strategy and the remuneration targets or parameters have to be adjusted accordingly in order to maintain the long-term and sustainable focus.

Maximum remuneration

Pursuant to section 87a (1) sentence 2 no. 1 of the AktG, the Supervisory Board has set an upper limit for the total amount of all remuneration elements in a given year, i.e. currently consisting of the fixed annual salary, ancillary benefits, the annual pension expenses pursuant to IAS 19, and variable remuneration (maximum remuneration). The maximum remuneration limits the maximum total remuneration (sum of the individual components based on maximum target achievement) that can be granted for one year. The maximum remuneration amounts to € 5.5 million (gross) for each Management Board member.

This upper limit refers to the total benefits granted to a member of the Management Board for his/her work on the Management Board in the financial year in question. Payments of long-term variable remuneration components, i.e. those that are paid out on a deferred basis, are attributed to the year of vesting. Ancillary benefits are recognised based on the non-cash benefit amount used for tax purposes. The maximum remuneration defined in this remuneration system does not release the Supervisory Board from its obligation to review the appropriateness of the specific upper remuneration limits when determining individual remuneration.

In contrast to remuneration systems featuring what are known as share ownership rules, in which Management Board members commit to holding a certain proportion of physical shares, the share price performance of virtual shares has to be included in the maximum remuneration. Standard practice in the market involves accounting for expenses for pension commitments in accordance with IAS 19. This figure is not, however, based on the annual contribution, but is largely determined by the age of the Management Board members and their length of service, and is subject to fluctuations.

Any severance payments paid in the event of premature termination of Management Board activities are not included in the maximum remuneration. The regulatory requirements that apply to severance payments remain unaffected.

Remuneration when positions in executive bodies are assumed

The assumption of paid or unpaid forms of secondary employment, honorary positions, supervisory board, advisory board or similar mandates, as well as work on expert opinions, require the prior written consent of the Supervisory Board's Executive and Nomination Committee. If and to the extent that the paid forms of secondary employment are directly related to the Bank (e.g. in cases involving mandates within the Group), the remuneration paid for these activities is offset against the individual's fixed annual salary. In the event that members of the Management Board assume positions in executive bodies outside of the Group, the Supervisory Board is responsible for deciding whether to offset the remuneration earned by the Management Board member in question against the total remuneration from his or her Management Board position.

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).

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) nos. 10 and 11 of the 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.

The provisions enacted by the German Risk Reduction Act (Risikoreduzierungsgesetz – "RiG") (section 45 (2) and (7) of the KWG) allow the competent supervisory authority to prohibit the payment of variable remuneration if state support measures are used or if the remuneration system is assessed as being inappropriate. The Supervisory Board will observe any corresponding regulatory restrictions.

Additional conditions for achievement of Group targets

In addition to ensuring sufficient risk-bearing capacity, the Supervisory Board defines additional conditions that would lead to the forfeiture of the Group component in the event of non-fulfilment. These additional conditions are set via specific indicators of sufficient capital and liquidity resources, and usually relate to CET1 and LC ratios that exceed the minimum thresholds.

Benefits paid in the event of temporary, non-permanent incapacity for work

In the event of temporary, non-permanent incapacity for work, members continue to receive their fixed annual salary for a period of up to six months. The Supervisory Board can decide at its own discretion whether the variable remuneration components are also granted in full or in part for the periods in which continued salary payments are made.

Contractual terms; permanent disability; death

The Management Board employment contracts are concluded for the duration of the appointment period in each case. This is usually three years for an initial appointment and five years for each subsequent appointment. In accordance with the German Public Limited Companies Act, the employment contracts do not provide for any option for termination for convenience; the right of both parties to terminate the employment contract without notice for good cause remains unaffected.

The Management Board employment contract ends automatically if the member becomes permanently incapacitated for work. In such cases, the Management Board employment contracts provide for the continued payment of the fixed annual salary (plus (substitute) social security contributions) from the beginning of the permanent disability and for a period of up to six months (taking into account the periods for which continued salary payments were already made), but not extending beyond the point in time at which the employment contract would have ended normally.

The contracts of employment may state that, if a member of the Management Board dies during the term of his/her contract, widows, widowers or civil partners and legitimate children (provided they have not yet turned 27 and are still in vocational training/further education) are entitled, as joint and several creditors, to continued fixed salary payments for the month of death and the following six months, but until the contract ends at the latest. In such cases, the variable remuneration is calculated pro rata for the period leading up to the member's death.

Rules governing severance pay

The Management Board employment contracts do not (with the exception of the provisions that apply in the event of a change of control) 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 and must not constitute remuneration for more than the remaining term of the employment contract (severance cap).

In the event of the loss of a Management Board position due to a **change of control** (i. e. essentially in cases of involuntary loss), the Management Board employment contracts may state that the members are to be paid the fixed remuneration component, the performance-related remuneration as well as the contractually agreed ancillary benefits for the remainder of the term of the contract. In such cases, 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 cases like these, the extent to which sectional and individual targets were achieved on average during the last three financing years prior to the termination of the Management Board position is used as a basis to determine the target achievement level for the individual and sectional targets for the remaining term of the contract.

In the event of resignation from the Management Board within a certain period after a change of control, the Management Board employment contracts may state that the members are only to receive the fixed remuneration and the contractually agreed ancillary benefits for the remainder of the term of the contract. In this case, the contracts do not provide for any entitlement to the variable remuneration component.

The total amount of the payments made to a member who has left due to a change of control is also limited to the severance cap of a maximum of two years' remuneration/remuneration for the remaining term of the contract.

Newcomer rule

The Supervisory Board can 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 decides upon the specific selection as well as remuneration of individual Management Board members, within its reasonable discretion, and taking the Company's specific needs and the general appropriateness review into account, it is possible to diverge from this rule.

The Supervisory Board has decided to only gradually build up the three-year period for measuring remuneration targets (phase 1) for newly appointed Management Board members. 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 correspondingly for periods with a shortened assessment period. Hence, for the first year, the assessment period is only one year, with the deferral period being 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.

Post-contractual non-compete clause

The Supervisory Board can agree a post-contractual non-compete clause for a period of up to 24 months. For this period, appropriate compensation to be determined on a case-by-case basis is agreed. Furthermore, if such a non-compete clause is agreed, the employment contracts generally state that the compensation is to be paid in monthly instalments, offsetting any severance payments.

Appropriateness review

In accordance with section 12 of the German Ordinance on Remuneration in Financial Institutions (Institutsvergütungsverordnung – InstVergV), the Supervisory Board regularly (at least annually) checks whether Management Board and employee remuneration is appropriate.

The appropriateness of the remuneration paid to the Management Board is assessed in particular in view of the remit and performance of the Management Board member, as well as the Bank's situation. The function, area of responsibility and experience of the individual Management Board members are taken into account when determining the amount of the total target remuneration. As a result, the Supervisory Board can set different remuneration levels for different Management Board members at its own due discretion, taking into account criteria such as standard market practice, the experience of the Management Board member, his/her length of service on the Management Board and the Management Board members area of responsibility.

When assessing whether the Management Board remuneration is in line with standard market practice, both vertical compatibility with peer group companies and horizontal compatibility with the remuneration structures for the employees of Aareal Bank AG in Germany are taken into account.

The vertical comparison involves looking at how the Management Board remuneration relates to the remuneration paid to the senior management team, and how it relates to the remuneration paid to the workforce as a whole. For the purposes of the vertical comparison, the workforce as a whole refers to all employees of Aareal Bank AG and its German Group companies working in Germany. As well as looking at how the remuneration paid to the two comparison groups currently relates to the remuneration paid to the Management Board, the Supervisory Board also looks at the development of the remuneration paid to the groups described over time.

When setting the Management Board remuneration, the Supervisory Board also ensures that the remuneration system for Management Board members is compatible with the system used for employees who are not covered by a collective agreement. This is achieved, among other things, by ensuring that the structure of the variable remuneration system – apart from regulatory requirements – is essentially the same for the Management Board and the Bank's employees: the incentives set for the Management Board and employees are focused on the Group's performance, and individual employee targets are developed based on the Management Board's sectional targets, which are, as a result, also closely linked to the corporate strategy. The pension benefits for employees are also aligned with the system that applies to the Management Board members, which is reflected, by way of example, in the fact that the same interest rate applies.

In addition, a full review is conducted at least every four years and at the latest before the remuneration system is resubmitted to the Annual General Meeting for approval. In addition to reviewing the amount of remuneration paid to the Management Board members, this review also takes into account employees' remuneration and employment conditions.

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 horizontal comparison groups. The comparison group companies are selected based on Aareal Bank's market position (in particular: sector, size, country). Therefore, the comparison groups are companies listed in the relevant stock exchange indices (currently the DAX, MDAX und SDAX), as well as banks of a similar size. The composition of the peer groups is reviewed on a regular basis as part of the full appropriateness review process.

Right to allow temporary deviations from the remuneration system

The Supervisory Board is entitled to temporarily deviate from the remuneration system for Management Board members pursuant to section 87a (2) of the AktG if it is necessary for the sake of the Company's long-term wellbeing.

This can prove necessary, for example, in the event of far-reaching and extraordinary changes in the economic situation, such as the occurrence of a severe economic crisis. Similarly, a significant change in corporate strategy may require a deviation from this remuneration system in order to ensure that appropriate incentives are set.

Deviations from the remuneration system are only possible by way of a corresponding Supervisory Board resolution based on a proposal put forward by the Remuneration Control Committee confirming the need for the deviation.

The option of deviating from the remuneration system for the Management Board temporarily is limited to the following components: the amount of the fixed maximum remuneration, the performance criteria for variable remuneration, ranges for possible target achievement levels for the variable remuneration parameters, the specific remuneration components and the relative shares of fixed and variable remuneration components. Deviations can also be made by temporarily granting additional remuneration components, for example in the form of extraordinary ancillary and special benefits.

Remuneration of the Management Board

Measures in the 2020 financial year

Absence of Hermann J. Merkens due to ill health

The Chairman of the Management Board of Aareal Bank AG, Hermann J. Merkens, informed the Supervisory Board and the other members of the Management Board on 8 November 2020 that for health reasons, he would not be able to perform his duties as member and Chairman of the Management Board for an expected period of three to four months. The other members of the Management Board assumed Mr Merkens' portfolio of responsibilities based on the substitution regulations in place with immediate effect. This relates primarily to Marc Hess, who, in addition to his role as Chief Financial Officer, assumed responsibility for Group Strategy, Group Communications and Governmental Affairs and Investor Relations/Sustainability, and Thomas Ortmanns, who, in addition to his role as Chief Digitalisation Officer, assumed responsibility for Group Human Resources & Infrastructure and Corporate Affairs, including the Legal department.

Increase in share deferral

For the ordinary members of the Management Board, the share deferral portion of the variable remuneration has been increased from 30 % to 35 %. The share of cash deferral has been reduced from 30 % to 25 % in turn. This increases the proportion of variable remuneration attributable to share-based payment to a total of 55 %, which already takes effect for the 2020 financial year. This adjustment has not yet been made for Mr Merkens due to his leave of absence.

Target achievement in the 2020 financial year

Target achievement

Due to the Covid-19-related low level of Group target achievement for the reporting year 2020, target achievement for individual Management Board members was significantly reduced, to approximately 50 %. Given the three-year target measurement period, this will also have a negative impact upon variable remuneration for the two subsequent

%		Hermann J. Merkens	Marc Hess	Dagmar Knopek	Christiane Kunisch-Wolff	Thomas Ortmanns	Christof Winkelmann
2020	Group targets	20.0	20.0	20.0	20.0	20.0	20.0
	Sectional targets	110.0	110.0	110.0	110.0	110.0	110.0
	Individual targets	120.0	130.0	120.0	120.0	130.0	120.0
	Target achievement for 2020	**50.0**	**51.6**	**50.0**	**50.0**	**51.6**	**50.0**
Overall target achievement for 2020, based on a three-year observation period		**71.7**	**72.9**	**70.6**	**71.2**	**72.1**	**71.7**
Amount of variable remuneration (€)		**895,626**	**568,231**	**550,680**	**555,360**	**562,380**	**558,871**

years. Likewise, the overall target achievement level for 2020 – on a three-year basis – also comprises target achievement levels for the two previous years, leading to a level of approximately 70 % for each member of the Management Board.

Group performance targets 2020

Group performance is calculated by multiplying the target achievement level for an earnings target with a risk-adjusting indicator. At the beginning of the year, consolidated operating profit before taxes of € 215 million and a target RWA level of € 17.2 billion based on Basel IV (fully phased-in) – as a risk-adjusting indicator – were set as the earnings target for 100 % target achievement. The target RWA level was achieved. However, the Covid-19 pandemic – and the precautionary measures taken in response – resulted in the Group reporting negative consolidated operating profit. The Supervisory Board has made allowances for these extraordinary developments by applying the "modifier", using the maximum adjustment level of 20 percentage points to ensure appropriate recognition of the Management Board's actual performance despite the Covid-19 pandemic, which was outside of their control.

Sectional and individual targets 2020

Specific sectional and individual targets were defined for each Management Board member. Whilst the individual targets reflect 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 overall 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. The measurement of the individual contribution is based, among other things, on the "risk culture report", which assesses the supervisory authorities' expectations regarding managers as role models, the personal responsibility of employees, the benefits of open, critical and constructive communication spanning all hierarchical levels and divisions, and the appropriate incentive effect of monetary and non-monetary instruments.

The target achievement levels for the sectional and individual contributions made by the individual members of the Management Board resulted from the following main reasons:

Hermann-Josef Merkens

Aareal Bank's effectiveness was strengthened through the further process-oriented alignment of the Bank's organisational structure and processes, as well as measures to optimise the integrated Group management approach. The results of the employee survey conducted in 2019 were implemented systematically and, in particular, progress was made in rejuvenating Aareal Bank by recruiting more young professionals. Cross-sectional ESG opportunity and risk management was established, and Aareal Bank's ESG measures initiated were positioned in the capital markets, which was reflected in positive external ESG ratings.

With regard to Hermann J. Merkens's individual contribution, the Supervisory Board recognised the fact that the projects and tasks assigned to him as part of the Aareal Next Level strategic framework were implemented despite the Covid-19 pandemic, while at the same time, the culture of discussion was promoted as a key outcome of the employee survey, and the sale of a minority stake in Aareon was successfully executed with his intensive involvement.

Even though Mr Merkens was unable to contribute to achievement of his targets during his time of absence, given the temporary nature of his absence during 2020, this only had a minor impact on target measurement.

Marc Hess

Aareal Bank's funding structure was optimised, allowing the Bank to maintain sufficient liquidity and capital resources at all times, even in the face of increased lending and the Covid-19 pandemic. In addition, Aareal Bank shaped its ESG profile, allowing the Bank to exploit more favourable funding terms, and to achieve higher allocations for bond issues of public-sector entities in some cases. The organisation's cost control and effectiveness have also been strengthened.

The projects and tasks assigned to him as part of the Aareal Next Level strategic framework were implemented despite the Covid-19 pandemic and the culture of discussion was promoted at the same time as a key outcome of the employee survey. Hermann Merkens's responsibilities for Group Strategy, Group Communications and Governmental Affairs and Investor Relations/Sustainability were continued successfully by Marc Hess in Mr Merkens's absence – in particular, the review of the strategic programme (which had been commenced) against the backdrop of the Covid-19 pandemic (the so-called 360-degree review) was completed.

Dagmar Knopek

The reduction in the Bank's non-core assets exceeded the planned level. In order to make lending more effective, Dagmar Knopek ensured, in particular, that processes were digitalised further. Transparency was enhanced in the property portfolio with regard to various ESG criteria, and this was reflected in lending processes.

The credit portfolio and the NPL portfolio were managed appropriately in the context of the Covid-19 pandemic, in particular thanks to co-operation between different divisions as promoted by Dagmar Knopek.

Christiane Kunisch-Wolff

The frequent adoption of new regulatory requirements, which were introduced even more frequently due to the Covid-19 pandemic, was anticipated and implemented at an early stage. In particular, this strengthened the adequacy and effectiveness of the risk management and internal control systems with regard to information security risks, cyber resilience, ESG, IT stability, sanctions as well as money laundering within the limits of the cost budget earmarked for this purpose.

Christiane Kunisch-Wolff ensured that immediate changes were made to risk and monitoring systems to deal with the Covid-19 pandemic, while intensively promoting their ongoing digital development. Thanks to increased transparency, the management of the Bank by the Management Board was optimised. She served as a role model regarding the benefits of a positive and constructive discussion culture in her direct contact with managers and non-managers alike. Ms Kunisch-Wolff successfully assumed Mr Merkens's responsibility for Group Audit during his absence.

Thomas Ortmanns

When it comes to responsibility for business divisions, the sectional contribution is measured primarily based on key operating figures. Even though Aareon's planned adjusted EBITDA for 2020 was not fully achieved, due to Covid-19, significant strategic product enhancements (including Virtual Assistant, Predictive Maintenance, Smart Platform) were implemented whilst clearly remaining below the cost budget that had been set. This is reflected, among other things, in increased revenue generated with digital products, despite Covid-19.

The projects and tasks assigned to him as part of the Aareal Next Level strategic framework were implemented despite the Covid-19 pandemic and the culture of discussion was promoted at the same time as a key outcome of the employee survey. The partial sale of Aareon AG was successfully supported. Hermann Merkens's responsibilities for Group Human Resources & Infrastructure and Corporate Affairs, including the Legal department, were continued successfully during his absence. Mr Ortmanns ensured that sufficient IT stability was ascertained at all times, despite a large number of employees working from home, and the availability of IT capacities for the digital further development of Aareal Bank Group's products and processes thanks to his intensive personal commitment. In addition, Thomas Ortmanns very successfully chaired the Pandemic Committee, which managed the internal response to the Covid-19 pandemic efficiently and, in doing so, made a significant contribution to protecting the workforce.

Christof Winkelmann

The portfolio targets were all achieved or exceeded. In particular, growth in those property markets that are relevant to Aareal Bank was achieved in spite of the Covid-19 pandemic, while the syndication ratio was increased as planned and new products, such as green lending products, were developed at the same time.

The increased flexibility in business activities already achieved in recent years allowed the portfolio to be readjusted during the year, in particular to increase the logistics property type. With his intensive involvement, contact with Aareal Bank's clients was intensified and they were supported in their response to the Covid-19 pandemic. Christof Winkelmann played a key role in promoting the close coordination between Aareal Bank Group employees that is necessary for management purposes. He assumed the function of membership on the Supervisory Board of Aareal Estate AG in Mr Merkens's absence, as well as various communications tasks.

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. No penalty-triggering events were found.

Other information

No severance payments were agreed with Management Board members in the last financial year.

What is more, the annual backtesting of past target achievement did not rewveal any indications requiring a decision on a subsequent adjustment to the variable remuneration and a possible clawback via clawback provisions agreed in the service contract.

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.

€	Year	Fixed remuneration	Variable remuneration						Ancillary benefits	Total remuneration
			Cash component		Share-based component		Target achievement level	Total		
			Cash bonus	Cash deferral[1]	Share bonus	Share deferral[1]				
Hermann J. Merkens	2020	1,425,000	179,125	268,688	179,125	268,688	71.7 %	895,626	69,680	2,390,306
	2019	1,425,000	257,825	386,738	257,825	386,738	103.1 %	1,289,126	36,079	2,750,205
Marc Hess[2]	2020	900,000	113,646	142,058	113,646	198,881	72.9 %	568,231	100,791	1,569,022
	2019	900,000	157,638	236,457	157,638	236,457	101.1 %	788,190	39,855	1,728,045
Dagmar Knopek	2020	900,000	110,136	137,670	110,136	192,738	70.6 %	550,680	38,959	1,489,639
	2019	900,000	156,671	235,006	156,671	235,006	100.4 %	783,354	56,012	1,739,366
Christiane Kunisch-Wolff	2020	900,000	111,072	138,840	111,072	194,376	71.2 %	555,360	38,965	1,494,325
	2019	859,957	153,754	230,631	153,754	230,631	102.2 %	768,770	34,797	1,663,524
Thomas Ortmanns	2020	900,000	112,476	140,595	112,476	196,833	72.1 %	562,380	38,598	1,500,978
	2019	900,000	159,245	238,867	159,245	238,867	102.1 %	796,224	40,678	1,736,902
Christof Winkelmann	2020	900,000	111,774	139,718	111,774	195,605	71.7 %	558,871	34,886	1,493,757
	2019	802,000	146,776	220,165	146,776	220,165	103.3 %	733,882	38,245	1,574,127
Total	**2020**	**5,925,000**	**738,229**	**967,569**	**738,229**	**1,247,121**	**71.7 %**	**3,691,148**	**321,879**	**9,938,027**
	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**

[1] The deferrals shown are subject to the criteria on retention of variable remuneration components and penalty criteria, as set out above.
[2] The increase in ancillary benefits for Marc Hess in 2020 is mainly due to the one-off effect of security expenses incurred in the 2020 reporting year.

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 € 1.7 million (2019: € 2.3 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 following table shows the portion of the variable component attributable to share-based remuneration arrangements as well as the corresponding number of virtual shares granted in 2020 and 2019, respectively – as well as the number of virtual shares already held as at the reporting date.

		Share-based remuneration		Total quantity of virtual shares held (31 Dec)
	Year	Value (€)	Quantity (number) [1]	Quantity (number)
Hermann J. Merkens	2020	447,813	22,906	47,218
	2019	644,563	25,357	58,753
Mark Hess	2020	312,527	15,986	6,502
	2019	394,095	15,503	1,405
Dagmar Knopek	2020	302,874	15,492	27,916
	2019	391,677	15,408	35,689
Christiane Kunisch-Wolff	2020	305,448	15,624	19,405
	2019	384,385	15,121	18,504
Thomas Ortmanns	2020	309,309	15,821	28,007
	2019	398,112	15,661	35,942
Christof Winkelmann	2020	307,379	15,723	17,805
	2019	366,941	14,435	15,751
Total	**2020**	**1,985,350**	**101,552**	**146,853**
	2019	**2,579,773**	**101,485**	**166,044**

[1] The stated number of virtual shares granted for 2020 is a preliminary figure, based on the price of Aareal Bank AG's share on 31 December 2020 (€ 19.55). The final conversion rate may only be determined after publication of preliminary results for 2020. The stated number of virtual shares granted for 2019 differs from the previous year's figure since the former was calculated using a final conversion rate of € 25.42.

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 sections 4.2.4 and 4.2.5 of the German Corporate Governance Code in the version dated 7 February 2017. In addition, the defined maximum remuneration is shown as an absolute upper limit pursuant to section 87a (1) 1 of the AktG.

Remuneration granted	**Hermann J. Merkens – Chairman of the Management Board**			
	2019	**2020**	**2020 (min)[1]**	**2020 (max)[2]**
€				
Fixed remuneration	1,425,000	1,425,000	1,425,000	1,425,000
Ancillary benefits	36,079	69,680	69,680	69,680
Total	**1,461,079**	**1,494,680**	**1,494,680**	**1,494,680**
One-year variable remuneration	250,000	179,125	–	375,000
Multi-year variable remuneration				
Cash deferral 2020 (March 2026)	–	268,688	–	562,500
Share bonus 2020 (March 2021)	–	179,125	–	375,000
Share deferral 2020 (March 2026)	–	268,688	–	562,500
Cash deferral 2019 (March 2025)	375,000	–	–	–
Share bonus 2019 (March 2020)	250,000	–	–	–
Share deferral 2019 (March 2025)	375,000	–	–	–
Total	**1,250,000**	**895,626**	**–**	**1,875,000**
Benefit expense[3]	788,303	864,322	864,322	864,322
Total remuneration	**3,499,382**	**3,254,628**	**2,359,002**	**4,234,002**

Remuneration granted	**Mark Hess**			
	2019	**2020**	**2020 (min)[1]**	**2020 (max)[2]**
€				
Fixed remuneration	900,000	900,000	900,000	900,000
Ancillary benefits	39,855	100,791	100,791	100,791
Total	**939,855**	**1,000,791**	**1,000,791**	**1,000,791**
One-year variable remuneration	156,000	113,646	–	234,000
Multi-year variable remuneration				
Cash deferral 2020 (March 2026)	–	142,058	–	292,500
Share bonus 2020 (March 2021)	–	113,646	–	234,000
Share deferral 2020 (March 2026)	–	198,881	–	409,500
Cash deferral 2019 (March 2026)	234,000	–	–	–
Share bonus 2019 (March 2020)	156,000	–	–	–
Share deferral 2019 (March 2026)	234,000	–	–	–
Total	**780,000**	**568,231**	**–**	**1,170,000**
Benefit expense[3]	519,026	637,516	637,516	637,516
Total remuneration	**2,238,881**	**2,206,538**	**1,638,307**	**2,808,307**

[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] Benefit expense refers to the service cost pursuant to IAS 19. The figures for 2019 were adjusted accordingly to reflect the service cost pursuant to IAS 19 for 2019.

Remuneration granted	Dagmar Knopek			
€	2019	2020	2020 (min)[1]	2020 (max)[2]
Fixed remuneration	900,000	900,000	900,000	900,000
Ancillary benefits	56,012	38,959	38,959	38,959
Total	**956,012**	**938,959**	**938,959**	**938,959**
One-year variable remuneration	156,000	110,136	–	234,000
Multi-year variable remuneration				
Cash deferral 2020 (March 2026)	–	137,670	–	292,500
Share bonus 2020 (March 2021)	–	110,136	–	234,000
Share deferral 2020 (March 2026)	–	192,738	–	409,500
Cash deferral 2019 (March 2025)	234,000	–	–	–
Share bonus 2019 (March 2020)	156,000	–	–	–
Share deferral 2019 (March 2025)	234,000	–	–	–
Total	**780,000**	**550,680**	**–**	**1,170,000**
Benefit expense3)	395,582	429,474	429,474	429,474
Total remuneration	**2,131,594**	**1,919,113**	**1,368,433**	**2,538,433**

Remuneration granted	Christiane Kunisch-Wolff			
€	2019	2020	2020 (min)[1]	2020 (max)[2]
Fixed remuneration	859,957	900,000	900,000	900,000
Ancillary benefits	34,797	38,965	38,965	38,965
Total	**894,754**	**938,965**	**938,965**	**938,965**
One-year variable remuneration	150,400	111,072	–	234,000
Multi-year variable remuneration				
Cash deferral 2020 (March 2026)	–	138,840	–	292,500
Share bonus 2020 (March 2021)	–	111,072	–	234,000
Share deferral 2020 (March 2026)	–	194,376	–	409,500
Cash deferral 2019 (March 2025)	225,600	–	–	–
Share bonus 2019 (March 2020)	150,400	–	–	–
Share deferral 2019 (March 2025)	225,600	–	–	–
Total	**752,000**	**555,360**	**–**	**1,170,000**
Benefit expense3)	460,018	557,884	557,884	557,884
Total remuneration	**2,106,772**	**2,052,209**	**1,496,849**	**2,666,849**

[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] Benefit expense refers to the service cost pursuant to IAS 19. The figures for 2019 were adjusted accordingly to reflect the service cost pursuant to IAS 19 for 2019.

Remuneration granted	Thomas Ortmanns			
	2019	2020	2020 (Min)[1]	2020 (Max)[2]
€				
Fixed remuneration	900,000	900,000	900,000	900,000
Ancillary benefits	40,678	38,598	38,598	38,598
Total	**940,678**	**938,598**	**938,598**	**938,598**
One-year variable remuneration	156,000	112,476	–	234,000
Multi-year variable remuneration				
Cash deferral 2020 (March 2026)	–	140,595	–	292,500
Share bonus 2020 (March 2021)	–	112,476	–	234,000
Share deferral 2020 (March 2026)	–	196,833	–	409,500
Cash deferral 2019 (March 2025)	234,000	–	–	–
Share bonus 2019 (March 2020)	156,000	–	–	–
Share deferral 2019 (March 2025)	234,000	–	–	–
Total	**780,000**	**562,380**	**–**	**1,170,000**
Benefit expense[3]	574,053	431,854	431,854	431,854
Total remuneration	**2,294,731**	**1,932,832**	**1,370,452**	**2,540,452**

Remuneration granted	Christof Winkelmann			
	2019	2020	2020 (Min)[1]	2020 (Max)[2]
€				
Fixed remuneration	802,000	900,000	900,000	900,000
Ancillary benefits	38,245	34,886	34,886	34,886
Total	**840,245**	**934,886**	**934,886**	**934,886**
One-year variable remuneration	142,115	111,774	–	234,000
Multi-year variable remuneration				
Cash deferral 2020 (March 2026)	–	139,718	–	292,500
Share bonus 2020 (March 2021)	–	111,774	–	234,000
Share deferral 2020 (March 2026)	–	195,605	–	409,500
Cash deferral 2019 (March 2025)	213,173	–	–	–
Share bonus 2019 (March 2020)	142,115	–	–	–
Share deferral 2019 (March 2025)	213,173	–	–	–
Total	**710,576**	**558,871**	**–**	**1,170,000**
Benefit expense[3]	509,514	720,696	720,696	720,696
Total remuneration	**2,060,335**	**2,214,453**	**1,655,582**	**2,825,582**

[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] Benefit expense refers to the service cost pursuant to IAS 19. The figures for 2019 were adjusted accordingly to reflect the service cost pursuant to IAS 19 for 2019.

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 in the version dated 7 February 2017. 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		Dagmar Knopek		Christiane Kunisch-Wolff	
	2020	2019	2020	2019	2020	2019	2020	2019
€								
Fixed remuneration	1,425,000	1,425,000	900,000	900,000	900,000	900,000	900,000	859,957
Ancillary benefits	69,680	36,079	100,791	39,855	38,959	56,012	38,965	34,797
Total	**1,494,680**	**1,461,079**	**1,000,791**	**939,855**	**938,959**	**956,012**	**938,965**	**894,754**
One-year variable remuneration	257,825	304,248	157,638	40,329	156,671	164,256	153,754	139,085
Multi-year variable remuneration	–	–	–	–	–	–	–	–
Cash deferral 2016 (April 2020)	191,250	–	–	–	107,503	–	68,511	–
Cash deferral 2017 (April 2020)	173,238	–	–	–	98,993	–	79,194	–
Cash deferral 2018 (April 2020)	91,274	–	8,642	–	49,277	–	41,725	–
Share bonus 2016 (April 2020)	269,482	–	–	–	151,478	–	96,536	–
Share bonus 2018 (April 2020)	269,383	–	35,707	–	145,433	–	123,146	–
Share deferral 2014 (April 2020)	66,766	–	–	–	66,607	–	–	–
Share deferral 2015 (April 2020)	139,985	–	–	–	99,373	–	–	–
Share deferral 2016 (April 2020)	135,307	–	–	–	76,057	–	48,470	–
Cash deferral 2015 (April 2019)	–	152,530	–	–	–	108,278	–	–
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	–	2,950	–	78,046	–	41,361
Total	**1,594,510**	**1,594,332**	**201,987**	**43,279**	**951,392**	**1,023,207**	**611,336**	**327,580**
Benefit expense[1]	864,322	788,303	637,516	519,026	429,474	395,582	557,884	460,018
Total remuneration	**3,953,512**	**3,843,714**	**1,840,294**	**1,502,160**	**2,319,825**	**2,374,801**	**2,108,185**	**1,682,352**

[1] Benefit expense refers to the service cost pursuant to IAS 19. The figures for 2019 were adjusted accordingly to reflect the service cost pursuant to IAS 19 for 2019.

Remuneration paid	**Thomas Ortmanns**		**Christof Winkelmann**		**Dr Wolf Schumacher**[2)]	
	2020	**2019**	**2020**	**2019**	**2020**	**2019**
€						
Fixed remuneration	900,000	900,000	900,000	802,000	–	–
Ancillary benefits	38,598	40,678	34,886	38,245	–	–
Total	**938,598**	**940,678**	**934,886**	**840,245**	**–**	**–**
One-year variable remuneration	159,245	173,856	146,776	139,085	–	–
Multi-year variable remuneration	–	–	–	–	–	–
Cash deferral 2016 (April 2020)	108,151	–	43,099	–	–	–
Cash deferral 2017 (April 2020)	97,784	–	80,161	–	–	–
Cash deferral 2018 (April 2020)	52,157	–	41,725	–	–	–
Share bonus 2016 (April 2020)	152,392	–	60,728	–	–	–
Share bonus 2018 (April 2020)	153,933	–	123,146	–	–	–
Share deferral 2014 (April 2020)	66,238	–	–	–	116,563	–
Share deferral 2015 (April 2020)	98,774	–	–	–	128,954	–
Share deferral 2016 (April 2020)	76,516	–	30,492	–	–	–
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	–	35,240	–	31,001
Total	**965,190**	**1,071,859**	**526,127**	**297,117**	**245,517**	**905,358**
Benefit expense[1)]	431,854	574,053	720,696	509,514	–	–
Total remuneration	**2,335,642**	**2,586,590**	**2,181,709**	**1,646,876**	**245,517**	**905,358**

[1)] Benefit expense refers to the service cost pursuant to IAS 19. The figures for 2019 were adjusted accordingly to reflect the service cost pursuant to IAS 19 for 2019.

[2)] Dr Wolf Schumacher resigned with effect from 30 September 2015.

Pensions

	2020			**2019**		
	Pension claims p.a.[1)]	**Balance of pension obligations (IFRS) as at 31 Dec 2020**	**Increase of pension obligations (IFRS) in 2020**	**Pension claims p.a.**[1)]	**Balance of pension obligations (IFRS) as at 31 Dec 2019**	**Increase of pension obligations (IFRS) in 2019**
000's €						
Hermann J. Merkens	396	11,426	1,859	371	9,567	2,297
Marc Hess	62	1,776	873	35	902	754
Dagmar Knopek	145	3,992	702	127	3,290	780
Christiane Kunisch-Wolff	97	2,769	771	75	1,998	826
Thomas Ortmanns	308	9,237	1,270	294	7,967	1,610
Christof Winkelmann	121	4,314	1,649	92	2,664	1,436
Total	**1,129**	**33,514**	**7,124**	**994**	**26,388**	**7,703**

[1)] The pension claims mentioned refer to old-age pension earned as at 31 December of the year under review, based on the grants made by the Bank, at the applicable retirement age.

Service cost (in accordance with IFRSs) incurred in the 2020 financial year in connection with the pension claims of members of the Management Board totalled € 4.0 million (2019: € 3.6 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 € 8.4 million in the year under review (2019: € 10.3 million). The total amount of pension obligations is € 70.1 million (2019: € 61.8 million). Of that amount, € 36.6 million relates to former members of the Management Board and their surviving dependants (2019: € 35.4 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.

The remuneration for any financial year shall be due and payable one month after the end of the respective financial year. The members of the Supervisory Board are also included in a D&O (directors' and officers') liability insurance policy maintained by the Bank in an appropriate amount with a deductible of 10 %.

Remuneration element	Description	Structure
Fixed remuneration	Remuneration for activities on the Supervisory Board; Depending on the role of the respective Supervisory Board member (e.g. Chairman)	– € 50,000 p.a. per Supervisory Board member – € 150,000 p.a. for the Chairman – € 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 – € 40,000 p.a. each for the chairmanship in the two committees – € 15,000 p.a. each for membership in other committees – € 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 Chairman	2020	265,000	55,000	320,000
	2019	265,000	37,000	302,000
Richard Peters Deputy Chairman (since 27 May 2020)	2020	114,903	44,000	158,903
	2019	100,000	25,000	125,000
Prof. Dr Stephan Schüller Deputy Chairman (until 27 May 2020)	2020	51,042	19,000	70,042
	2019	125,000	23,000	148,000
Klaus Novatius Deputy Chairman	2020	105,000	37,000	142,000
	2019	105,000	21,000	126,000
Jana Brendel (since 27 May 2020)	2020	50,528	14,000	64,528
	2019	–	–	–
Christof von Dryander (since 27 May 2020)	2020	59,444	25,000	84,444
	2019	–	–	–
Thomas Hawel	2020	65,000	22,000	87,000
	2019	65,000	13,000	78,000
Petra Heinemann-Specht	2020	81,889	29,000	110,889
	2019	70,000	15,000	85,000
Jan Lehmann (since 27 May 2020)	2020	38,639	12,000	50,639
	2019	–	–	–
Dr Hans-Werner Rhein (until 27 May 2020)	2020	34,708	17,000	51,708
	2019	85,000	21,000	106,000
Sylvia Seignette	2020	90,000	24,000	114,000
	2019	90,000	15,000	105,000
Elisabeth Stheeman [1]	2020	85,000	28,000	113,000
	2019	85,000	19,000	104,000
Hans-Dietrich Voigtländer	2020	115,000	38,000	153,000
	2019	115,000	25,000	140,000
Prof. Dr Hermann Wagner	2020	118,917	37,000	155,917
	2019	110,000	21,000	131,000
Beate Wollmann (until 27 May 2020)	2020	28,583	12,000	40,583
	2019	70,000	15,000	85,000
Total	**2020**	**1,303,653**	**413,000**	**1,716,653**
	2019	**1,285,000**	**250,000**	**1,535,000**

[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 Office (Bundeszentralamt für Steuern, BZSt).

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 remuneration system for the Management Board and the remuneration system for employees are closely aligned, aside from regulatory requirements. Consistency between the systems is achieved, in particular, by using the Group component in the structure of the variable remuneration system, such that both the Management Board and employees (not covered by collective agreements) are set targets based on the Group performance criteria. In general, the targets set for the employees are derived from those set for the members of the Management Board, meaning that, as well as the structure of the two systems being consistent, the actual content of the targets set is also cascaded throughout the entire workforce from the strategic Group targets.

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 Bank (as of 1 January 2021: Banking & Digital Solutions) segment. The central staff functions and control units, as well as the Treasury division, are measured based on their respective 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 mostly 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. 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. Variable remuneration for employees not classified as risk takers is split into two components, too: the Group component (25 % of target variable remuneration) and the individual component (75 % of target variable remuneration). This means that 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 Group component and – for risk takers – the organisational component 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) of the 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.

Reporting on quantitative disclosure requirements

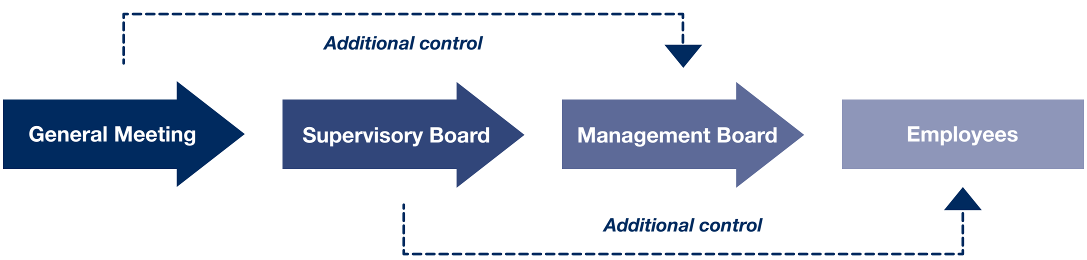
This report only covers the qualitative disclosure requirements regarding employee remuneration set out in Article 450 of the EU's Capital Requirements Regulation 2013/575 (CRR) and section 16 InstVergV. The quantitative disclosure requirements relating to the provisions set out above are published in a separate report entitled "Disclosure of Remuneration Indicators", which can be found on the website of Aareal Bank AG. This report is made available within six months of the end of the financial year: www.aareal-bank.com/en/investors-portal/finance-information/regulatory-disclosures/archive/2020/.

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

Determination and control of remuneration systems



(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 following years, the Supervisory Board reviews, 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.

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

In accordance with the German Act Implementing the Second Shareholder Rights Directive (ARUG II), the remuneration system for Management Board members is submitted to the Annual General Meeting for approval at least every four years and in the event of significant changes (Say-on-Pay). The remuneration system will be presented to the 2021 Annual General Meeting for the first time in line with these provisions.

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 to the consolidated financial statements.

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 advisors

In order to review the appropriateness of the Supervisory Board remuneration, an external remuneration advisor is engaged at least every four years to prepare an opinion as to the appropriateness of this remuneration – and especially, on whether this remuneration is in line with common practice and is comparable.

In addition, a horizontal comparison of the remuneration paid to Aareal Bank's Management Board members with suitable peer companies is carried out by an external remuneration advisor to review the appropriateness of the Management Board emuneration. The composition of the peer groups is reviewed on a regular basis by the remuneration advisor as part of the appropriateness review process.

The Remuneration Control Committee and the Supervisory Board are advised by hkp/// within this context. The Bank also seeks advice from the law firm Freshfields Bruckhaus Deringer on matters relating to remuneration law.

Takeover Disclosures in Accordance with Section 315a (1) 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 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 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-articipation 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 be attached exclusively to bearer no-par value shares and are limited to a maximum amount of € 71,828,664.00 of the Company's share capital. 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 Gen-eral 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 authorised the Management Board by way of a resolution dated 27 May 2020, 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 purchase or prior to assuming a purchase obligation by more than 10%. This authorisation expires on 26 May 2025. The volume of shares acquired for this purpose must not exceed 5 % of the issued share capital of Aareal Bank AG at the end of any given day.

Furthermore, the Management Board was authorised by means of a resolution of the General Meeting held on 27 May 2020, pursuant to section 71 (1) no. 8 of the AktG, to purchase treasury shares in a volume of up to 10 % of the share capital for any permitted purposes. This authorisation expires on 26 May 2025. 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. This authorisation may be exercised – also by direct or indirect subsidiaries of Aareal Bank AG – in full or in part, on one or more occasions.

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.

Combined Separate 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.