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2010

Aareal Bank AG – Annual Report 2010

Aareal Bank

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Management Report

Business and operating environment

Group structure and business activities

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

Aareal Bank is a member of the Association of German Banks (*Bundesverband deutscher Banken* – "BdB") and the Association of German Pfandbrief Banks (*Verband Deutscher Pfandbriefbanken* – "vdp").

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

Structured Property Financing

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

In this segment, we facilitate property projects for our domestic and international clients. Aareal Bank is active in more than 20 countries across Europe, North America and Asia within the scope of its three-continent strategy. Its particular strength lies in its success in combining local market expertise and sector-specific know-how. In addition to local experts, the bank also has industry specialists at its disposal, to create financing packages for logistics properties, shopping centres and hotels. This enables us to structure tailor-made financing concepts to meet the special requirements of our national and international clients. What makes Aareal Bank special are its direct and long-standing client relationships.

Aareal Bank has a broad refinancing base. It has established itself as an active issuer of Pfandbriefe, which account for a major share of the bank's long-term funding. The quality of the cover assets pool is confirmed by the triple-A rating of Aareal Bank's Pfandbrief issues. To cater to a broad investor base, Aareal Bank also covers a wide range of other refinancing tools, including promissory notes and bank bonds. Capital market activities are focused on private placements. Larger public transactions with volumes of € 500 million and higher are entered into selectively. The Bank also generates deposits from its long-term business relationships with companies in the institutional housing industry, and with money market clients.

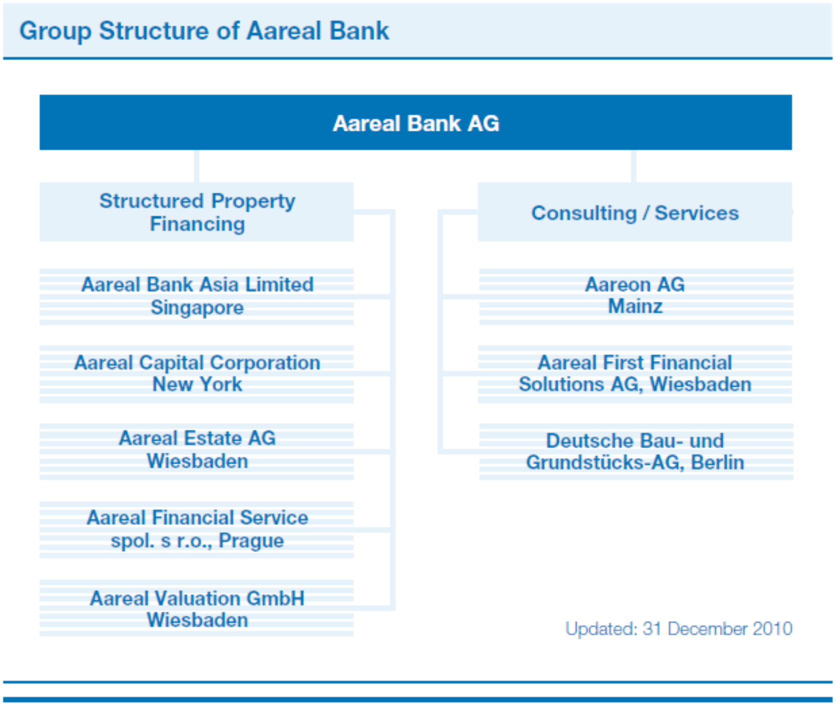
The success of capital and money market activities and the business with institutional housing industry clients is a result of a combination of a sustainable business model, a sound understanding of the capital markets, and the quality of the cover assets pool.

Consulting / Services

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

We operate our IT systems consultancy and related advisory services for the institutional housing industry through Aareon AG, which looks back on more than 50 years' experience. Aareon pursues a multi-product strategy that covers the requirements of every client group. The ERP product portfolio for efficient process planning comprises SAP-based solutions such as Blue Eagle, and Wodis, an in-house development with a new product generation ("Wodis Sigma"), as well as the GES and WohnData solutions that have long been established on the market. This product range is combined with extensive advisory services and integrated services that support networking between property companies and their business partners.

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



Corporate management

Aareal Bank AG manages its business at Group level; hence, the following detailed description of corporate management is based on Aareal Bank Group.

Sustainable company development is at the core of Aareal Bank Group's management concept; the standard is to create added value for our shareholders, our clients, and our employees. Particularly against the background of the financial markets crisis, our corporate management's balanced approach proved its mettle.

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

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

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

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

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

The property financing portfolio as a whole is actively managed throughout Aareal Bank Group, with the aim of optimising its risk diversification and earning power. 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 balance sheet portfolio, which is part of Group planning. This helps us to identify – and to respond to – market changes at an early stage. Active portfolio management makes it possible for us to optimally allocate equity to the most attractive products and regions from a risk/return perspective, within the scope of our three-continent strategy. By taking into consideration maximum allocations to individual countries, products and property types, we ensure broad diversification and avoid risk concentrations.

In the Consulting / Services segment, subsidiary management is oriented towards specific indicators, primarily EBIT (earnings before interest and taxes) and the EBIT margin, depending on each entity's business focus. We also use specific performance indicators that are typical for consulting and services in the IT business, the focus of this segment. These include indicators relating to regular customer satisfaction surveys regarding project work as well as capacity utilisation indicators. For the banking business within this segment, the primary performance indicators are deposit volumes and margins. The volume of deposits represents a portion of the bank's overall liquidity, and the margin is crucial to profitability. These objectives are at times competitive, and are weighted according to the business context and environment.

Macroeconomic and industry-specific environment

Global business environment

Following the severe recession in the global economy, the economic recovery that began in mid-2009 continued in most economies in 2010. However, recovery lost momentum in the second half of the year, and economic development diverged widely. The financial markets were influenced by speculation concerning the euro, rising sovereign debt in euro zone countries and the US, as well as rescue packages for Greece and Ireland. Equities, and particularly commodities markets by contrast, proved to be resilient and in some cases saw considerable price increases for selected commodities.

Central banks in Europe and the US continued to supply the financial system throughout 2010 with sufficient liquidity at varying levels; they kept key interest rates at historic lows to ensure economic recovery. In China, by contrast, the central bank and government undertook measures to prevent the economy from overheating.

Economy

Following the severe recession in 2009, the year under review saw a marked recovery in major economies. The dramatic growth in China in particular stimulated global trade and lead to unexpected high growth in export-oriented economies in 2010.

There were a wide variety of different causes behind the positive economic development seen in many countries. The expansive monetary policies employed by central banks – comprising low key interest rates and an expansive open market policy – also made a contribution, as did the national economic stimulus programmes instituted in years prior that continued to have an impact during 2010. The easing seen on the financial markets following the high point of the crisis in autumn of 2008 also played a considerable role in the positive economic development, even if the debt crisis prevented the financial markets from normalising fully in 2010.

Economic recovery slowed slightly over the second half of the year. One reason was that the process of inventory replenishment by companies weakened considerably. A further cause was that numerous stimulus programmes expired over the course of the year and many different countries, among them Spain and the UK, simultaneously introduced austerity measures to reduce budget deficits.

In the wake of the economic and financial markets crisis, national budget deficits and debt levels expanded dramatically. In 2010, sovereign debt continued to grow, and budget deficits remained high across the vast majority of countries.

The positive development of the global economy was spearheaded by emerging economies in Asia. Particularly China, but also other Asian countries such as Singapore, exhibited remarkable growth rates. By contrast, the economies of industrialised nations in North America and Europe experienced slower recovery. Economic development also varied within these regions. Whilst the economies of Germany, Poland, Sweden and Turkey grew markedly (for example), economic development in Ireland, Greece and Spain declined.

Unemployment rose considerably over the course of the economic and financial markets crisis in the majority of countries. In 2010 most countries also saw unemployment continue to rise or stagnate at a high level. Only very few countries, Germany in particular, succeeded in achieving a notable decline in unemployment.

Financial markets, monetary policy and inflation

Whilst at the beginning of the year, some easing could be observed on the financial markets compared to the previous years, distortions mounted further as a result of the sovereign debt crisis in some countries at the periphery of the euro zone. Investor concerns heightened dramatically concerning the financial situation in Greece in spring, spreading into a confidence crisis. In April, Greece was no longer able to refinance maturing government bond issues on the capital markets without third-party support. Member states of the euro zone and the International Monetary Fund (IMF) supported Greece with an aid package totalling more than € 110 billion. As the loss of confidence amongst investors spread to certain other euro zone countries, such as Ireland, the European Union (EU), euro zone member states and the IMF launched a rescue package totalling € 750 billion. These packages offer financial support to those countries facing refinancing difficulties. Ireland subsequently took advantage of these financial stability measures in November. Some questions relating to the rescue package remain unresolved. These include the volume of the package, the question regarding what will happen after current support measures expire, and the issue of creditor involvement.

As an additional support measure, the European Central Bank (ECB) instituted a purchase programme in May 2010 for public-sector and private bonds from euro zone governments or public-sector entities and other legal entities within the European Monetary Union. Debt securities must be denominated in euros and exchange-listed to qualify. These bonds and their issuers must also fulfil the requirements set out by ECB guidelines for open-market transactions. Within the framework of this programme, the ECB then purchased various government bonds. The aim of this measure was to shore up market slumps and liquidity for bonds of certain euro zone states rated as high risk by the capital markets, and to correct disruptions on these securities markets.

The announcement of the various measures was greeted with a certain degree of easing on the financial markets. However, risk premiums for the government bonds of Greece, Ireland and Portugal widened significantly after a brief lag. Spain, Italy and Belgium also faced considerably higher refinancing costs as a result. At the same time, investor demand shifted to countries with more secure ratings, such as Germany and France. As a result, the difference in returns on the different government bond markets widened significantly. Spreads over Euribor for German Pfandbrief or promissory note issues widened only slightly by comparison. This testifies to investor confidence in the quality of the German Pfandbrief.

In response to persisting distortions on the financial markets and the lack of confidence in economic development, as well as in view of moderate inflation, major central banks continued to pursue expansive monetary policies. The key interest rates were kept at very low levels by the ECB, the Bank of England (BoE) and the US Federal Reserve (Fed) throughout the entire year. The Japanese central bank lowered its benchmark rate in October from 0.1 % to a corridor of 0.0 % to 0.1 %. The central banks of Sweden and Canada pursued a slightly different course, raising their key interest rates in 2010. However, at 1.25 % and 1.0 % respectively at year-end 2010, both were very low.

The open-market policy entailing central banks' securities purchasing to supply liquidity to the markets yielded a more complex picture. The BoE allowed an extensive securities purchasing programme to expire in January, and the ECB ended a twelve-month programme for purchasing covered bonds as planned in June. In May, the ECB launched the programme mentioned above to purchase public and private bonds. Accompanying measures were also taken to prevent the purchases from causing an increase in money supply. Other monetary policy measures, such as shortening the term of central bank loans to commercial banks, signalled a careful repeal of individual monetary policy measures taken in response to the financial markets crisis. The Federal Reserve's open-market policy, by contrast, was considerably more expansive. After the Fed indicated its intention in August to use funds released from its extensive covered mortgage bond purchasing programme to buy up government bonds, it announced a new purchase programme in November for government bonds that totalled USD 600 billion, in response to slow economic recovery. The Chinese central bank pursued a quite different track in the face of sharply rising loan volumes and prices for residential property, by increasing minimum reserve requirements for commercial banks and key interest rates.

As a consequence of the debt crisis, the euro initially suffered considerable losses against the US dollar and the pound sterling. After the mid-year point, these developments changed, and the euro rebounded before losing some ground in late autumn. By year-end, the value of the euro vis-à-vis the US dollar and the pound sterling was thus below its level at the beginning of the year. The Japanese yen appreciated significantly against both the euro and the US dollar. Amongst other factors, this appreciation can be traced back to China's efforts to achieve a higher weighting of the Japanese yen in its currency reserves. In response to the appreciation, the Japanese central bank intervened in the foreign exchange market in September – for the first time in six years – and sold large volumes of Japanese yen.

Interest rate developments varied widely depending on maturities. Short-term interest rates for currencies[1] in which we are active increased slightly, albeit from a very low level. Long-term interest rates, by contrast,[2] declined further. Annual inflation rates rose slightly in 2010 over the very low rates of 2009, yet remained at a moderate level. The rise in inflation was primarily attributable to higher commodity prices. The annual rate of inflation averaged 1.6 % in the euro zone, and 2.1 % in the EU. Inflation in the US developed comparably. As household income has yet to see any material increase, and savings rates remained high compared to the period before the economic and financial markets crisis, this too contributed to moderate inflation in many countries. The UK, certain Eastern European countries and China experienced higher inflation rates. China in particular saw a rise in disposable income and a considerable increase in lending, causing the government and central bank to introduce significant measures to counteract any overheating on the horizon. Low deflation could be observed in Japan as well as in Ireland by contrast.

Global commercial property markets

Property performance is determined by a number of different factors. These include macroeconomic factors such as economic growth, unemployment trends and interest rate development. On most of the property markets where we are active, these underlying conditions improved in 2010. Other factors include local trends, such as regional economic development. In most of the regions in which we finance property, these were also positive during the year under review. The attractiveness of a property to users is also defined by specific factors such as location, modernisation status, area and energy efficiency, flexibility of use, and property management. From an investor's perspective, the tenant mix, the terms and conditions of rental contracts, and tenant quality also play a role. Given this multitude of influencing factors, it is clear that commercial property markets are not homogeneous. In making statements about general developments on the property markets, it is therefore important to take into account that individual properties may differ if property-specific factors are below-average.

In 2009, commercial property markets were largely affected by one consistent trend entailing rising vacancies, declining rents and lower market values in the wake of the economic and financial markets crisis. Few markets were able to break away from this trend, notably only during the second half of 2009. In 2010, market developments tended to vary more widely. Most property markets were split into two parts. One side included first-class properties that fared well under the aforementioned categories, due to their high quality. These properties were able to attract users, and rents generally stabilised or increased over the previous year. Investors focused on prime properties, and these were in greater demand in 2010 than in 2009. Investor yield requirements for these properties stabilised over the previous year, or even declined in some markets. The decrease in yield requirements and the stabilisation of rent expectations amongst investors

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[1] Short-term interest rates were analysed on the basis of three-month LIBOR (London Interbank Offered Rate), Euribor and comparable reference rates.
[2] For long-term interest rates, the relevant ten-year swap rates served as a reference.

resulted in rising market prices. Yield requirements still remained above the levels seen prior to the start of the economic and financial markets crisis. As such, property prices did not reach pre-crisis levels.

However, not all properties tracked these trends. Second-class properties faced difficulties in retaining users or finding new ones. As a consequence, rents for these properties continued to experience pressure. Demand amongst buyers and investors also remained low.

Transaction volumes on the commercial property markets increased markedly over the very low levels of the previous year, though they were still considerably lower than the high volumes seen in 2006 and 2007. The wide gap in price perceptions between potential buyers and sellers in 2009 narrowed in 2010, causing negotiation periods to shorten. Demand continued to concentrate on first-class properties in particular, as described above. On some markets, demand exceeded supply in this segment. Demand for second-class properties remained low. In addition to these factors, the availability of credit to refinance property investments is also an essential factor influencing market liquidity. This development varied widely – both globally and regionally, even in individual sub-markets or market segments.

During previous years, Asia's share of global transaction volumes increased whilst the North American share declined significantly. This trend changed over the course of 2010 as the share of the North American investment market in global transaction volumes increased again somewhat, though it remained significantly below its pre-crisis levels. The Asian and European investment markets saw rising revenues on the whole, though their shares in global transaction volumes underwent a slight year-on-year decline in 2010.

Rents were also differentiated between first-class and second-class properties. With respect to first-class properties, economic recovery had a positive effect on the rents that had been placed under considerable pressure during 2009. Rents for high-quality properties in many areas stabilised over the course of the year to the previous year's levels. In some markets, such as the market for premium office properties in London, Warsaw and Stockholm, rents rose. However, individual markets in the first-class property segment also experienced declining rents, such as the markets in Barcelona and Madrid. With regard to commercial property belonging to the class of less desirable property in terms of valuation factors, rents remained under pressure overall.

In the hotel sector, a number of different markets saw positive developments over the weakness seen in 2009. Due in particular to rising occupancy rates, average revenues per hotel room increased.

Economic and commercial property market development in individual regions

Western Europe

After Germany's economic output contracted significantly in 2009, the German economy proved to be the driving force behind Europe's positive economic development. The country's real gross domestic product rose by 3.5 %, driven by high growth in corporate investment and exports, whereas private consumption rose only slightly. The employment market in Germany developed favourably; as unemployment fell over the course of year, Germany stood out from the majority of European countries.

Economic development was also positive in France, though – at 1.5 % – growth was not as robust as in Germany. In combination with government expenditure and exports, private consumption contributed to recovery. Unemployment fell only slightly in France. With growth of 2.7 %, the economy in Switzerland experienced a marked recovery. The Austrian economy grew by 1.9 %.

In the Netherlands and Belgium, the real gross domestic products rose by 1.7 % and 2.1 % respectively. Unemployment rates remained largely unchanged over year-end 2009. Along with Austria, which experienced a rise in unemployment in 2010, the Netherlands was amongst the countries with the lowest unemployment rates within the EU.

The economy of the United Kingdom experienced a downturn comparable to the German economy in 2009 and achieved growth of 1.6 % in 2010. However, economic development declined during the final quarter in comparison to the previous quarter. Unemployment remained at a high, yet stable level for the UK during 2010.

The budget deficits that grew dramatically in the wake of the economic and financial markets crisis remained high in most Western European countries in 2010. At roughly 10 % of its gross domestic product, the public deficit in the UK was particularly high.

Ireland's public finances were heavily burdened by massive aid measures for Irish banks. The budget deficit amounted to approximately 32 % of its gross domestic product. In November, Ireland was forced to apply for monetary support as a result. € 85 billion in aid was supplied by the EU, euro zone member states as well as the UK, Sweden, Denmark, and the IMF. Whilst residential property prices had risen sharply prior to the crisis, there was a significant contraction which, in conjunction with low corporate investment and state austerity measures, burdened the economy. As a consequence, Ireland's real gross domestic product sank by 0.8 % in 2010. At the same time, unemployment continued to rise markedly.

The commercial property markets in Western Europe developed in line with the trend described above, with a market split between first-class properties and less desirable properties. The markets for second-class properties faced rental difficulties: as a result, rents tended to remain under pressure. This overall trend applied to office and retail properties, as well as to logistics properties.

Rent developments for first-class properties predominantly stabilised or increased. In many locations, rents for premium offices were stable compared with the previous year, including Frankfurt, Amsterdam, Utrecht, Marseilles and Geneva. Rising rents for high-quality office properties were also reported in many locations across Western Europe. This applied to Brussels, Lille, Lyon, Paris, Berlin, Düsseldorf, The Hague, Rotterdam and Zurich. In the UK, rents increased in the major centres London, Birmingham and Manchester, whilst remaining stable in Glasgow and falling in Edinburgh. Office rents in Hamburg and Munich also decreased slightly in the premium segment.

For first-class retail properties, major centres saw predominately stable rents over the course of the year. This applies to the German economic centres Dusseldorf and Hamburg as well as French economic centres. Rents for premium retail properties also remained stable in Amsterdam, The Hague, Brussels and Geneva, as well as in Edinburgh and London's West End. Top retail property rents in Berlin, Frankfurt, Munich and Zurich differed, rising as they also did in the UK markets of Birmingham, Glasgow and Manchester. Falling retail rents in the premium segment were however seen in the City of London as well as in Rotterdam and Utrecht in the Netherlands.

The picture of first-class logistics properties was less uniform. In Germany, rents remained stable in Berlin and Munich whilst Dusseldorf, Frankfurt and Hamburg experienced slight declines. The Benelux countries saw rents for first-class logistics properties increase in Amsterdam, whilst they decreased in Utrecht and Brussels. In contrast, rent price development was stable in The Hague and on the market in Rotterdam, which is of considerable importance as Europe's largest harbour. The trend in rents for first-class logistics properties in the greater Paris region was positive, and stable to slightly rising in Switzerland. The United Kingdom showed a mixed picture. There rents for prime logistics properties in Manchester increased, remained unchanged in Glasgow and London Heathrow, and declined in Birmingham and Edinburgh.

In the hotel property segment, major Western European locations for hotels such as London, Paris, Berlin, Frankfurt, Hamburg, Munich, Amsterdam and Brussels were able to report considerable increases in average revenues per room over the weak levels of the previous year. The rise in returns was attributable to improved occupancy ratios and room rates as economic recovery. Only few markets, such as Rotterdam, showed a drop in average revenue per room. At over 80 %, the occupancy ratio in London remained very high in a Europe-wide comparison.

Price development also showed differences between first-class and less desirable properties. After Western European investors' yield requirements for every property class increased significantly in the wake of the economic and financial markets crisis, 2010 saw yield requirements for premium properties stabilise or generally trend downwards. Declining investor yield requirements for first-class properties resulted in rising market values and prices.

Buyer interest in second-class properties remained low, however. Accordingly, market values were generally not able to develop positively, and were instead placed under pressure. The decisive issue was, however, the question of how the properties were to be assessed in terms of value-determining factors such as location, modernity, equipment, rental situation and tenant credit quality.

Southern Europe

Spain was heavily impacted by the economic and financial markets crisis and the associated collapse of housing prices and construction activity. Unlike the majority of countries, the economy was not able to gain real traction in 2010, and its real gross domestic product declined slightly by 0.2 %. Italy's economy developed more positively and saw slight growth of 1.0 % following the sharp collapse of 2009. At the same time, the unemployment rate rose slightly. It was, however, significantly lower than Spain's rise in unemployment during 2010, to clearly above 20 %. At 5.0 % of its gross domestic product, Italy's budget deficit was higher than the Maastricht threshold of 3 %, yet was much lower than the Spanish deficit of nearly 10 %. With a budget deficit of over 7 %, Portugal was also affected by the debt crisis which widened risk premiums on Portuguese government bonds considerably. Portugal's real gross domestic product did, however, show growth of 1.3 % in 2010.

Rents for first-class properties in both Italian economic centres Milan and Rome showed no year-on-year changes in 2010. This applied to both office and retail properties, as well as to logistics properties. Milan showed a slightly different picture with mild increases in rents for first-class retail properties. Across the different property qualities, the Italian national average for rents for office properties declined slightly in 2010, whilst the national average in the retail segment remained largely stable. The national average for residential property rents declined.

Rents in Spain, by contrast, decreased for both first-class and other properties. The economic centres Barcelona and Madrid saw rent declines for prime properties as well. Only high-quality retail properties in Barcelona enjoyed stable rents.

In the hotel segment, Rome, Milan, Barcelona and Madrid saw slight increases in average revenues per room, supported by high occupancy ratios.

Investor yield requirements for prime properties remained unchanged or declined slightly over the previous year in both Italian economic centres Milan and Rome, which had a positive impact on property values in these markets. The Italian national average for office and residential property prices declined slightly, whilst prices for retail properties were nearly stagnant.

In both Spanish economic centres, yield requirements in the premium segment in 2010 fell slightly. Investment demand for lesser-quality properties in Spain was low. As such, values were under pressure.

Northern Europe

At 5.3 %, Sweden could report the highest rate of economic growth in the Nordic region during 2010. Finland's and Denmark's economic output also grew markedly by 3.0 % and 2.2 % respectively. Norway's economy virtually stagnated, which was attributable to a significant decline in oil and energy production. Despite a mild increase, unemployment in Norway remained low. Economic recovery in Finland and Sweden saw a marked year-on-year decline in unemployment. In Denmark, it rose further. Public deficits varied widely in 2010. Whilst the budget deficit in Denmark rose to roughly 5.0 % of its gross domestic product, it was low in a Europe-wide comparison for Finland and Sweden at 3.8 % and 1.3 % of the countries' respective gross domestic products. Owing once again to income from oil production, Norway had a considerable budget surplus.

Rents for first-class properties saw stable to generally rising development in the major centres in Finland and Sweden. These rents continued to experience pressure in Denmark. Rents for high-quality office, retail and logistics properties increased in both Helsinki and Stockholm. Gothenburg saw stable rents for first-class office properties. Rents for prime office and logistics properties continued to decline in Copenhagen, but remained stable for premium retail properties. In Northern Europe, rents for lesser quality properties continued to be placed under pressure. This applied to both office and retail properties, as well as to logistics properties.

Copenhagen was one of the few hotel markets with declining average revenues per hotel room. This could be traced back to significant decreases in room rates. In Stockholm and Helsinki, by contrast, average revenues per hotel room rose.

The major economic centres in Finland and Sweden saw a decline in investor yield requirements for various types of first-class properties. This had a positive effect on market values. In Denmark, however, they were stable or declined slightly. Investment demand for lesser-quality properties also remained low in Northern Europe. These property values thus tended to experience pressure, with the assessment of the various value-determining factors playing a significant role.

Eastern Europe

Economic development varied widely across Eastern Europe in 2010. Poland saw a 4.0 % year-on-year economic growth rate. The Czech Republic and Russia turned the tide of the 2009 downturn with growth of 2.3 % and 3.5 % respectively, whereby Russia's economic growth was attributable to increased commodity prices. Hungary experienced only a low growth in its real domestic product at only 1.1 %. The Turkish economy was able to break free from the previous year's economic downturn with 8.1 % growth in its real domestic product. In Turkey and Russia, the economic upturn was accompanied by a decline in the unemployment rate. Despite economic growth, the unemployment rate in Poland and Hungary climbed further. In the Czech Republic, unemployment increased slightly over the course of the year.

Budget deficits were also high in Eastern European countries, in the wake of the economic and financial markets crisis. Poland's budget deficit amounted to 7.7 % of its gross domestic product. Budget deficits (in terms of gross domestic product) were lower in the Czech Republic and Russia at approximately 5 %, just under 4 % in Hungary, and at about 3.7 % in Turkey.

In line with the general trend, rents and property values saw stable or positive developments for first-class property in Eastern European locations. Investor yield requirements for high-quality properties increased in Istanbul, Moscow, Prague and Warsaw, and remained stable in some markets. Yield requirements remained unchanged for high-quality retail properties in Moscow and Prague, as did high-quality office properties in Istanbul, whilst lesser-quality properties faced difficulties. This segment experienced low investor demand. Particularly in Russia, but also in Turkey, investor yield requirements remained significantly higher than the levels in Poland and the Czech Republic.

Rents for first-class office premises in Istanbul and Prague were unchanged. They increased, by contrast, in Moscow and Warsaw, where they had fallen sharply in 2009. In the retail sector, rents for premium properties in Prague and Warsaw remained stable and rose in Istanbul. Marginal declines were seen in Moscow. Rents for high-quality logistics properties were stable in Prague and Warsaw, whilst they rose slightly in Moscow. The logistics market in Istanbul is not yet highly developed with respect to high-quality properties. Rents for lesser-quality properties came under pressure in various countries.

Following the overall trend on the hotel markets, average revenues per room climbed in the Eastern European centres Moscow, Prague and Warsaw as a result of improved occupancy ratios. This also applied to Istanbul, which benefited from its status as the European Capital of Culture for 2010.

North America (NAFTA states)

The US economy recovered palpably at the beginning of the year, yet lost momentum in the second and third quarter before again returning to some more robust growth in the final quarter. The real domestic product of the United States rose by 2.9 %. Despite high unemployment and an increased savings ratio in comparison to pre-crisis levels, private consumption made an important contribution to growth, in combination with corporate investments. The overall economic trade balance slowed growth of gross domestic product due to increased imports. At just under 10 %, unemployment in the US was at a historic high over the course of the year. In December 2010 it amounted to 9.4 % and was thus slightly below the figure for 2009 (9.9 %). Spending programmes and declines in tax income incurred as a consequence of the economic and financial markets crisis caused the budget deficit to reach a high of just under 10 % of gross domestic product. As the economic upturn lost momentum, the US government once again adopted broad stimulus measures. The Fed's monetary policy remained very expansive with its launch of a new government bond purchasing programme totalling USD 600 billion, over and above the programmes already in existence.

Economic developments in Canada and Mexico are heavily influenced by the economic development of the US. Canada's real gross domestic product climbed 2.9% in 2010, and Mexico saw an increase of 5.0%.

The US commercial property market lagged behind the development of rents in Europe and Asia. The national average for office rents in the US experienced a slight year-on-year decline; this applied to both premium and less desirable office properties. The trend showed the formation of a bottom, albeit subject to some regional differences. Office rents for premium properties in the centre of Chicago remained stable, whilst they declined slightly in the centre of Los Angeles but climbed in Manhattan and the business districts of San Francisco and Washington D.C. Rents for offices in less central districts were under greater pressure and declined in the outskirts of Chicago, Los Angeles and San Francisco. In Canada, by contrast, the national average for rents for premium offices in city centres remained stable, yet rose on average in less central districts.

There was a decline in rents for retail properties on a national average in the US. Here too, regional differences could be observed, and retail rents rose markedly in New York City but sank in Los Angeles. Logistics property rents continued to experience pressure on a national average in the US. New York City defied the trend and saw climbing logistics rents. In Los Angeles, these rent prices remained largely stable, whilst they declined in Chicago and San Francisco.

High occupancy ratios resulted in an increase in average revenues per hotel room in the USA as well, after a weak 2009. Average revenues per hotel room also rose in Canada and Mexico.

In North America, the investment markets for commercial property recovered in 2010 over the previous year, and transaction volumes increased markedly. Revitalised investment activities in the US and Canada saw declines in investor return requirements. Various different property types were affected by this trend. Only a few sub-markets defied the trend of falling yield requirements.

Asia

Asia's economy saw robust growth in 2010. China assumed the role of the driver of growth with a 10.3 % increase in the country's real gross domestic product. Over the course of the year, concerns arose that the economy could be overheating in light of lending volume developments and the prices for residential property, which exhibited a significant year-on-year increase. In order to mitigate the threat of overheating, the Chinese government and central bank ushered in a number of different measures, such as increasing key interest rates and minimum reserve requirements for commercial banks.

Following a sharp contraction at the beginning of the previous year, Singapore's economy underwent tremendous growth beginning in mid-2009; this trend continued in 2010, with 14.8 % growth in the real gross domestic product. Buoyed by a strong uptick in exports, particularly to neighbouring Asian countries, Japan's economy was able to recover and its real gross domestic product grew markedly by 4.2 %. Japan's unemployment rate was low by international comparison but comparatively high historically. The budget deficit of Japan amounted to 8.0 % of its gross domestic product, against the background of an enormous debt level, totalling roughly twice its gross domestic product. However, Japan’s government debt is largely refinanced within its own country. At 1.6 % of its gross domestic product, China's budget deficit was low on an international comparison, whilst Singapore's budget enjoyed a slight surplus.

Asia's strong and positive economic development also affected the commercial property markets. Rents for first-class office properties in prime locations in both of China's most populous cities, Beijing and Shanghai, increased in 2010 as they did in Singapore. In contrast, high-quality office rents in Tokyo continued to decline slightly.

Major shopping locations in Beijing and Shanghai saw rising rents for retail properties whilst the development was relatively stable in Singapore.

Rents for first-class logistics properties climbed slightly in Beijing and Shanghai. Singapore, which represents the region's most important trade centre due to its harbour, followed this trend of slight rent increases.

The hotel markets in Beijing, Shanghai and Singapore saw robust recovery, with strong growth in average revenues per room. This was attributable to improved occupancy ratios as well as higher average room rates. Shanghai in particular saw high growth rates in returns as the city benefited from the World Expo in 2010.

The property investment climate improved in Asia, and transaction volumes for commercial property were up year-on-year. Investor yield requirements for prime office and retail properties remained stable or decreased slightly in Shanghai, whilst Beijing noted a more pronounced decline. Returns for these property types were also down in Singapore during 2010. Falling yield requirements combined with rent developments in the three locations mentioned resulted in rising property values for office and retail properties. The first-class logistics properties segment was stable in Shanghai but increased in Beijing and Singapore. Yield requirements for high-quality office, retail and logistics properties remained unchanged from 2009 in Tokyo.

The German institutional housing industry

The German institutional housing industry proved once again to be a solid sector in 2010. The contributing factors were largely consistent and predictable rental income, and continued robust development in property values.

Despite the challenging market environment that persisted, investment activity amongst commercial housing enterprises remained at a stable level compared to 2009. The focus of investment was, as in the year prior, placed on building modernisation, repairs and maintenance. With regard to the ecological sustainability of property, commercial housing enterprises made ongoing investments in energetic renovation for flats. Roughly 60 % of residential portfolios in companies organised in the Federation of German Housing Enterprises have already undergone energetic modernisation. The challenges posed by demographic changes were also a focus of investment activity. This included making residential property more accessible for seniors, such as renovations reducing barriers, as well as additions to technical aid equipment and the range of personal services.

The financial markets and economic crisis increased the investment appeal of residential property. The interest in residential property shown by institutional investors since 2009 continued to mount in the period under review. Low volatility and stable cash flows are decisive criteria amongst investors. Overall, residential property portfolios totalling roughly € 3.8 billion were traded, amounting to an 18 % year-on-year increase in turnover. A quarter of the transaction volume was transacted in sales lower than € 25 million.

On the buyer side, property funds, pension funds and German residential property companies largely determined transaction activity. 25 % of all property funds initiated during the first nine months of the year were launched in the residential property segment. High net worth private investors and family offices also influenced the residential property transaction market as investors. The focus on pension funds and special institutional funds rested primarily on development projects in urban areas, with average prices per square metre of € 2,000 to € 3,000. In contrast, foreign investment funds and private property companies generally purchased larger-sized portfolios at low prices. The share of foreign investors accounted for approx. 38 % of total turnover and increased nearly twofold over 2009 (20 %).

The recovery observed over the course of the year bolstered the positive development of rents on the German residential property market. Rents for newly built flats increased by 2.5 % in Germany during 2010. In medium-sized cities with populations between 200,000 to 300,000 residents, the increase for portfolio properties was even higher at roughly 5.3 %. The causes of this development include an increased demand for flats arising from the growing number of single-person households as well as a trend towards re-urbanisation in major cities in Eastern and Western Germany. In more than three quarters of cities with more than 60,000 inhabitants, city centres experienced stronger population growth than peripheries.

However, developments varied regionally. Vacancy ratios in Western Germany totalled roughly 3 % whilst roughly 10 % of flats in Eastern Germany were vacant. Growth regions continued to benefit from job-related population increases whilst residents moved out of weak economic regions.

The use of modern and user-friendly technology platforms gained importance on the market for property management software. Such systems offer more user-friendly designs, and allow new functionality to be implemented more quickly. Ways to integrate additional services were another focus. Both providers of proprietary products as well as SAP partners are active on the market.

Financial performance

Aareal Bank AG posted € 74 million in operating profit after loan loss provisions for the 2010 financial year – up 42 % year-on-year (2009: € 52 million).

At € 480 million, the aggregate of net interest income and net commission income showed a significant improvement of € 82 million compared with the previous year. Interest income from lending and money market transactions declined by € 105 million, whilst interest income from securities decreased by € 23 million. Interest expenses were down by € 190 million. Current income of € 20 million (2009: € 5 million) was predominantly attributable to investment fund distributions. Net commission income of € 20 million was up by € 6 million compared with the previous year.

Administrative expenses (including depreciation and amortisation of intangible and tangible fixed assets) rose slightly, from € 224 million to € 230 million, reflecting the continued cost discipline.

Net other operating income and expenses decreased by € 4 million year-on-year, to €–3 million; the net figure includes the result from currency translation in the amount of € +3 million.

The balance of provisions for loan losses and the result from securities held as liquidity reserve was € -172 million (2009: € -125 million). This figure includes expenditure for specific and general loan loss provisions.

Net other income and expenses of € -69 million comprised essentially expenses of € 36 million for the recognition of pension provisions (which was adjusted pursuant to the German Act on the Modernisation of the Accounting and Reporting Laws (*Bilanzrechtsmodernisierungsgesetz* – "BilMoG")), € 15 million in profits realised upon the merger of Aareal Bank France S.A. into Aareal Bank AG, as at 1 January 2010, as well as results from investment securities. This item also includes the valuations of subsidiaries and their results, as well as € 16 million in transfers to reserves pursuant to section 340g of the German Commercial Code (*Handelsgesetzbuch* – "HGB"). The major influencing factor on the previous year's figure of € -21 million was a € 22 million transfer to reserves pursuant to section 340g of the HGB.

Taking into account a tax liability of € 3 million (2009: € 29 million), the bank posted net income of € 0.4 million (2009: € 2 million).

Financial position

Net assets

Aareal Bank AG had total assets of € 44.9 billion as at 31 December 2010, compared with € 41.7 billion as at 31 December 2009. Factors contributing to this increase included higher property financing volumes as well as a bond issued during the financial year under review, which the bank took onto its own books.

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

As at 31 December 2010, the securities portfolio with a nominal volume of € 17.1 billion comprised the four asset classes of public-sector borrowers, Pfandbriefe and other covered bonds, bank bonds, and asset-backed securities.

Property financing portfolio

Portfolio structure

During 2010 the volume of Aareal Bank AG's property financing portfolio expanded from € 20.2 billion to € 21.9 billion. This equates to an increase of 8.4 %.

The portfolio's regional structure changed only marginally in 2010 compared with the end of the previous year. The proportion of portfolio exposures to Germany, Southern and Eastern Europe was down slightly, compared with an increase in the share accounted for by Western Europe and North America.

The allocation of the portfolio by property type remained more or less unchanged during the year under review, whereby the share of residential property financings was reduced further.

Portfolio development

Aareal Bank AG maintained its selective stance in originating new business during 2010, and continued to focus on its existing client base. The share of loan renewals relative to total new business was down compared with the previous year.

Repayments on the property financing portfolio include all types of scheduled and unscheduled principal payments by clients. The volume of repayments was more or less stable during 2010 (compared with the previous year), reflecting the still moderate volume of new investments on the property markets, compared with previous years.

A portion of the property financing portfolio has been committed in foreign currencies. As a rule, foreign-currency loans are refinanced in the same currency. Although material exchange rate risks are hedged, exchange rate fluctuations impact on the performance of the euro equivalent of the portfolio volume. Some currencies fluctuated considerably against the euro in 2010 – in particular, the US dollar, the Canadian dollar and the Swiss franc. This affected portfolio volumes during the course of the year. At year-end, the euro/US dollar exchange rate was slightly lower than at the start of the year; portfolio volume slightly increased as a result.

The volume of loans included in cover for mortgage bonds increased further during the year under review: from € 8.2 billion as at 31 December 2009 to € 8.5 billion as at 31 December 2010, up by around € 300 million. This equates to an increase of approx. 4 %. This allows Aareal Bank to further strengthen its position as a major Pfandbrief issuer; the share of Pfandbrief issues in total long-term funding has thus been further increased.

The secondary market – the market for syndication and securitisation of commercial property financings – remained quite unreceptive during the financial year under review, due to persistent market tension and the resulting reticence of market participants. As in the previous year, only a limited amount of new syndications was therefore carried out through our international network of partner banks during the 2010 reporting period. However, the total volume of new syndications was increased relative to 2009. The focus of our secondary market activities was on renewing and managing existing syndicated loans.

No securitisations were carried out during the reporting period.

Financial position

Interbank and repo business

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

The funding portfolio as at 31 December 2010 included € 3.3 billion in funds raised via repo transactions as well as € 1,0. billion from other interbank transactions.

No open-market transactions were concluded with the ECB during 2010. No fixed-rate repurchase transactions were outstanding as at 31 December 2010.

Customer deposits

As part of our activities on the money market, we generate deposits from institutional housing clients, and from institutional investors. The volume of deposits from the institutional housing industry increased.during the reporting period, reaching € 4.5 billion (2009: € 3.8 billion) as at 31 Dec 2010. Deposits from institutional investors also increased slightly in 2010, amounting to € 4.4 billion (2009: € 4.3 billion) as at 31 Dec 2010.

Long-term funding

Funding structure

Aareal Bank Group's funding is solid, as evidenced by the high proportion of long-term refinancing. This encompasses registered and bearer Pfandbriefe, promissory note loans, medium-term notes, other bonds and subordinated issues, including subordinated liabilities, profit-participation certificates, silent participations and trust preferred securities. As at 31 December 2010, the long-term refinancing portfolio accounted for € 25.8 billion.

Refinancing activities

During the period under review, Aareal Bank succeeded in raising a total of € 3.9 billion of medium- and long-term funds on the capital market. The issue volume of long-term unsecured funds amounted to € 1.5 billion. Mortgage Pfandbriefe accounted for € 2.2 billion of the total volume and Public Sector Pfandbriefe issues for € 0.2 billion. This once again proves how very important Pfandbrief issuance is to Aareal Bank's refinancing activities. Of the various privately- and publicly-placed issues, particular mention should be made of the two benchmark Mortgage Pfandbriefe placed in January and June 2010, with terms of five and three years respectively, and an issue volume of € 500 million each.

Although the market environment remained challenging, the Pfandbrief proved itself once again in the 2010 financial year as a hallmark of security. In view of the level of quality, strict legal requirements and successful capital market history, Pfandbriefe offer a reliable refinancing source and a refinancing option to Pfandbrief banks to raise long-term funds, especially during times when investors are demanding high security requirements. This offers Aareal Bank significant refinancing advantages. Pfandbrief issuance will continue to play a central role in Aareal Bank's refinancing mix.

In June 2010, Aareal Bank exercised the option of drawing on the remaining € 2 billion available under SoFFin's guarantee facility. This measure was purely precautionary. Aareal Bank will continue to hold the bond on its own books. The guarantee facility will continue to secure financial flexibility for the bank's funding activities until 2013. This precautionary drawing on the SoFFin guarantee facility is a reflection of our efforts to ensure that we are able to respond quickly and flexibly at all times to possible market disruptions in this uncertain market environment.

Effects of the financial markets, economic and debt crises

Following the severe recession, the global economic recovery that set in as of mid-2009 remained intact in most economies in 2010. However, recovery lost momentum in the second half of the year, and economic development diverged widely across different regions. The emerging economies of Asia – China in particular – experienced the most positive development. In contrast, growth rates in North America and Europe were down and differed depending on the specific country in question. The economies in Germany, Poland, Sweden and Turkey posted significant recoveries, whereas real economic output in Ireland, Greece and Spain contracted.

Financial markets were impacted by the debt crisis of some of the euro zone's peripheral countries, such as Greece and Ireland, leading to considerable distortions during the course of the year. In April, Greece was no longer able to refinance maturing government bond issues on the capital markets without third-party support. As a reaction to this situation, euro zone member countries and the IMF put together a € 110 billion rescue package for Greece. Because the loss of confidence that prevailed among investors spread to some other euro zone countries such as Ireland, the EU, the IMF and euro zone members issued another rescue package totalling € 750 billion. These support measures provide financial support to those countries that have encountered problems in raising funding. Ireland also sought support in November, which it was granted in the amount of € 85 billion, to cover the budget's refinancing requirements: the Irish government had run into trouble following a massive bailout of Irish banks, which were recapitalised using the support provided. In the course of the debt crisis, the risk premiums for government bonds considered by the capital markets to be subject to higher levels of risk, such as Greece, Ireland and Portugal, widened significantly during 2010. As a result, the risk premiums of different countries' bonds also widened considerably, whereas German Pfandbrief spreads only widened marginally. Overall, the financial markets clearly relaxed after the tensions in the wake of the financial markets crisis peaked in the autumn of 2008. Nonetheless, they had not yet fully returned to normal last year.

The economic recovery improved the climate on the commercial property markets, and the volume of transactions increased considerably compared with the weakness seen in 2009. However, there was evidence of a clear split on commercial property markets, distinguishing first-class and second-class properties. Investor demand was concentrated on first-class properties. The previous year's significant rise in yield requirements for first-class properties stabilised on many markets or even declined, which had a positive effect on market values. Meanwhile, market values and prices for second-rate properties tended to remain under pressure. This division was also evident on the rental markets. Rents for first-class properties remained stable or increased on the vast majority of markets, whilst the rents for properties of lesser quality were weaker or came under pressure.

Against the background of the debt crisis, the volatile development on capital markets led to fluctuations in the value of our portfolio of government bonds from the second quarter onwards. The bank held no Greek bonds in its portfolio during the financial year under review; taking a forward-looking stance, small holdings of Irish government bonds were liquidated. Bearing in mind that future EU rescue mechanisms have not been finally resolved by the EU, markets are expected to remain volatile during 2011.

On the money market, Aareal Bank's deposit-taking business returned to normal for the most part, even though the market environment remained difficult. The volume of deposits from institutional investors rose slightly from € 4.3 billion at the start of 2010 to € 4.4 billion as at 31 December 2010.

As a result of 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. Developments on financial markets forced us to accept additional costs. Although the situation eased somewhat during the fourth quarter, derivatives on some currencies (such as the US dollar or pound sterling) still imply a premium.

The stable Consulting / Services segment was also unable to completely escape the effects of the financial and economic crisis. The low interest rate environment, which is very unfavourable in terms of income earned from deposits from the institutional housing industry, had a negative impact. Nonetheless, the volume of deposits from the institutional housing industry were increased slightly over the previous year, amounting to € 4.5 billion as at 31 December 2010 (2009: € 3.8 billion).

In order to protect its sustainable business model, and at the same time overcome the very difficult market environment, Aareal Bank Group had reached an agreement with the German Financial Markets Stabilisation Fund (SoFFin) on 15 February 2009, whereby SoFFin extended a perpetual silent participation in the amount of € 525 million to Aareal Bank, plus a guarantee facility for new unsecured issues up to a total of € 4 billion. We used € 2 billion of this framework guarantee to place a bond issue in March 2009. In addition, we opted to draw on the remaining € 2 billion available under SoFFin's guarantee facility in June 2010. This measure was purely precautionary in nature, and the bond is being held on our own books. There are no plans at present to place it on the market.

Against the background of sound operating performance and the bank's solid capitalisation, Aareal Bank commenced repayment of SoFFin's silent participation. A first tranche of € 150 million was repaid on 16 July 2010, reducing the residual amount of the silent participation to € 375 million.

Regulatory indicators

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

Aareal Bank Group applied the Advanced IRB approach (AIRBA) for the first time as at 31 December 2010, replacing the previous Credit Risk Standard Approach (CRSA). In contrast to the CRSA, the Advanced IRB Approach is based on internal models: it allows for a more accurate measurement of credit risks, and hence, for a more precise and risk-adequate allocation of capital.

To ensure the figures are comparable, the following tables are shown in accordance with the AIRBA as well as the CRSA:

Regulatory indicators pursuant to AIRBA

	31 Dec 2010[1]	31 Dec 2009
Euro mn		
Core capital	2,284	2,415
Liable capital	2,910	3,290
Risk-weighted assets (incl. market risk)	17,663	–
%		
Tier 1 ratio	12.9	–
Total capital ratio	16.5	–

Regulatory indicators pursuant to CRSA

	31 Dec 2010[1]	31 Dec 2009
Euro mn		
Core capital	2,284	2,415
Liable capital	2,910	3,290
Risk-weighted assets (incl. market risk)	21,675	21,875
%		
Tier 1 ratio	10.5	11.0
Total capital ratio	13.4	15.0

[1] After confirmation of the financial statements 2010 of Aareal Bank AG. The inclusion of retained earnings transferred as part of Aareal Bank AG's liable equity as at 31 December 2010 is subject to approval by the Annual General Meeting.

Employees

Personnel data as at 31 December 2010

	31 Dec 2010	31 Dec 2009	Change
Number of employees of Aareal Bank Group	2,407	2,315	4.0 %
Number of employees of Aareal Bank AG	999	987	1.2 %
of which: outside Germany	121	106	14.2 %
of which: Proportion of woman	46.0 %	46.8 %	
No. of years service	12.0 years	11.8 years	0.2 years
Average age	43.0 years	42.7 years	0.3 years
Staff turnover rate	2.0 %	1.2 %	
Part-time ratio	17.4 %	15.7 %	
Retired employees and surviving dependants	573	583	-1.7 %

As at 31 December 2010, Aareal Bank Group employed 2,407 employees, so that the number of employees has increased by 92 compared to 31 December 2009. The rise in employee numbers is largely due to the takeover of Dutch SG|automatisering bv, Emmen, by subsidiary Aareon AG on 1 November 2010.

Age structure and fluctuation

The fluctuation ratio for 2010 was 2.0 %. The average number of years of service in the company was twelve. These two figures are a reflection of the strong relationship of the employees with the company. On average, our employees are 43 years of age.

Qualification and training programmes

Aareal Bank invests in its employees on an ongoing basis, and in a targeted manner. The emphasis is on supporting specialist, entrepreneurial and communicative skills over the long term. The international orientation of the continued professional development is also particularly important. Specifically, this involves preparing and training to achieve linguistic and cultural competencies.

The broad range of management, qualification and training programmes offered by our internal corporate university, the "Aareal Academy", underlines the great importance Aareal Bank attaches to promoting qualification and continuing professional development. Our range of courses was expanded further during the year under review and used regularly by Aareal Bank staff members.

Aareal Bank views its training and continued professional development activities as an investment in its own employees, and therefore in the future of the entire Group. More than 1,000 individual development measures were agreed between management and employees at the start of 2010. As a result, 3,064 employees participated in continuing professional development measures during the year under review. This represents an increase of 16 % over 2009.

Additionally, Human Resources advises the various divisions on strategic human resources development, providing a starting point for the development measures offered, particularly in the case of Aareal Bank's experts. Human Resources developed the corresponding customised measures for the different divisions. The outcome of this systematic Human Resources development approach is that Aareal Bank employees of Aareal Bank invested one week a year on average in professional development seminars and workshops in 2010.

The bank also focused on professional development programmes for systematic executive development and to strengthen the expert career path. The internal series of events "From Experts for Experts" established another element in the transfer of knowledge.

An intensive executive development programme started in the 2010 financial year, which was oriented on the results of the employee reviews. At the same time, a procedure for assessing potential was established in 2010, which offers systematic support prior to the transfer of a management duty or specialist (expert) position.

Aareal Bank actively promoted international networking and teamwork during the 2010 financial year. Managers were involved in the development of corresponding training units for the experts in both the Sales units and Credit Management functions. Particular attention in this context was paid to the new business seminars relating to all aspects of the lending business that were developed on a joint basis and across the various units.

In cooperation with the EBS Business School (EBS) and its Real Estate Management Institute, Aareal Bank offers its employees the chance to participate in executive courses of study specific to the property sector. Employees may also attend events arranged by EBS, the bank's partner institution of higher education. This good working relationship is also boosted in particular by the fact that Aareal Bank staff actively support the development of the training courses by acting in the capacity of guest lecturers. Aareal Bank extended its cooperation with the EBS Business School for a further three years. With the Aareal Foundation Chair for Property Investment and Financing at the EBS Real Estate Management Institute (EBS-REMI), Aareal Bank has been one of the most important supporters of the university since 2006.

Group subsidiary Aareon AG implemented the training measures that were devised by the development centre for executives in the 2010 financial year. New executives also participated in a development centre in 2010. The training also focused on enhancing the qualifications of facilitators, training offers for the Wodis Sigma product line, plus the revival of the training programme to become a Certified Property Manager at the HfWÜ Hochschule für Wirtschaft und Umwelt Nürtingen-Geislingen.

Promoting the next generation

Promoting the next generation through training is a central element of our HR work. To this end, Aareal Bank has been offering an individually tailored trainee programme for university graduates since 2000. This programme has now been offered for the last ten years. Six new employees embarked on the Aareal Bank trainee programme during the period under review.

The comprehensive work placement programme introduced in 2008 met with a very good response. During the 2010 financial year, numerous students took up the opportunity to become more familiar with one of the bank's divisions – or one of its locations – through active collaboration. A well-functioning network has been created on the basis of the good response to this programme.

Group subsidiary Aareon AG also offers vocational training in various careers; office administrator, IT applications developer, IT system integrator, in addition to the opportunity to study for a degree (BA) in business administration, specialising in real estate management, in cooperation with the University of Cooperative Education in Leipzig and the Duale Hochschule Baden-Württemberg (DHBW) in Mannheim.

Recognition as a top employer

Aareal Bank has been listed as one of Germany's "Top Employers" for the third time now. Certification is awarded by the independent CRF Institute research company. The list is exclusively made up of companies that nurture a positive corporate culture and provide intensive support to their employees. Aareal Bank achieved particularly good results in the area of corporate culture and development potential, and was ranked third among all participating companies in relation to work/life balance.

Work/life balance

Aareal Bank also supported a private initiative offering crèche places in Wiesbaden during the period under review, thus helping its employees to improve the compatibility of family and working life. Additionally, the company cooperated with the City of Wiesbaden to offer childcare facility to its employees during the school holidays. We also offer our employees – provided the position allows it – the opportunity to incorporate home working into their working hours, as well as offering flexible part-time working arrangements.

Report on material events after the reporting date

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

Risk Report

Risk management at Aareal Bank AG

The responsible targeted handling of risks is crucially important to a bank's stability and business performance. Therefore, a professional risk management infrastructure is at the heart of our business decisions. Against this background, we have committed extensive human and technological resources to continue developing our risk management system during the financial year under review.

Risk management – scope of application and areas of responsibility

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

Overall responsibility
Management Board and Supervisory Board of Aareal Bank AG

Type of risk		Risk management	Risk monitoring
Market price risks		Treasury, Transaction Committee	Risk Controlling
Liquidity risks		Treasury	Risk Controlling
Credit risks	Property Finance (individual risks)	Credit Business Market, Credit Management	Risk Controlling, Credit Management
Credit risks	Property finance (portfolio risks)	Credit Management, Credit Portfolio Management	Risk Controlling
Credit risks	Treasury business	Treasury, Counterparty and Country Limit Committee	Risk Controlling
Credit risks	Country risks	Treasury, Credit Management, Counterparty and Country Limit Committee	Risk Controlling
Operational risks		Process owners	Risk Controlling

Process-independent monitoring: Audit

Strategies

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

Risk-bearing capacity and risk limits

The bank's ability to carry and sustain risk – which is defined by the amount of aggregate risk cover – is a core determining factor governing the structure of its risk management system. Aggregate risk cover is defined as core (Tier 1) capital less any negative differences between the carrying amount of securities held and their market value, plus the budgeted net income before taxes. The calculation does not include additional funds such as supplementary and subordinated capital. The aggregate risk cover is updated at least once a year, and additionally in the event of significant changes occurring (such as a capital increase, or a change in earnings projections). We have thus implemented a system based upon limits defined in a conservative manner, and differentiated according to the type of risk. The aggregation of individual limits is based on the assumption that no risk-mitigating correlation effects exist amongst different types of risk. A monthly report submitted to the Management Board provides information regarding the utilisation of individual limits for the material types of risk, as well as on the overall limit utilisation.

In addition, a substantial portion of the aggregate risk cover serves as a risk cushion, which is not applied to risk limits, and is thus available for risk types that cannot be quantified (for example, reputational or strategic risks). Overall, aggregate risk cover and risk limits are harmonised to ensure Aareal Bank's ability to bear risk at any time, based on the going concern assumption – even against the background of market distortions as a result of the financial markets crisis.

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

Stress testing

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

Approval to apply the Advanced Internal Ratings-Based Approach (AIRBA)

We have applied to the German Federal Financial Supervisory Authority (BaFin) to approve the application of internal ratings-based methods for our core business of commercial property financing. Following the successful audit of our models, BaFin approved Aareal Bank's application of the Advanced Internal Ratings-Based Approach (AIRBA) with effect from 31 December 2010. The risk classification procedures we have implemented represent a central element of our risk management process. Internal ratings have been used for the first time, as at the 31 December 2010 reporting date, to determine the regulatory capital requirements to cover our counterparty credit risk exposure in commercial property financing.

Organisational structure and workflows

Lending business

Division of functions and voting

Aareal Bank AG's structural organisation and business processes are consistently geared towards effective and professional risk management. This includes the extensive implementation of regulatory requirements regarding the structural organisation and workflows in the credit business.

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

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

The Counterparty and Country Limit Committee (CCC), which consists of executives from non-Sales units is responsible for the Credit Management vote regarding the approval of counterparty, issuer, or country limits.

We have implemented and documented the clear separation of Sales and Credit Management processes across all relevant divisions.

Process requirements

The credit process comprises several phases: specifically, these include credit approval, further processing, and monitoring of loan processing. Credit exposures subject to increased risks involve supplementary processes for intensified handling, the handling of problem loans, and – if necessary – for provisioning/impairment. The corresponding processing principles are laid down in the bank's standardised rules and regulations.

Important factors determining the counterparty risk of a credit exposure are identified and assessed on a regular basis, adequately taking into account sector and (where appropriate) country risks. Critical issues regarding an exposure are highlighted, and analysed assuming different scenarios where appropriate.

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

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

Early risk detection procedures

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

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

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

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

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

Risk classification procedures

Aareal Bank AG employs various risk classification procedures for the initial, regular, or event-driven assessment of counterparty risk. The rating scales and exposure definitions have been customised to match the respective methods. Responsibility for development, quality assurance, and monitoring implementation of risk classification procedures, is outside the Sales units. These units are responsible for the annual validation of the risk classification procedure.

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

Property financing business

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

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

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

The second step involves calculating the loss given default (LGD). The LGD estimates the extent of the economic loss in the event of a borrower defaulting. In simple terms, this is the amount of the claim not covered by the proceeds from the realisation of collateral. The LGD procedure applied in the bank was further modified during the financial year under review on the basis of the requirements of the Solvency Ordinance.

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

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

Financial institutions

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

Sovereign states and local authorities

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

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

Trading activities

Functional separation

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

On the front office side, the processing chain comprises the Treasury division; back office tasks (as defined by MaRisk) are carried out by the independent Operations and Risk Controlling divisions. Beyond this Finance and Audit are responsible for tasks not directly related to processes.

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

The detailed assignment of responsibilities is outlined below.

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

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

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

The bank has also established a Counterparty and Country Limit Committee that votes on all limit applications, and is responsible for conducting the annual review of limits. Where required by current developments, the Committee may reduce or revoke counterparty or issuer limits.

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

Process requirements

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

Moreover, processes and systems are designed in a way that allows to incorporate new products into the risk monitoring system swiftly and adequately, in order to ensure the flexibility of Sales units in their business activities.

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

As part of the limit monitoring process, the Management Board and Treasury are notified of limits and their current usage on a daily basis. Clearly-defined escalation and decision-making processes have been set out to deal with limit breaches.

Risk exposure by type of risk

Credit risks

Definition

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

Credit risk strategy

Based on the bank's overall business strategy, Aareal Bank's credit risk strategy sets out all material aspects of the Group’s credit risk management and policies. Proposals for the credit risk strategy are prepared jointly by Sales units and Credit Management, and adopted by the entire Management Board and the Supervisory Board. The credit risk strategy will be reviewed, at least once a year, as to its suitability regarding the bank’s risk-bearing capacity and its business environment; amendments will be made as necessary. This process is instigated by management, and implemented by the Sales units and Credit Management, who submit a proposal (on which they are both agreed) to management. Designed in principle for a medium-term horizon, the credit risk strategy is adapted when necessary to reflect material changes in the Group’s credit risk and business policies, or in the Group’s business environment (as in the case of the financial markets crisis).

Aareal Bank’s credit risk strategy comprises the Group Credit Risk Strategy, containing general guidelines, plus individual sub-strategies (lending policies) defining the type of new business the bank wishes to generate, with respect to various markets and types of business. Given the hierarchical structure of the credit risk strategy, the Group credit risk strategy overrides individual sub-strategies.

Risk measurement and monitoring

The credit business is subject to a variety of risk measurement and monitoring processes. This includes the application of two different credit risk models incorporating concentration and diversification effects at a portfolio level, from which both the expected and unexpected loss (credit-value-at-risk) are derived. Credit value-at-risk corresponds to the maximum amount by which the actual loss can exceed the anticipated loss, at portfolio level, for a given confidence interval.

Based on the results of these models, the bank’s decision-makers are regularly informed of the performance and risk content of property financing exposures, and of business with financial institutions. The models permit to identify, measure, monitor and manage risks at a portfolio level. During the financial year under review, our credit risk model was adjusted to take account of the property financing business, where default correlations between borrowers have a significant effect on the credit value-at-risk. The bank oriented the parametrisation of the asset correlation on the regulatory requirements for capital adequacy as laid down by the Solvency Ordinance.

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

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

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

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

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

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

Credit risk mitigation

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

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

Market values and mortgage lending values are set in accordance with the responsibilities for decision-making on lending, and form an integral part of the lending decision. The values to be determined by the bank are generally pegged on the valuation prepared by an independent appraiser; any discrepancies must be substantiated in writing. In any case, the market and mortgage lending values determined by the bank must not exceed the values assessed by independent internal or external appraisers.

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

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

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

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

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

The derivatives master agreements used by the bank contain netting agreements to reduce prepayment risk at a single transaction level (payment netting), and arrangements for the termination of individual or all transactions under a master agreement (close-out netting). For repo transactions, depending on the counterparty, payment or delivery netting is agreed upon; contract documentation also generally provides for close-out netting.

To further reduce default risks, the provision of collateral is agreed upon.

Derivatives entered into with financial institutions provide equity relief in accordance with the Solvability Ordinance ("SolvV"); repo transactions are generally not eligible.

Prior to entering into agreements, the responsible legal services unit within the Operations division assesses the legal risks, and the legal effectiveness and enforceability. The bank uses an internal rating system to assess the credit quality of counterparties. For derivatives transactions entered into with financial institutions, where the bank is looking for capital adequacy relief in accordance with the SolvV, a clause providing for a review of eligibility is added to the netting agreements. This review is carried out in accordance with sections 206 et seq. of the SolvV, particularly through obtaining regular legal opinions, using a database developed for this purpose.

Operations is responsible for the daily valuation of the bank's trades, including collateral accepted or pledged, and using validated valuation procedures. Collateral for derivatives transactions is transferred on a regular basis, as provided for in the respective agreements. Margin calls for repo transactions are determined on a daily basis. Haircuts are applied to account for potential fluctuations in collateral value.

Only cash collateral is accepted for derivatives, whereas collateral for repos can be provided in cash or in securities. Some of the collateral agreements the bank has entered into provide for a reduction in the allowance and the minimum transfer amount under the collateral agreement in the event of a downgrade of the bank's external rating; as a result, the bank might have to provide additional collateral.

Aareal Bank AG enters into credit derivatives exclusively with financial institutions having an investment-grade rating.

In principle, Aareal Bank AG pursues a 'buy, manage and hold' strategy in managing its credit portfolio: this means that loans are generally held until maturity; sales of loans to third parties during their term are only used on a selective basis. Loan syndication is used as an active element of portfolio management.

Any assets acquired upon the realisation of collateral are predominantly properties. The consideration received upon disposal is applied to repay the underlying financing. An immediate sale is generally sought for such properties.

Country risk

Definition

When defining country risk, in addition to the risk of sovereign default or default of state entities, Aareal Bank AG also considers the risk that a counterparty could become unable to meet its payment obligations as a result of government action, despite being willing and able to pay, due to restrictions being imposed on making payments to creditors (transfer risk). These types of risks arise only if the borrower is located in a different country from the lender, or if the financed property is located in another country. The bank always complied with the country limits defined in accordance with its ability to carry and sustain risk throughout the financial year under review.

Country risk measurement and monitoring

Geographical diversification and the avoidance of concentration risks are of greater importance, from the bank’s overall perspective, than the observation of transfer risks. The system for managing country risk, utilised within the overall management of the bank, was designed in such a way that it takes both criteria into consideration.

Country risk exposure is managed using a cross-divisional process. The Counterparty and Country Limit Committee carries out a risk assessment of the relevant countries, grades them in country risk groups, and conducts an annual review in terms of country rating. The limits are set by the Management Board. The Risk Controlling division is responsible for the continuous monitoring of country limits and for monthly reporting on limit utilisation. Country limits defined for the purposes of risk management were always observed during the financial year under review.

In addition to monitoring the bank’s international exposure, internal limit monitoring reports utilisations for the bank’s domestic business, broken down by Federal states (Länder).

Market price risks

Definition

Market price risk is broadly defined as the threat of losses due to changes in market parameters. Aareal Bank's market price risk exposure predominantly comprises interest rate risks, whilst currency risks are largely eliminated through hedges. Commodity and other price risks are irrelevant for the bank's business. Hence, the primary market price risk exposures are related to the risk parameters interest rates, equity prices, exchange rates, and implied volatilities. All relevant parameters are covered by our management and monitoring tools.

Derivative financial instruments are entered into almost exclusively in the trading book, and are primarily used as hedging instruments. Spread risks between the various yield curves (e.g. government, Pfandbrief and swap curves) are taken into account. The risk exposure from bonds that is not related to market price or interest rate risks is managed as part of 'specific risk', in particular, credit and liquidity risk exposure of the bond portfolio.

Risk measurement and monitoring

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

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

A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. Determined on a daily basis for the Group and all its operating units, the VaR figure takes into account the correlation between individual risk types. Statistical parameters used in the VaR model are calculated directly from 250-day historical data maintained within the bank. The loss potential is determined applying a 99 % confidence interval and a ten-day holding period.

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

The limit set for the VaR figure is derived from the analysis of the bank's risk-bearing capacity, which is carried out at least once a year. Limits are defined at Group level, as well as for the individual Group entities. Being authorised to maintain a trading book, Aareal Bank AG has defined an additional trading book limit, plus a separate value-at-risk limit for fund assets held.

Limits were unchanged during the financial year under review. No limit breaches were detected. On average, the value-at-risk limit we have determined for the aggregate of market price risk and specific risk, was utilised at 60.7 % during the year under review.

Backtesting

The quality of forecasts made using this statistical model is checked through a weekly backtesting process. The quality of the statistical procedure used to measure risk is checked using a binomial test, whereby daily profits and losses from market fluctuations are compared with the upper projected loss limit (VaR) forecast on the previous day (known as 'clean backtesting'). In line with the selected confidence level of 95 %, only a small number of events are expected to break out of the VaR projection (≤ 5 for a 250-day period). The number of negative outliers at Group level did not exceed five during 2010, affirming the high forecasting quality of the VaR model we use.

Stress testing

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

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

The worst-case scenario used in the financial year under review was a hypothetical scenario, where the deteriorating financial markets crisis caused bond and CDS spreads to widen due to rating downgrades, combined with an appreciation of the euro and unchanged interest rate markets. This scenario implied a present value loss of 18 % of the stressed aggregate risk cover limit as at 31 December 2010. No breach of set limits occurred during the year under review.

Interest rate sensitivity

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

Interest rate gap analysis

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

Trading book

Being authorised to maintain a trading book, Aareal Bank AG is the Group entity that is in a position to assign transactions to the trading portfolio as defined by the German Banking Act. Given that no such trades were concluded during 2010, trading book risks played a negligible role in the overall risk scenario.

Liquidity risks

Definition

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

Risk measurement and monitoring

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

a) Cash flow forecast

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

b) Liquidity run-off profile

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

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

c) Funding profile

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

Stress testing

Moreover, we employ stress tests and scenario analyses to assess the impact of sudden stress events 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 customers' current account balances as the most significant scenario. Even in this stress scenario, liquidity is sufficient to cover the expected liquidity needs under stress conditions.

Liquidity Ordinance

The requirements of the liquidity ratio in accordance with the Liquidity Ordinance, which is relevant to liquidity management, were always complied with throughout the year 2010, as were the limits set by reference to the liquidity run-off profile.

Operational risks

Definition

Aareal Bank AG defines operational risk as the threat of losses caused by inappropriate internal procedures, human resources and systems (or their failure), or through external events. This definition also includes legal risks. In contrast, strategic, reputational and systematic risks are not included.

Risk measurement and monitoring

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

The bank currently uses the following tools to manage operational risks:

- Self assessments: analysis thereof can provide management with indicators of any potential risks within the organisational structure.
- Risk inventories that include a periodic systematic identification and compilation of all relevant risks.
- A loss database, in which relevant damages incurred are reported, and in which they can be monitored until they are officially closed.

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

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

Analyses conducted using the instruments employed have shown that the bank is not exposed to disproportionate operational risks; nor did they indicate any material risk concentration. There were cases reported in the loss database during the financial year under review, but there were no losses involving significant monetary damages.

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

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

Other risks

Definition

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

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

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

Risk measurement and monitoring

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

Other risks are predominantly managed and monitored through qualitative measures. A Group-wide Code of Conduct sets the framework regarding integrity and professional conduct for all activities. The Code provides a standard that is binding for all employees of Aareal Bank AG – regardless of position, and hence, including members of the Management Board or supervisory bodies. Accordingly, the Code defines the fundamental standards for the conduct of each individual employee. Each employee or member of an executive body is personally responsible for complying with this Code of Conduct. Aareal Bank AG ensures compliance with these standards, employing its internal facilities and organisational units (including, in particular, Internal Audit and Compliance / Anti-Money Laundering / Data Protection). Managers are responsible for raising staff awareness within their area of responsibility.

Aareal Bank AG's Management Board is responsible for managing strategic risk; it coordinates its actions with the Supervisory Board. The Management Board is supported in this task by Corporate Development, for instance, via the continuous monitoring of trends which may be relevant to business policy.

Internal control and risk management system related to accounting and financial reporting

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

The accounting-related internal control and risk management system includes principles, procedures and measures to ensure the effectiveness and the efficiency of internal and external accounting, in accordance with applicable legal provisions. Pursuant to section 289 (5) of the German Commercial Code (HGB), the tasks of the accounting-related internal control system mainly include ensuring proper conduct of business activities, guaranteeing proper internal and external accounting, as well as ensuring compliance with relevant statutory and legal requirements applicable to the company.

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

Organisation of the accounting-related ICS and RMS

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

The Finance division is predominantly responsible for accounting and financial reporting. Finance centrally manages all processes for the preparation of Aareal Bank AG's annual and interim financial statements. Specifically, Finance is responsible for preparing the financial statements (including the management report) in accordance with the HGB; in addition to monthly reporting, Finance is also responsible for defining accounting rules in accordance with German commercial law, and for related IT specifications.

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

The Supervisory Board is responsible for monitoring the Management Board. It approves both the single-entity financial statements of Aareal Bank AG and the consolidated financial statements. Measures taken by the Supervisory Board to ensure an efficient performance of its control functions include the establishment of an Accounts and Audit Committee, which is primarily responsible for financial reporting issues and monitors the effectiveness of Aareal Bank's internal control system pursuant to the requirements of the BilMoG, which came into force in 2009. The committee analyses and assesses the financial statements submitted to it, the internal risk reports, and the annual Internal Audit report. In addition, the committee is responsible for determining the focal points of the audit, as well as for evaluating the auditors' findings. The Accounts and Audit Committee includes an independent finance expert, pursuant to section 100 (5) of the AktG.

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

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

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

Components of the accounting-related ICS and RMS

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

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

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

Internal accounting instructions are used to define the activities to be carried out for the preparation of the financial statements. Aareal Bank AG's voucher documentation rules comprise the rules governing the documentation of accounting vouchers throughout the bank's posting units. Legal requirements as well as the relevant accounting standards are specified in detail in the accounting instructions, and in the structure of the account system. These are reviewed regularly by the Finance division, and updated if required. Valuation within Aareal Bank AG is based on amortised cost or fair value, using current market prices and generally accepted valuation techniques. The valuation techniques used, as well as the underlying parameters, are controlled regularly, and adjusted if necessary. When applying hedging relationships to valuation (*Bewertungseinheiten*), compliance with defined criteria is examined regularly. For further information on measurement, please refer to the relevant notes to the financial statements.

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

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

Adherence of accounting to generally accepted accounting principles is ensured by both preventive and detective controls within the accounting process itself, as well as through a comprehensive review of processed data. The preparation of the consolidated financial statements is characterised by multiple analyses and plausibility checks. Besides the evaluation of individual accounting issues, these include comparisons of periods, and between plan and actual data. Balances and positions are reconciled with clients and counterparties, in accordance with existing regulations. Control processes have been established for risk provisioning in the lending business, in accordance with MaRisk. Reconciliation is carried out both between the general ledger and upstream position-keeping systems, as well as on the level of individual accounts. Adequate control processes have been implemented for both manual and automated accounting transactions. In addition, control processes exist which ensure that all transactions are fully captured in the bank's accounting systems.

Various divisions are involved in certain processes to increase the level of quality of control, and are also required to carry out reconciliation work. An example of cross-divisional reconciliation is the process for the preparation of annual and interim reports. All divisions involved must ensure and (prior to preparation by the Management Board) confirm the quality of the sections of the reports they are responsible for. This represents an additional control level for the data to be disclosed.

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

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

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

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

Future opportunities and outlook

Macroeconomic and industry-specific environment

Global business environment

The economic recovery lost some of its momentum during the second half of the previous year. Financial markets have not returned to normal, not least due to the sovereign debt crisis affecting certain countries at the euro zone periphery. Significant uncertainty remains with respect to future economic developments. Hence, any assessment of economic performance going forward is bound to be affected by a degree of uncertainty.

Economy

At present, factors burdening future economic developments are the high level of unemployment in many countries, combined with a high savings ratio which depresses consumer demand. In addition, capacity utilisation in many economies – despite some improvement – is still very low: a factor which dampens the propensity to invest. To reduce their high budget deficits, numerous countries have either implemented significant tax increases (which burden consumption), as well as public spending cuts, or have announced their intention to do so. Government support programmes are about to expire in some countries. On top of this, consumer demand in many regions is also burdened by rising inflation rates, which are driven by soaring commodity prices, and which are not offset by corresponding salary increases. Conversely, central banks and governments in some overheating markets – which are unaffected by some of the factors mentioned – are taking strict measures to slow down economic growth. Where credit-financed asset bubbles have occurred in precious few regions, active measures are being adopted to tackle these. As long as inflation remains commodity-driven, and does not feed through to salaries, and provided that credit growth does not reach unhealthy levels, we expect the central banks of developed industrialised nations to only increase their interest rates moderately, in order to prevent any additional burdens to growth or public-sector budgets. Looking at these effects, economic growth during 2011 and 2012 is only expected to be moderate, with momentum set to be lower than in 2010 in many markets. We consider the risk of growth rates falling below 1 % in major economies (such as the US, Germany, France, and the UK) to be relatively low – in our view, another recession is unlikely, but not entirely impossible.

In this context, it must be noted that historically, economic recovery phases went hand in hand with lending developments. In other words, the ability of the financial services sector to extend credit (in the broadest sense) is another factor that should not be ignored. There is a risk of this ability being burdened by regulatory measures – which have sometimes been uncoordinated, and in some cases have had add-on effects – and by charges levied by governments.

The situation might also be exacerbated by the very funding ability of individual EU countries being questioned, which may lead to escalating euro zone turbulence. Considering the extensive cross-relationships amongst euro zone economies, such a development could also severely affect countries such as Germany, within the scope of second-round or third-round effects – due to loss of exports to affected countries, for example.

Despite these burdening factors and risks, the more probable scenario from our perspective is for the economy to continue showing a marked recovery during the current year and 2012, even though this trend is likely to be less dynamic, with lower growth rates compared to the previous year. Further support for the economy is expected to come from central banks, which we believe will maintain their expansive monetary policy.

By contrast, future financial market developments remain a major risk factor for the real economy, in view of investor uncertainty caused by high debt levels and budget deficits of various countries – particularly those at the euro zone's periphery. Whilst the support measures implemented by the EU and the IMF have a positive effect on economic development, the prevailing high risk premiums for those government bonds considered by the capital markets to be subject to higher levels of risk clearly indicate that the market has not returned to normal as yet. In this scenario, any assessment of future economic developments is subject to considerable uncertainty.

We expect the strong economic divergence between the various regions, as seen during the year under review, to prevail and persist during 2011 and 2012. The Asian economic regions – especially the Chinese economy – will continue to post stronger growth, albeit with slightly lower momentum. Conversely, economic growth in North America and Europe is expected to be lower, but still positive. Growth rates will diverge notably, even within Europe, where only a few economies – such as Greece, Italy, or Portugal – are likely to continue posting negative growth rates during the current year or the next.

In view of the anticipated slower economic growth, unemployment in many countries is expected to fall at a slow pace, or might even stagnate. This means that unemployment rates will remain at a high level in many countries – with a few exceptions, such as Germany. In some countries (e.g. Spain), unemployment is even expected to rise further. Assuming a continued recovery, we expect some relief on the labour markets next year.

Inflation, monetary policy and interest rates

Annual inflation rates were moderate in many countries during the year under review. Given the expected sluggish recovery going forward, and in the absence of any major changes to the environment, inflation is set to remain subdued during 2011 and 2012. Higher inflation rates are possible however in some Eastern European countries, such as Russia, and in the Asian emerging market economies, although the Japanese price level is expected to remain virtually unchanged. The value-added tax hike, which some European countries such as the UK introduced in order to consolidate their budgets, might trigger a temporary inflation increase. The assessment of future inflation rates is made difficult by the fact that commodity prices – being one of the key input factors for price developments – are influenced by speculation and political factors.

Although some central banks, including the ECB, have taken steps towards exiting their comprehensive liquidity support measures provided in the wake of the financial markets crisis, current monetary policy continues to be expansive, especially in the US. Looking at the moderate inflation outlook and the forecast slow economic recovery, there are no indications of a short-term reversal of the expansive policy stance. Against this background, for the current year we expect slight to moderate increases in short-term and long-term interest rates for the currencies in which we are active. For the following year, we consider a more pronounced interest rate increase to be possible.

Global commercial property markets

Many commercial property markets exhibited divergence during the year under review. At the top end of the market, rents for first-class commercial property generally stabilised, or increased over the previous year. Investor yield requirements for these properties also stabilised; in some markets, they decreased. Accordingly, the decrease in yield requirements and the stabilisation of rent expectations resulted in rising market prices. In contrast, the rents and prices of properties of lesser quality tended to come under pressure. Similar and ongoing market divergence is conceivable for the current year and the next.

The improving investment climate on numerous commercial property markets, as well as expected economic growth provide for a positive outlook for commercial property. Bearing in mind that growth rates are likely to remain moderate in many economies, and that unemployment is expected to stagnate (or to fall only slowly), we are cautious regarding future rent and price developments; our overall view is that we anticipate stable to moderately rising rents and prices, both for the current year as well as for 2012. Whilst the expected relief on the labour markets would indicate a more favourable outcome, this might be neutralised by potential interest rate increases, especially from 2012 onwards.

First-class properties have potential to outperform the market average: already during the year under review, this segment has experienced a notable increase in demand, both for rentals and acquisitions. Provided that the financial markets remain stable, moderate increases in values and rents will be possible for first-class properties. In contrast, developments on markets that are burdened by extremely weak (or stagnating) economic and labour market developments are likely to be less positive or even negative, even in the segment for first-class properties. Lower-quality properties are generally expected to underperform first-class properties.

Further developments on property markets will be influenced by the extent to which uncertain economic factors will dominate overall economic development. The future situation on the financial markets will be of particular importance to the performance of the property markets. Significant distortions on financial markets, due to the debt crisis, could result in negative feedback on the property markets. The high volume of commercial property financings that will mature in the current year and the next – bank loans as well as commercial property securitisations – represents another element of uncertainty. A failure by finance providers to renew these exposures, combined with a lack of buyers for the properties concerned, might trigger distressed sales – which would in turn depress prices. To date, we have not observed such effects in the commercial property markets to any material extent. The low volume of building completions, due to the economic and financial markets crisis, might have a positive impact on rents and property values. Completions during the years 2011 and 2012 are anticipated to be lower, particularly in the US, but also in Europe – whereas the level of completions in Asia is high. Bearing this low volume of new construction in North America and Europe in mind, a shortage of new, modern floorspace in attractive locations is likely to develop in both regions.[3]

Economic and commercial property market development in individual regions

Europe

During the current year we expect growth in most European economies to be rather slow and moderate. Some economies – such as Germany and Sweden – which posted strong growth rates last year, are likely to experience somewhat lower momentum this year, but should still be growing. A recession is only expected in very few European countries this year: this could apply to Greece, Ireland and Portugal, whose economies are burdened by the debt crisis and the resulting cuts to government budgets. In fact, Spain was still in recession during 2010 – the expectation there is for the economy to turn positive again, albeit at weak growth rates. The highest rates of real GDP growth in Europe are expected in some of the emerging market economies such as Turkey and Russia. Overall, in most economies, a moderate recovery is anticipated for 2012, which should be largely comparable to the situation seen during the current year.

For European commercial property markets, we envisage the general trend of stabilising average rents and market values to prevail during 2011 and 2012 – possibly growing moderately. Some sub-markets may diverge, however: further pressure on rents and prices is possible especially in economies burdened by very low growth rates and very high unemployment. Particularly from 2012 onwards, commercial property markets may be negatively affected by potential interest rate increases.

North America (NAFTA states)

Economic growth in the US and Canada is expected to be moderate this year. Despite the burdens on the US economy, due to lower house prices and high unemployment, growth could still be possible, thanks to current sizeable government stimulus programmes and the continued expansive monetary policy. The recovery is expected to be more pronounced in Mexico. For 2012, all three economies are expected to slightly accelerate.

Looking at the development of rents and prices during the current year and the next, we remain cautious for the North American commercial property markets, despite expected economic growth, and we anticipate levels to remain stable on average. In the case of the US, it should be noted that there is a high volume of property loans maturing during the forecast period which were funded through securitisations: this could lead to forced sales, which in turn would exercise pressure on prices.

Asia

Emerging Asian economies – and China in particular – will continue to post the highest global growth rates during 2011 and 2012. However, various economic and monetary policy measures are likely to slow down Chinese growth rates compared with the previous year. Singapore's economy is predicted to grow significantly, albeit falling short of the extraordinary growth rates seen during 2010. It is also unlikely that Japan will be able to repeat its remarkable performance of the previous year in 2011 and 2012: however, positive growth rates are nevertheless expected.

Even though robust economic growth – again, particularly in China – might support developments on the commercial property markets going forward, this effect might be neutralised to some extent by a more restrictive monetary policy, and hence rising interest rate levels. Overall, we remain cautious regarding developments on Asian commercial property markets during 2011 and 2012.

The German institutional housing industry

We anticipate the development of the German institutional housing industry to remain stable during 2011 and 2012, thanks mainly to largely constant rental returns and long-term financing structures.

[3] Assessments of individual sub-markets and properties could deviate from the general assessment of the commercial property markets outlined in this section, and in the following one.

Due to a significant lack of housing suitable for the elderly, companies are increasingly facing the need to adapt existing residential units to the changing needs of an ageing population. Furthermore, investments for modernisation – and especially, refurbishments to improve the energy efficiency of buildings – will grow in importance. Subsidies for carbon dioxide emission optimisation of buildings and urban development programmes will however be cut during 2011: these curbs on investment incentives for housing enterprises bear the risk that the planned refurbishment projects may fail to materialise.

Nonetheless, the German residential property market is expected to remain stable during 2011 and 2012, whereby residential demand will continue to be driven by regional economic performance. Against the background of accelerating economic recovery, the trend towards urban living – as well as the labour market-driven migration to growth regions – are both set to continue.

Given the growing number of single-person households and the weak construction activity during recent years, continued demand – particularly in the prospering conurbations – meets limited supply. Hence, rent increases of between 3 % and 4 % are anticipated for newly-built flats in Berlin, Frankfurt, Hamburg and Munich during next year. Conversely, structurally weak regions may be affected by the younger population – in particular – migrating to other regions, burdening the residential market and leading to excess supply.

Against the background of the sound German residential market overall, and the continuing search for secure investments, we expect ongoing investor interest in the German residential property market during 2011 and 2012. In this context, institutional investors are expected to continue dominating the market. Should demand for core investments exceed available supply, buyers might extend their focus to include more risky value-added portfolios.

Accordingly, there are numerous indications for 2011 transaction volumes to exceed the previous year's levels – whereby the size of residential portfolios changing hands is also expected to rise. Property owners who bought residential portfolios during the boom years in the transaction market, from 2004 to 2007, might join the ranks of sellers going forward, as they look to sell their properties before 2012, to pre-empt the impending portfolio refinancing and restructuring process.

Corporate development

Aareal Bank Group conducts its corporate and business planning in accordance with IFRSs. No single-entity plan is drawn up for Aareal Bank AG: for this reason, the following statements regarding corporate development refer to Group planning in accordance with IFRSs.

For the 2011 financial year, Aareal Bank Group sees good prospects for maintaining its good overall business performance, despite the market environment for commercial property financing – which is set to remain challenging during the current year.

Against the background of slightly rising interest rates during the 2011 financial year, net interest income is expected to be stable or slightly higher than in the previous year. Higher margins achieved on new business originated during 2009 and 2010 have boosted average lending margins. We expect this positive effect to fade, to some extent. For 2012, we expect net interest income to be stable compared with 2011, or slightly higher. Negative factors could arise, however, especially from a change to the underlying interest rate environment on which the planning is based.

The gradual return of property markets to normality is expected to continue, even though some markets will still face losses during the current year; also, the various uncertainties and challenges involved in commercial property finance are likely to persist. Specifically, these include future economic developments in certain sub-markets, the situation on the capital markets, and the impact of the various regulatory actions. Against this background, we expect allowance for credit losses to remain within a range of € 110 million to € 140 million during the 2011 financial year. In a business environment that will remain challenging, we nonetheless anticipate slightly lower relative risk costs during 2012. As in the previous years, the bank cannot rule out additional allowances for credit losses that may be incurred during 2011 and 2012 – especially in the event of negative developments in the business environment.

We expect a moderate year-on-year rise in net commission income for 2011. The repayment of the SoFFin-guaranteed bond will have a positive impact on this item from 2012 onwards, as guarantee fees will no longer be payable. The anticipated increase in net commission income will also be supported by expected further improvements in Aareon's results.

Net trading income/expenses essentially comprises the results of hedge transactions related to refinancing our core business, predominantly currency and interest rate hedges. We only engage in traditional own-account trading to a very limited extent. The item also includes changes in value from the sale of hedges for selected EU governments, so-called credit default swaps (CDS). In our opinion, the valuation of the hedging transactions remains subject to the same high volatility as in the last two years, especially in the current environment. As a result, it is impossible to forecast net trading income/expenses for 2011 and 2012.

Because of the consistent and conservative risk policy we have pursued in recent years, we anticipate no material burden on the results from non-trading assets during 2011 and 2012.

Administrative expenses continue to be defined by the unchanged cost discipline, and the figure for 2011 is expected to be marginally higher than in the previous year, taking the burden associated with the bank levy into account. Our ongoing efforts to enhance efficiency are expected to have a positive impact on administrative expenses for 2012.

We are confident, from today's perspective, that the bank will increase the good operating profit achieved during the 2010 financial year, in a challenging market environment. Based on the conditions set out above, we expect 2012 operating profit to clearly exceed the figure for 2011, reaching a double-digit return on equity before taxes. Despite the additional burdens facing banks as a result of the bank levy, Aareal Bank considers a return on equity before taxes of at least 12 per cent to be achievable in a normal market environment.

From today's perspective, new business originated in the Structured Property Financing segment during 2011 is expected to be in line with the previous year's levels.

In the Consulting/Services segment, we anticipate the interest rate environment to remain difficult for segment results in 2011. We thus expect operating profit to be slightly higher compared with the financial year under review. For 2012, we are forecasting higher interest rates, and a corresponding increase in margins generated in this segment. Together with the expected increase in Aareon's sales revenues, this is likely to further benefit the segment result.

Corporate Governance Statement Pursuant to Section 289a of the HGB

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

Principles of remuneration

The Supervisory Board determines the structure and amount of remuneration for members of the Management Board. Specifically, it determines the structure of salaries and other remuneration components for members of the Management Board.

Aareal Bank AG has entered into fixed-term service contracts with the members of its Management Board. In addition to fixed salary components, which are paid in twelve identical monthly instalments, the members of the Management Board receive a variable remuneration, comprising a cash bonus and a long-term component in the form of phantom shares allocated.The basis for this variable remuneration component is a target system, largely based on net income (of the Group) as reported under International Financial Reporting Standards (IFRSs), as well as qualitative and quantitative targets, which are re-defined annually.

To the extent that the Company distributes dividends, a corresponding payment is made as other remuneration.

In addition to fixed salary components, which are paid in twelve identical monthly instalments, members of the Management Board who were appointed on or after 1 November 2010 receive a variable remuneration, which comprises a cash bonus and phantom shares in equal proportions; 40 % of these components is paid out immediately, and the remaining 60 % after a retention period. The precise details governing variable remuneration comply with the requirements of the German Ordinance on Remuneration in Financial Institutions (*Institutsvergütungsverordnung*), with the variable remuneration commitment being subject to further specifications of supplementary remuneration rules.

In the context of the bank's agreement entered into with the German Financial Markets Stabilisation Fund (SoFFin), the members of the Management Board have foregone payment of contractually agreed fixed remuneration components over and above € 500,000, as well as any variable remuneration components.

Remuneration for the services of the Supervisory Board members is specified in Article 9 of the Memorandum and Articles of Association of Aareal Bank AG. The resolution passed at the Annual General Meeting of 23 May 2006 determined the current remuneration that was adjusted in line with the remuneration system of the Supervisory Board.

The total remuneration of the Supervisory Board will comprise a fixed and a variable remuneration component, comparable to the remuneration package of the Management Board. The variable remuneration is performance-related and comprises a short-term and a long-term component.

Please refer to the Notes for further details about the remuneration system for members of the Management Board and the Supervisory Board of Aareal Bank AG, as well as on the existing change of control regulations.

The remuneration systems for members of Aareal Bank Group staff are based on the Group's business strategy, the long-term, sustainable development of the business, and the results of operations. Limits to variable remuneration components are designed to avoid any incentives for taking excessive risks. The remuneration systems were agreed upon with the employee representative bodies in the respective Group entities, and have been published. Salary comparisons are carried out regularly, 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.

The German Ordinance Regarding the Regulatory Requirements for Remuneration Systems of Institutions (*Institutsvergütungsverordnung* – "InstitutsVergV" – referred to below as the "Ordinance"), which came into effect on 13 October 2010, introduced new financial requirements regarding remuneration systems. The Ordinance is applicable to Aareal Bank AG, as well to all subsidiaries which are banks/credit institutions or financial enterprises, or who offer ancillary services.

Supported by external advisors, Aareal Bank AG is working on adjusting and realigning its remuneration systems in order to implement the requirements under the Ordinance throughout Aareal Bank Group. The necessary negotiations to implement new remuneration systems were still ongoing at the time of going to print with this annual report. In principle, the plan is to apply the new remuneration systems with retrospective effect from 1 January 2011. Aareal Bank AG will publish the legally required disclosures on its website as soon as the specifications of the new remuneration rules have been defined.

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

Composition of subscribed capital

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

Restrictions affecting voting rights or the transfer of shares

The German Financial Markets Stabilisation Fund (SoFFin) agreed to provide a stabilisation measure to the bank in March 2009, in the form of a silent participation. In the context of this stabilisation measure, SoFFin and the bank's main shareholder, Aareal Holding Verwaltungsgesellschaft mbH ("Aareal Holding") entered into an agreement under which Aareal Holding has undertaken to maintain its stake in the bank's capital (currently 37.23 %) throughout the term of the recapitalisation, and to act in SoFFin's interest when casting certain votes during the General Meeting (or to seek SoFFin's opinion prior to such a poll). Furthermore, Aareal Holding has undertaken to exercise its voting rights for resolutions to be adopted by a General Meeting in such a way that Aareal Holding will retain its blocking minority.

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

Shareholdings exceeding 10 % of voting rights

Details regarding any shareholdings exceeding 10 % of voting rights are provided in the Notes.

Shares with special rights granting the holder supervisory powers

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

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

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

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

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

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

Authorisation of the Management Board to issue or repurchase shares

Authorised capital

The Annual General Meeting held on 19 May 2010 resolved to authorise the Management Board to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 64,132,500 (Authorised Capital) by issuance of new shares for contribution in cash or in kind. This authorisation will expire on 18 May 2015. The shareholders must be granted subscription rights in the event of a capital increase against cash contributions. The Management Board is authorised to exclude shareholders' pre-emptive subscription rights in the event of a capital increase not exceeding 10 % of the issued share capital at the time of the authorisation becoming effective or being exercised, subject to approval by the Supervisory Board and provided that the issue price is not significantly lower than the prevailing market price of shares already listed, at the time of final determination of the issue price. Article 5 (4) lit. b) to d) of the Memorandum and Articles of Association sets out further conditions for excluding shareholders' pre-emptive subscription rights. The Management Board may exclude shareholders' pre-emptive subscription rights in the event of a capital increase against contributions in kind. When exercising this authorisation, the Management Board will restrict the exclusion of shareholders' pre-emptive rights to a total of 20 % of the Company's registered share capital. Accordingly, the aggregate exclusion of shareholders' subscription rights upon exercise of this authorisation must not exceed 20 % of the registered share capital at the time said authorisation comes into effect or is exercised. No use has been made to date of the authorised capital.

Conditional capital

Pursuant to Article 5 (5) of the Memorandum and Articles of Association, the share capital is subject to a conditional capital increase of up to € 30 million by means of issuing up to 10 million new notional no-par value bearer shares. The purpose of the conditional capital increase is the granting of shares to holders or creditors of convertible bonds and/or bonds cum warrants issued in accordance with the authorisation by the General Meeting held on 19 May 2010. Under this authorisation, bonds cum warrants or convertible bonds with an aggregate nominal amount of up to € 600 million may be issued until 18 May 2015. Under the authorisation, subsidiaries of Aareal Bank AG may also issue convertible bonds and / or bonds cum warrants, and subject to approval by the Supervisory Board allows the company to guarantee such issues as well as to issue shares to fulfil the resulting conversion or option rights. Subject to the approval of the Supervisory Board, the Management Board may exclude shareholders' pre-emptive rights in the certain cases. Notwithstanding the provisions of section 9 (1) of the AktG, in certain circumstances holders of conversion or option rights are entitled to be protected against dilution. The new shares will be issued at the conversion or option price to be set as defined in the resolution passed by the General Meeting on 19 May 2010. The conditional capital increase will be executed only to the extent that holders of conversion or option rights exercise such rights or any conversion obligation from such convertible bonds and/or bonds with warrants is performed, and to the extent that treasury shares are not utilised to service such convertible bonds and/or bonds cum warrants. The new shares will be entitled to a share in the profits from the beginning of the financial year in which they come into existence, by way of exercise or conversion. The Management Board is authorised to determine any further details of the conditional capital increase, subject to approval by the Supervisory Board. The purpose of this authorisation to issue convertible bonds and/or bonds cum warrants (where the issue of shares to honour the obligations under such convertible bonds and/or bonds cum warrants is covered by the conditional capital) is to provide the Management Board with the flexibility to act swiftly when raising finance, in the interests of the company. The Management Board has not yet exercised this authorisation.

Authorisation to purchase treasury shares

The General Meeting held on 19 May 2010 authorised the Management Board, pursuant to Section 71 (1) No. 8 of the AktG, up to 18 May 2015, to acquire and sell treasury shares for purposes other than securities trading, up to a maximum volume of 10 % of the issued share capital at the time of passing the resolution or – if this value is lower – of the share capital existing at the time of exercising this authorisation for purposes other than securities trading. Shares may be acquired via the stock exchange or by means of a public offer to buy, directed at all shareholders. Where acquisition is effected via the use of derivatives in the form of put or call options, or a combination of both, the option terms must ensure that said options are only serviced with shares that were purchased, in accordance with the principle of equal treatment, at the stock exchange at the prevailing share price of the Company's share in Xetra trading (or a comparable successor system) at the time of the purchase on the stock exchange.

The Management Board is authorised to effect the sale of any treasury shares acquired in accordance with this authorisation, subject to approval by the Supervisory Board, via channels other than the stock exchange or an offer to all shareholders, provided that the sale is carried out at a price that is not significantly lower than the stock exchange price of the company's shares at the time of sale. This authorisation is subject to the proviso that the aggregate value of shares sold under this authorisation and of shares issued to the exclusion of shareholders' subscription rights, in accordance with section 186 (3) sentence 4 of the AktG, shall not exceed 10 % of the issued share capital at the time of said authorisation becoming effective or being exercised. Subject to approval by the Supervisory Board, pre-emptive subscription rights on the sold shares may also be excluded in the event of a sale against contributions in kind, or if the sold shares are given to the holders of conversion or option rights in lieu of new shares from a contingent capital increase. The Management Board is also authorised to exclude the pre-emptive subscription rights to the extent required to grant subscription rights to new shares to owners of convertible bonds or bonds cum warrants which were issued in the meantime in such an amount as would be due to them once they exercised their option rights. The Management Board is authorised to call in any of the shares acquired under this authorisation, without any further resolutions by the General Meeting being necessary. The company did not exercise this authorisation to purchase or dispose of treasury shares during the year under review.

The authorisation to purchase treasury shares is granted for a five-year period; it is in line with widely accepted practice of German listed companies. In line with authorised capital and conditional capital, this serves the company's interest of having access to flexible financing options.

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

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

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

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

Annual financial statements

Income statement of Aareal Bank AG for the period from 1 January to 31 December 2010

€ mn			2010	2009
Expenses				
Interest expenses			**1,101.7**	1,291.3
Commission expenses			**46.8**	33.0
Net expense from the trading portfolio			**0.1**	-
General administrative expenses				
a) Staff costs				
aa) Wages and salaries	100.3			
ab) Social security contributions, pensions and other employee benefits	17.6	117.9		
including: pensions 6.5				
b) Other administrative expenses		107.9	**225.8**	220.6
Amortisation, depreciation and write-downs of intangible and tangible fixed assets			**4.0**	3.9
Other operating expenses			**27.5**	25.4
Write-downs and valuation allowances of loans and advances and specific securities, as well as additions to loan loss provisions			**172.2**	124.6
Amortisation and write-downs on participations, interests in affiliated companies, and investment securities			**34.0**	-
Expenses for assumption of losses			**20.1**	1.6
Additions to the fund for general banking risks			**15.6**	22.0
Extraordinary expenses			**40.9**	-
Net income taxes			**3.4**	29.5
Other taxes not reported under other operating expenses			**0.0**	0.8
Net income			**0.4**	2.0
Total expenses			**1,692.5**	**1,754.7**
Net income / net loss			**0.4**	2.0
Profit carried forward from the previous year			**0.0**	0.0
Withdrawals from retained earnings				
from the reserves for treasury shares			0.0	0.0
from other retained earnings			0.0	0.0
Transfer to retained earnings				
to the reserve for treasury shares			0.0	0.0
to other retained earnings			0.0	0.0
Net retained profit			**0.4**	**2.0**

€ mn		2010	2009
Income			
Interest income from			
a) Lending and money market transactions	1,041.7		
b) Fixed-income securities and debt register claims	500.1	**1,541.8**	1,670.2
Current income from			
a) Equities and other non-fixed income securities	16.6		
b) Participating interests	0.1		
c) Interests in affiliated companies	3.5	**20.2**	4.9
Income from profit pools, profit transfer agreements and partial profit transfer agreements		**21.3**	2.9
Commission income		**66.3**	47.2
Net income from the trading portfolio		**0.0**	2.2
Income from write-ups to participating interests, shares in affiliated companies and securities held as fixed assets		**0.0**	0.8
Other operating income		**24.1**	26.5
Extraordinary income		**18.8**	-
Total income		**1,692.5**	**1,754.7**

Balance Sheet of Aareal Bank AG as at 31 December 2010

€ mn			2010	2009
Assets				
Cash funds				
a) Cash on hand		0.0		
b) Balances with central banks		922.5	922.5	989.2
including:				
with Deutsche Bundesbank 867.6				
Loans and advances to banks				
a) Payable on demand		834.0		
b) Other loans and advances		1,526.4	2,360.4	1,488.9
Loans and advances to customers			**24,534.5**	22,915.4
including: secured by charges on real property 10,519.6				
Loans to local authorities 1,671.2				
Debt and other fixed-income securities				
a) Money market instruments		--		
b) Bonds and notes				
ba) Public-sector issuers	6,512.4			
including: securities eligible as collateral with Deutsche Bundesbank 6,145.8				
bb) Other issuers	4,375.8	10,888.2		
including: securities eligible as collateral with Deutsche Bundesbank 4,070.7				
c) Own bonds		4,341.8	15,230.0	14,136.3
Nominal amount 4,351.2				
Equities and other non-fixed income securities			**475.5**	492.8
Participating interests			**3.1**	4.1
including: interests in banks 0.8				
Interests in financial services providers -				
Interests in affiliated companies			**514.7**	498.7
including: interests in banks 1.8				
Interests in financial services providers -				
Trust assets			**541.4**	626.0
including: trustee loans 539.9				
Intangible assets				
a) Internally generated industrial property rights and similar rights and assets		--		
b) Purchased concessions, industrial property rights and similar rights and assets as well as licences in such rights and assets		2.3		
c) Goodwill		1.1		
d) Advance payments made		--	**3.4**	4.4
Tangible fixed assets			**7.3**	7.4
Other assets			**64.9**	327.9
Prepaid expenses			**135.0**	123.9
Deferred tax assets			**76.3**	36.5
Total assets			**44,869.0**	**41,651.5**

€ mn			2010	2009
Liabilities				
Liabilities to banks				
a) Payable on demand		588.1		
b) With an agreed maturity or notice period		4,833.8	5,421.9	5,336.1
Liabilities to customers				
a) Savings deposits				
aa) With an agreed notice period of three months	0.0			
ab) With an agreed notice period of more than three months	0.0	0.0	0.0	
b) Other liabilities				
ba) Payable on demand	3,870.6			
bb) With an agreed maturity or notice period	18,933.0	22,803.6	22,803.6	21,402.8
Certificated liabilities				
a) Bonds issued		11,977.0		
b) Other certificated liabilities		--	11,977.0	10,443.7
Trust liabilities			**541.4**	626.0
including: trustee loans 539.9				
Other liabilities			**405.9**	77.3
Deferred income			**115.2**	114.5
Deferred tax liabilities			**39.5**	24.1
Provisions				
a) Provisions for pensions and similar obligations		81.3		
b) Tax provisions		25.1		
c) Other provisions		134.9	**241.3**	178.5
Subordinated liabilities			**782.6**	783.3
including: maturing within two years 100.8				
Profit-participation certificates			**450.3**	450.4
including: maturing within two years 275.0				
Fund for general banking risks			**167.6**	152.0
Equity				
a) Subscribed capital		128.3		
Contributions by silent partners		595.2		
b) Capital reserve		509.5		
c) Retained earnings				
ca) Legal reserve	4.5			
cb) Reserve for treasury shares	--			
cc) Statutory reserves	--			
cd) Other retained earnings	684.8	689.3		
d) Net retained profit		0.4	1,922.7	2,062.8
Total equity and liabilities			**44,869.0**	**41,651.5**
Contingent liabilities				
a) Contingent liabilities from discounted forwarded bills		--		
b) Liabilities from guarantees and indemnity agreements		646.5		
c) Liability from the pledging of collateral for third-party liabilities		--	646.5	956.9
Other commitments				
a) Repurchase obligations from securities repurchase agreements		--		
b) Placement and underwriting obligations		--		
c) Irrevocable loan commitments		1,793.7	1,793.7	1,690.9

Notes

Basis of accounting

The financial statements of Aareal Bank AG for the financial year 2010 were prepared in accordance with the provisions of the German Commercial Code (*Handelsgesetzbuch* – ”HGB”) and the supplementary regulations of the German Public Limited Companies Act (*Aktiengesetz* – ”AktG”) and the German Accounting Directive for Banks and Financial Services Providers (*Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute* – ”RechKredV”).

Accounting and valuation principles

Application of the German Accounting Law Modernisation Act (*Bilanzrechtsmodernisierungsgesetz* - "BilMoG")

Effective 1 January 2010, Aareal Bank AG fully implemented the German Accounting Law Modernisation Act (BilMoG) in its accounting and financial reporting, including all effects of legally required measures.

Pursuant to section 67 (8) sentence 2 of the Introductory Law to the German Commercial Code ("EGHGB"), no adjustment to the previous year's figures was required following the first-time application of the BilMoG.

Merger of Aareal Bank France S.A. into Aareal Bank AG

Effective 1 January 2010, Aareal Bank France S.A. was merged into Aareal Bank AG on the basis of book values. The merger resulted in a merger gain at Aareal Bank AG in the amount of € 14.8 million which is reported in the bank's net extraordinary income.

Loans and advances

Loans and advances to banks and customers are carried at amortised cost, including deferred interest. Premiums and discounts are shown under deferred items, in accordance with section 340e (2) of the HGB. Credit risks are accounted for by setting aside provisions in the amount of the expected loss, using prudent estimates. General loan loss provisions are recognised for risks which have already materialised, but which cannot be allocated to individual loans and advances due to lack of knowledge. For this purpose, groups of financial assets with comparable default risk profiles are combined in portfolios. The bank refined the method for calculating general loan loss provisions during the year under review: previously, the calculation was based on historical default rates, using risk parameters derived from standard risk costs. In addition, a value adjustment was recognised on the basis of economic developments. Both methods were aggregated to form the methodology applied during the 2010 financial year for the first time. Henceforth, these calculations will be carried out using a formula-based method, on the basis of the Basel II parameters of 'loss given default' (LGD) and 'probability of default' (PD), used in accordance with the Advanced IRB Approach (AIRBA).

Securities

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

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

Participating interests, interests in affiliated companies and tangible assets as well as purchased intangible assets are stated at purchase or production costs, less depreciation/amortisation. Write-downs are required in the event of impairments in value deemed to be other than temporary.

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

The option to disclose a net amount, pursuant to section 340c (2) of the HGB has been exercised.

Liabilities

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

Provisions

Provisions are recognised in the amount of the required settlement amount, as determined based on prudent commercial judgement. Pursuant to section 253 (2) sentence 1 of the HGB, provisions with a remaining term of more than one year have to be discounted using the average market interest rate of the past seven years applicable for their average remaining term. Provisions for pensions have to be recognised at the settlement amount, taking into account future wage, salary and pension trends. The amount recognised has to be discounted pursuant to the provisions set out in section 253 (2) of the HGB.

Provisions for pensions and similar obligations are determined in accordance with actuarial principles.

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

Actuarial method applied:	Projected unit credit method
Fundamental calculation assumptions:	
Interest rate used for valuation	5.16%
Expected wage and salary increases	2.25%
Mortality tables used	"Richttafeln 2005G" mortality tables by Prof Klaus Heubeck

Aareal Bank has fully accounted for the € 36.0 million addition to pension provisions required as a result of the revaluation pursuant to the BilMoG during the 2010 financial year, and recognised this as an extraordinary expense.

As at 30 November 2010, assets which are held exclusively for the purpose of fulfilling pension obligations were netted against provisions for pensions, within the framework of a Contractual Trust Agreement (CTA) where the trustee is acting on behalf of both parties (in the capacity of an administrative trustee and security trustee).

After this netting of assets (with a fair value of € 30.5 million, compared to costs of purchase of € 29.8 million), the pension provisions to be recognised totalled € 81.2 million.

The balance sheet item "Provisions for pensions" includes € 13.8 million (2009: € 0.0 million) of investment fund units, € 2.9 million (2009: € 0.0 million) of debt securities, and € 13.8 million (€ 0.0 million) of reinsurance cover, all of which are exclusively reserved to meet Aareal Bank's pension obligations vis-à-vis its active and retired employees in Germany.

Income recognised during the current year under review amounted to € 1.1 million.

Provisions for taxes and other provisions have been set aside for existing legal or constructive obligations in the settlement amount, as required by prudent commercial judgement. Pursuant to section 253 (2) sentence 1 of the HGB, provisions with a remaining term of more than one year have to be discounted using the average market interest rate of the past seven years applicable for their average remaining term.

Currency translation

The bank has classified all foreign exchange transactions as 'specific cover' in accordance with section 340h of the HGB. Hence, income and expenses from currency translation were recognised in the income statement.

The bank decomposes foreign exchange forward transactions into an agreed spot base and the swap rate, recognising a deferred liability (reported under other liabilities) equivalent to the net aggregate difference between the spot base and the exchange rates prevailing on the reporting date. Forward premiums or discounts are amortised in net interest income over the term of the transaction.

Currency translation income and expenses are reported in net other operating income/expense.

Trading portfolio

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

Hedging relationships

The bank establishes hedging relationships within the meaning of section 254 of the HGB. Accordingly, fixed-income securities of the liquidity reserve in a nominal amount of € 3,118.2 million as well as securities held as fixed assets in a nominal amount of € 62.9 million are hedged against changes in value attributable to interest rate risk, on the basis of so-called "micro hedges". In this context, the underlying transaction and the hedge generally are acquired within the framework of so-called "asset swap packages", i.e. they are so-called "perfect hedges" where all value-affecting factors between the hedged portion of the underlying transaction substantially correspond to the hedging portion of the hedge. The prospective effectiveness of the hedging relationship, which refers to the period until the security's final maturity, is proven, based on the so-called "critical terms match method". Regression and correlation coefficients are used as criteria to measure retrospective effectiveness.

This is presented in the financial statements using the so-called "net hedge presentation method" ("*Einfrierungsmethode*"). Under this method, the cumulative changes in the value of the underlying transaction is determined on the basis of the hedged risk, and compared to the changes in the value of the hedge. Any previously existing negative ineffectiveness based on the hedged risk is reflected in a provision for hedging relationships. The changes in value attributable to the hedged risk are reflected on a portfolio basis, in the form of a write-down on the security concerned.

The bank continues to establish hedging relationships between repurchased own bonds in an amount of € 4,332.6 million and the corresponding securitised liabilities.

Measurement convention

In addition, Aareal Bank AG recognises derivative financial instruments of the banking book (non-trading book) for the purpose of controlling various risks as part of overall management of the bank. In accordance with HGB, these instruments represent "pending transactions" which are not recognised in the balance sheet. They form a "hedging relationship", together with the recognised assets and liabilities. No provision for anticipated losses had been recognised as at the balance sheet date. The present value of the banking book is positive as at 31 December 2010.

Derivatives

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

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

Acquired as well as issued structured products were accounted for as groups of uniform assets and liabilities in accordance with IDW RS HFA 22.

Structured products subject to different types of risks or rewards are accounted for separately as individual receivables or liabilities.

Notes to the income statement

Income by geographical segment

The aggregate of (i) interest income, (ii) current income on equities and other non-fixed income securities, and on participating interests and interests in affiliated companies, (iii) commission income and (iv) other operating income is broken down by the following regions, in accordance with section 34 of the RechKredV.

€ mn	2010	2009
Germany	1,446.7	1,562.1
Europe / Americas / Asia	205.7	186.7
Total	**1,652.4**	**1,748.8**

Administration and intermediation services rendered to third parties

Administration and intermediation services rendered to third parties concerned the administration and intermediation of loans and trust assets.

Other operating income and expenses

Other operating income totals € 24.1 million (2009: € 26.5 million) and comprises income from the reversal of provisions in the amount of € 10.7 million, income under agency contracts for other Group subsidiaries in the amount of € 2.4 million, as well as the result from currency translation in the amount of € 2.7 million. In the previous year, the result from currency translation was reported in the item "Net profit on financial operations".

Other operating expenses of € 27.5 million (2009: € 25.4 million) include expenses for subsidiaries in the amount of € 12.8 million, of which € 3.1 million are attributable to agency contracts for other Group subsidiaries. The figure also includes € 1.8 million from the compounding of provisions pursuant to the BilMoG.

Extraordinary income and expenses

Extraordinary income in the amount of € 18.8 million (2009: € 0.0 million) consist of the gains arising on the merger of Aareal Bank France S.A. into Aareal Bank AG of € 14.8 million, which was carried out as of 1 January 2010. In addition, extraordinary income includes income from the first-time application of the German Accounting Law Modernisation Act (BilMoG) in the amount of € 4.0 million.

Extraordinary expenses comprise expenses in the amount of € 40.9 million (2009: € 0.0 million) from the first-time application of the BilMoG, which includes € 36.0 million in expenses from the change in the accounting method for pension obligations. Aareal Bank AG has thus fully recognised the addition required to match the settlement value of pension obligations (which significantly increased due to the application of the BilMoG) during the 2010 financial year.

Net income taxes

The net income tax position amounts to € 3.4 million (2009: € 29.5 million) in expenses, of which € 13.2 million in current taxes is payable in Germany: this figure comprises € 8.6 million in corporation tax and € 7.2 million in trade tax payable for the current year, as well as € 2.6 million in tax refunds for previous years. Current tax expenses include € 18.0 million in income from the recognition of deferred tax assets and 8.2 million in expenses for the bank's foreign branch offices.

The tax reconciliation is used to determine why the actual tax expense (current taxes and deferred taxes) differs from the expense derived from the calculation using a flat tax rate. No comparative figures are available for the previous year, since this disclosure is based on an amendment to the HGB by virtue of the BilMoG.

€ mn	31 Dec 2010
Operating profit (before income taxes)	3.8
Expected income tax expense rate: 31.2% (unch. yoy – including 15.4% trade tax, 15.0% corporation tax and 0.8% solidarity surcharge)	1.2
Reconciliation	
Different foreign tax burden	6.5
Tax attributable to tax-exempt income	-24.2
Tax attributable to non-deductible expenses	22.7
Remeasurement of deferred taxes	0.0
Current taxes referring to previous years	-1.9
Effect of changes in tax rates	-0.9
Other tax effects	0.0
Income tax expense reported	3.4
Effective tax rate (%)	89.64

Prohibition of distribution

A total amount of € 37.5 million in profits is subject to a prohibition of distribution, pursuant to section 268 (8) of the HGB, of which € 76.3 million is attributable to the recognition of deferred tax assets, and € -39.3 million to the recognition of deferred tax liabilities. A prohibition of distribution applies to a net amount of € 0.5 million (after fair-value netting of assets).

Notes to the balance sheet

Securities negotiable at a stock exchange

Analysis of securities negotiable at a stock exchange in the balance sheet line items shown below:

€ mn	Listed 31 Dec 2010	Unlisted 31 Dec 2010
Debt and other fixed-income securities (excluding accrued interest)	14,946.9	50.0
Equities and other non-fixed-income securities	11.2	4.6
Participating interests	-	-
Interests in affiliated companies	-	-

Hedging relationships as defined by section 254 of the HGB have been created with respect to negotiable securities in an aggregate amount of € 7,515.85 million (2009: € 7,593.6 million).

Bonds and notes of € 15,230.0 million (2009: € 14,136.3 million) (including accrued interest) reported under debt and other fixed-income securities include € 671.7 million (2009: € 717.3 million) in securities which are not eligible as collateral with Deutsche Bundesbank. Of that amount, € 345.76 million (2009: € 298.6 million) relate to sovereign foreign-currency bonds, which are eligible for securities lending.

Investment fund units

	Book value as at 31 Dec 2010	Market value as at 31 Dec 2010
AllianzGI MMS I Global Funds	327.0	331.0
DBB INKA	92.0	92.0
Arsago Multistrategie	41.0	41.0
31 Dec 2010	**460.0**	**464.0**

AllianzGI MMS Global Funds and DBB INKA are investment funds under German law (*Sondervermögen*) which invest in assets permitted under the German Investment Act (Investmentgesetz – "InvG"), observing the principle of risk diversification. The Arsago Multistrategie fund is a multi-strategy hedge fund which uses derivative instruments to gain exposure to various interest rate, currency and macro strategies.

Daily fund unit redemption is subject to certain restrictions. The value of investment fund units as defined by section 36 of the InvG is € 464 million. There are € 4 million in hidden reserves on the AllianzGI MMS I Global Fund. Distributions on AllianzGI MMS Global Funds amounted to € 16.6 million during the financial year.

Subordinated assets

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

€ mn	31 Dec 2010	31 Dec 2009
Loans and advances to banks	-	38.0
Loans and advances to customers	18.5	22.2
Debt and other fixed-income securities	-	-
Equities and other non-fixed-income securities	0.8	0.7
Other assets	-	-

Movements in fixed assets:

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

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

As at 31 December 2010, the securities held as fixed assets include an ABS portfolio of high credit quality, bonds of North American financial institutions, as well as securities issued by public-sector entities from Eastern and Southern European countries. Securities with a nominal amount of € 7,072.8 million were not measured at the lower of cost or market. An examination of cost vs. market value as at 31 December 2010 did not indicate any temporary impairment. The difference between market value and book value (including effects from hedging relationships) amounted to € -431.2 million.

					Tangible fixed assets (Assets – item #12)	
€ mn	Debt and other fixed-income securities (Assets – item #5)	Participating interests (Assets – item #7)	Interests in affiliated companies (Assets – item #8)	Intangible fixed assets (Assets – item #11)	Office furniture and equipment	Land and buildings
Cost						
1 Jan 2010	**7,435.5**	**4.3**	**558.5**	**39.7**	**32.8**	**0.6**
Additions	447.2	0.0	77.3	1.8	2.6	-
Disposals	768.4	1.0	47.9	4.4	5.4	0.5
Changes in inventory / transfers	0.0	0.0	0.0	0.0	0.0	0.0
31 Dec 2010	**7,114.3**	**3.3**	**587.9**	**37.1**	**30.0**	**0.1**
Depreciation, amortisation and write-downs						
1 Jan 2010	**0.0**	**0.2**	**59.8**	**35.3**	**26.0**	**0.1**
Scheduled depreciation and amortisation	0.0	0.0	13.4	1.8	2.2	0.0
Extraordinary write-downs	0.0	0.0	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	3.4	5.4	0.1
Transfers	0.0	0.0	0.0	0.0	0.0	0.0
Write-ups	0.0	0.0	0.0	0.0	0.0	0.0
31 Dec 2010	**0.0**	**0.2**	**73.2**	**33.7**	**22.8**	**0.0**
Book value as at 31 Dec 2010	**7,114.3**	**3.1**	**514.7**	**3.4**	**7.2**	**0.1**
Book value as at 31 Dec 2009	7,435.5	4.1	498.7	4.4	6.9	0.5

€ mn	Book values 31 Dec 2010	Book values 31 Dec 2009
Participating interests	3.1	4.1
Interests in affiliated companies	514.7	498.7
Debt and other fixed-income securities	7,114.3	7,435.5

The option to aggregate non-trading assets, pursuant to section 34 (3) of the RechKredV, has been exercised.

The bank has rented the majority of business land and buildings used for its business operations from one of its subsidiaries.

As part of the transfer of some of the business activities from DEPFA Deutsche Pfandbrief Bank AG to Aareal Bank AG, goodwill has been capitalised and will be amortised over the associated useful life of ten years.

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

Other assets

Other assets include, in particular, € 27.3 million in tax receivables and € 25.2 million in receivables from profit and loss transfer agreements.

In the previous year, other assets included, in particular, € 258.7 million in assets recognised from currency translation and € 39.7 million in tax receivables.

Deferred taxes

At the beginning of the 2010 financial year, within the scope of the first-time application of BilMoG, deferred tax liabilities were increased by € 28 million, to € 51.8 million; deferred tax assets were reduced by € 6 million, to € 30.5 million; and deferred tax assets were recognised on tax loss carryforwards, in the amount of € 40 million. During 2010, deferred tax liabilities were reduced by € 12.2 million, to € 39.5 million, and deferred tax assets increased by € 26.7 million, to € 57.2 million. Deferred tax assets on tax loss carryforwards were reduced to € 19.1 million during 2010. Accordingly, as at 31 December 2010, € 76.3 million in deferred tax assets and € 39.5 million in deferred tax liabilities were reported. Deferrals are made in the amount of the assumed tax burden or relief in coming financial years based on the respective local tax rates for 2010.

Deferred tax assets of € 19 million relate to tax loss carryforwards. Deferred tax assets were also recognised for provisions for impending losses from executory contracts, as required under German commercial law, on flat-rate specific provisions for loans and advances to customers, on provisions for pensions, as well as for valuation differences for debt and fixed-income securities compared to their tax base.

Other liabilities

Other liabilities include, in particular, € 299.1 million in liabilities recognised from currency translation, and € 48.1 million in interest liabilities on silent participations.

In the previous year, other liabilities included € 43.5 million in interest liabilities on silent participations.

Subordinated liabilities

Subordinated funds raised in accordance with section 10 (5a) of the KWG do not provide for any early repayment obligation for Aareal Bank AG. In the event of liquidation or insolvency, claims on interest and principal from these liabilities are subordinated to the claims of all other creditors of Aareal Bank AG, which are not themselves subordinated. This also applies to those subordinated funds raised that are not specified in detail.

Total interest expenses for subordinated liabilities of € 42.7 million (2009: € 43.7 million) include € 11.0 million (2009: € 11.7 million) in deferred interest not yet due.

Aareal Bank AG has € 250.0 million in subordinated capital from Aareal Capital Funding LLC, DelawareWilmington, Delaware, USA, at its disposal. The amount exceeds 10 % of the aggregate nominal value of all subordinated liabilities; this bears an interest of 7.135 %. These subordinated funds are due for repayment on 31/12/2026. The bank has had a right to terminate, on a quarterly basis, since 31/12/2006; the creditors do not have any early termination rights.

Profit-participation certificates

The terms and conditions of the profit-participation certificates issued comply with the requirements of section 10 (5) of the KWG. It comprises the following profit-participation certificates issued by Aareal Bank AG:

€ mn	Nominal Amount	Issue currency	Interest rate (% p.a.)	Maturity
Bearer profit-participation cer	125.0	EUR	6.750	2002 - 2011
	100.0	EUR	6.375	2002 - 2011
	60.0	EUR	6.125	2003 - 2013
	285.0			
Registered profit-participatior	5.0	EUR	7.010	2002 - 2012
	10.0	EUR	7.010	2002 - 2012
	5.0	EUR	7.010	2002 - 2012
	10.0	EUR	7.010	2002 - 2012
	5.0	EUR	7.100	2002 - 2012
	10.0	EUR	7.150	2002 - 2012
	5.0	EUR	7.030	2002 - 2012
	5.0	EUR	7.220	2002 - 2016
	5.0	EUR	7.220	2002 - 2016
	5.0	EUR	6.080	2003 - 2013
	20.0	EUR	6.120	2003 - 2013
	5.0	EUR	6.310	2003 - 2017
	10.0	EUR	5.750	2004 - 2014
	2.0	EUR	5.470	2004 - 2014
	5.0	EUR	5.480	2004 - 2014
	5.0	EUR	5.380	2004 - 2016
	20.0	EUR	5.950	2004 - 2016
	6.0	EUR	5.830	2005 - 2017
	138.0			

Pursuant to the terms and conditions of issue, holders of profit-participation certificates have a claim on interest payments which takes precedence over the profit entitlements of shareholders. To the extent that a distribution would cause a net loss, said interest claim would be reduced, possibly down to zero, creating a claim for backpayment during the term of the certificates at the same time.

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

€ 28.0 million (2009: € 28.0 million) in interest expenses were incurred in 2010 with respect to profit-participation certificates issued.

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

Profit-participation certificates meet the requirements for liable equity capital pursuant to section 10 (5) of the KWG.

Purchase of treasury shares

The Company has been authorised by the Annual General Meeting held on 19 May 2010 to purchase and sell treasury shares, pursuant to section 71 (1) no. 7 of the AktG, until 18 May 2015. The volume of shares acquired for this purpose must not exceed 5 % of the Company’s share capital at the end of any day. The lowest price at which a share may be acquired is determined by the average closing price of the Company's shares in Xetra (or a comparable successor system) on the three last trading days on the Frankfurt/Main stock exchange prior to such purchase, or assumption of an obligation to purchase, less ten per cent (10 %). The highest price shall not exceed such average closing price plus ten per cent (10 %).

The Company was authorised at the same Annual General Meeting in accordance with section 71(1) no, 8 of the AktG to purchase own shares not exceeding 10 % of the bank's share capital for other purposes than securities trading until 18 May 2015. Shares may be acquired via the stock exchange or by means of a public offer to buy, directed at all shareholders. Neither the purchase price, excluding ancillary costs, (if the acquisition takes place via the stock market) nor the offering price, excluding ancillary costs, (in case of a public offer to buy) may exceed or fall below the average closing price of the bank's shares in Xetra (or a comparable successor system) during the three trading days prior to the purchase or the public announcement of the purchase offer by more than ten per cent (10 %).

Said authorities were not utilised. No treasury shares were held at the end of the year under review.

Development of shareholders' equity reported on the balance sheet

	Subscribed capital	Capital reserves	Retained earnings		Net retained profit	Equity
			Legal reserve	Other retained earnings		
€ mn						
1 Jan 2010	**873.5**	**509.5**	**4.5**	**673.3**	**2.0**	**2,062.8**
First-time application of the BilMoG				9.5		
(of which: contributions by silent partners)	(745.2)	**0.0**	**0.0**	**0.0**	**0.0**	(745.2)
Addition from net retained profit 2009	0.0	0.0	0.0	2.0	0.0	2.0
Addition from net income 2010	0.0	0.0	0.0	0.0	0.0	0.0
Partial repayment of SoFFin silent participation	-150.0					
31 Dec 2010	**723.5**	**509.5**	**4.5**	**684.8**	**0.4**	**1,922.7**
(of which: contributions by silent partners)	(595.2)					(595.2)

Subscribed capital amounts to € 128.3 million and is divided into 42,755,159 bearer shares at a nominal amount of € 3.00 per share.

On 31 March 2009, the German Financial Markets Stabilisation Fund (SoFFin) provided a € 525 million silent participation to Aareal Bank AG, agreed upon as part of the package of support measures on 15 February 2009. This perpetual silent participation bears interest at 9 % p.a. On 16 July 2010, Aareal Bank AG repaid a first tranche of € 150 million of the € 525 million silent participation provided by the German Financial Markets Stabilisation Fund (SoFFin).

Aareal Bank has opted to determine regulatory indicators at Group level only from 2007 onwards; as a result of this waiver, regulatory details no longer need to be disclosed at a single-entity level.

Authorised capital

Aareal Bank has authorised capital pursuant to the resolution by the Annual General Meeting held on 19 May 2010. Accordingly, the Management Board is authorised to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 64,132,500 (Authorised Capital) by issuance of new bearer shares for contribution in cash or in kind (where such contribution may represent the full contribution, or part thereof), subject to the approval of the Supervisory Board; this authority will expire on 18 May 2015. In the event of a capital increase against cash contributions, the shareholders shall be granted a subscription right, unless the Management Board exercises its authority to exclude shareholder's pre-emptive subscription rights. The Management Board may exclude shareholders' subscription rights, subject to approval by the Supervisory Board and the conditions set out below:

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

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

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

d. Up to an amount of € 4,000,000 in order to offer employees (of the Company or its affiliated companies) shares for subscription.

In the event of a capital increase against contributions in kind, the Management Board is authorised to exclude shareholders' subscription rights, subject to the approval by the Supervisory Board. When exercising this authorisation, the Management Board will restrict the exclusion of shareholders' pre-emptive rights to a total of 20 % of the Company's registered share capital. Accordingly, the aggregate exclusion of shareholders' subscription rights upon exercise of this authorisation must not exceed 20 % of the registered share capital at the time said authorisation comes into effect or is exercised.

This authority was not exercised in the year under review.

Conditional capital

The share capital is subject to a conditional capital increase of up to € 30 million by means of issuing up to 10 million new no-par value bearer shares, with a share in the Company's share capital of € 3.00 each. Such conditional capital increase serves to enable the company to service convertible bonds and/or bonds with warrants on the basis of the authorisation resolution of the Annual General Meeting held on 19 May 2010. Said resolution authorised the Management Board, subject to the consent of the Supervisory Board, to issue, on one or more occasions until 18 May 2015, convertible bonds and/or bonds cum warrants with a limited or an unlimited term in an aggregate nominal amount of € 600 million and to grant option and/or conversion rights to bearers or holders of bonds with regard to no-par value bearer shares of the Company, equivalent to a share in the share capital of up to € 30 million.

The bonds may be issued in euro as well as in any other currency - with the corresponding equivalent value - which is the legal tender of, for example, an OECD member state. They may also be issued via an indirect or a direct subsidiary of the Company; in this case, the Management

Board is authorised, subject to the consent of the Supervisory Board, to issue a guarantee with regard to the bonds on behalf of the Company and to grant to the bondholders conversion or option rights to no-par value bearer shares of the Company.

The conditional capital increase will be executed only to the extent that holders of conversion or option rights exercise such rights or any conversion obligation from such convertible bonds and/or bonds with warrants are performed, and to the extent that treasury shares are not utilised to service such convertible bonds and/or bonds with warrants. The new shares will be entitled to a share in the profits from the beginning of the financial year in which they come into existence through the exercise of conversion or option rights or the performance of conversion obligations.

No convertible bonds or warrants were in issue as at the balance sheet date. Neither said authorisation nor conditional capital were exercised or utilised in the year under review.

Contingent liabilities and other commitments

Contingent liabilities as at 31 December 2010 include € 62.8 million (2009: € 71.4 million) in maximum default guarantees extended to DEPFA Deutsche Pfandbriefbank AG (within the scope of splitting the former DEPFA Group), for the purpose of providing cover against risks of default with respect to the property loan portfolio held by pbb Deutsche Pfandbriefbank AG.

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

Irrevocable loan commitments are made up of credit and loan commitments. Of the total amount, € 79.2 million (2009: € 117.8 million) relates to domestic borrowers and € 1,714.5 million (2009: € 1,573.1 million) to foreign borrowers.

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

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

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

Remaining terms

€ mn	31 Dec 2010	31 Dec 2009
Loans and advances to banks	**2,360.4**	**1,488.9**
Payable on demand	834.0	423.4
Up to 3 months	818.4	225.3
Between 3 months and 1 year	30.3	43.3
Between 1 year and 5 years	59.4	136.8
More than 5 years	132.1	140.3
Pro rata interest	486.2	519.8
Loans and advances to customers	**24,534.5**	**22,915.4**
Up to 3 months	2,098.7	1,505.4
Between 3 months and 1 year	2,949.4	2,219.8
Between 1 year and 5 years	13,825.5	12,997.4
More than 5 years	5,511.6	6,061.0
Indefinite maturity	-	-
Pro rata interest	149.3	131.8
Debt and other fixed-income securities maturing in the following year (nominal amount)	**789.3**	**621.1**
Liabilities to banks	**5,421.9**	**5,336.1**
Payable on demand	588.1	657.2
Up to 3 months	1,331.2	2,925.7
Between 3 months and 1 year	2,416.9	724.2
Between 1 year and 5 years	462.2	388.5
More than 5 years	275.9	298.3
Pro rata interest	347.6	342.2
Savings deposits with agreed notice period	**0.0**	**0.0**
Up to 3 months	0.0	0.0
Between 3 months and 1 year	0.0	0.0
Between 1 year and 5 years	0.0	0.0
Pro rata interest	0.0	0.0
Other liabilities to customers	**22,803.6**	**21,402.8**
Payable on demand	3,870.6	3,605.6
Up to 3 months	2,732.8	3,259.9
Between 3 months and 1 year	2,234.0	1,500.5
Between 1 year and 5 years	4,169.5	3,651.1
More than 5 years	9,486.5	9,075.2
Pro rata interest	310.2	310.5
Bonds issued maturing in the following year (nominal amount)	**2,025.4**	**2,427.0**
Other certificated liabilities	**0.0**	**0.0**

Deferred items

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

Deferred assets in the amount of € 135.0 million (2009: € 123.9 million) include € 4.7 million (2009: € 7.0 million) in premiums on originated loans, in accordance with section 340e (2) sentence 3 of the HGB, as well as € 40.1 million (2009: € 29.6 million) in discounts on bonds issued and borrowings pursuant to section 250 (3) of the HGB as well as € 89.1 million (2009: € 86.2 million) from upfront payments/option premiums related to derivatives.

€ 5.5 million (2009: € 9.2 million) of deferred liabilities (total 2010: € 115.2 million; total 2009: € 114.5 million) refers to discounts on originated loans, in accordance with section 340e (2) sentence 2 of the HGB, and to upfront payments/option premiums related to derivatives in the amount of € 107.9 million (2009: € 103.9 million).

Trust business

€ mn	Trust assets 31 Dec 2010
Loans and advances to banks	-
Loans and advances to customers	539.9
Equities and other non-fixed-income securities	1.5
Total	**541.4**

€ mn	Trust liabilities 31 Dec 2010
Liabilities to banks	415.4
Liabilities to customers	126.0
Total	**541.4**

€ mn	Trust assets 31 Dec 2009
Loans and advances to banks	-
Loans and advances to customers	624.5
Equities and other non-fixed-income securities	1.5
Total	**626.0**

€ mn	Trust liabilities 31 Dec 2009
Liabilities to banks	418.8
Liabilities to customers	207.2
Total	**626.0**

Notes on affiliated companies and enterprises with a participatory interest

	Affiliated companies 2010		Enterprises with a participatory interest 2010		Affiliated companies 2009		Enterprises with a participatory interest 2009	
€ mn	Certificated	Not certificated	Certificated	Not certificated	Certificated	Not certificated	Certificated	Not certificated
Loans and advances to banks	-	-	-	-	-	312.0	-	-
Loans and advances to customers	-	1,848.7	-	-	-	1,765.1	-	-
Debt and other fixed-income securities	-	-	-	-	-	-	-	-
Liabilities to banks	-	-	-	-	-	19.0	-	-
Liabilities to customers	-	341.2	-	1.0	-	255.7	-	0.8
Certificated liabilities	-	-	-	-	-	-	-	-
Subordinated liabilities	-	250.0	-	-	-	250.0	-	-

Shareholdings

As at 31 December 2010, Aareal Bank AG holds interests in the following companies within the meaning of section 271 (1) of the HGB. In contrast to the disclosure on the balance sheet, this list includes companies in which the bank holds an indirect interest (section 285 no. 11 of HGB).

No.	Company name	Registered office	Share in capital (%)	Equity (Euro mn)	Results (Euro mn)
1	Aareal Bank AG	Wiesbaden			
2	Aareal Bank Asia Ltd.	Singapore	100.0	4.1 mn S $	0.0 mn S $ 1)
3	Aareal Bank Capital Funding LLC	Wilmington	100.0	250.0	0.0
4	Aareal Bank Capital Funding Trust	Wilmington	100.0	0.0	0.0
5	Aareal Capital Corporation	Wilmington	100.0	174.1 mn USD	25.7 mn USD
6	Aareal Estate AG	Wiesbaden	100.0	2.8	0.0 3)
7	Aareal Financial Service Polska Sp.z o.o.	Warsaw	100.0	2.1 mn PLN	0.0 mn PLN 2)
8	Aareal First Financial Solutions AG	Wiesbaden	100.0	3.2	0.0 3)
9	Aareal Gesellschaft für Beteiligungen und Grundbesitz Dritte mbH & Co. KG	Wiesbaden	100.0	0.8	-3.5 1)
10	Aareal Gesellschaft für Beteiligungen und Grundbesitz Erste mbH & Co. KG	Wiesbaden	94.9	0.1	0.0 1)
11	Aareal IT Beteiligungen GmbH	Wiesbaden	100.0	145.0	0.0 3)
12	Aareal Partecipazioni S.p.A.	Rome	100.0	6.9	0.0 2)
13	Aareal Participations France S.à.r.l.	Paris	100.0	1.8	0.0 2)
14	Aareal Property Services B.V.	Amsterdam	100.0	29.8	0.1 1)
15	Aareal Valuation GmbH	Wiesbaden	100.0	0.5	0.0 3)
16	Aareal-Financial Service, spol. s r.o.	Prague	100.0	31.5 mn CZK	0.2 mn CZK 2)
17	Aareon AG	Mainz	100.0	72.9	11.3
18	Aareon Deutschland GmbH	Mainz	100.0	32.2	0.0 3)
19	Aareon France S.A.S.	Meudon-la Forêt	100.0	3.8	1.3
20	Aareon Immobilien Projekt GmbH	Oberhausen	51.0	0.8	0.0
21	Aareon Software Handelsgesellschaft mbH	Mainz	100.0	-0.5	0.2
22	Aareon UK Ltd.	Coventry	100.0	2.1	0.2
23	Aareon Wodis GmbH	Dortmund	100.0	2.0	0.0 3)
24	arsago Alternative Investments SPC	Grand Cayman	67.0	n/a	n/a
25	Aufbaugesellschaft Prager Straße mbH	Dresden	100.0	0.1	0.0 1)
26	BauBo Bau- und Bodenverwertungs- und -verwaltungsgesellschaft mbH	Wiesbaden	100.0	13.5	0.0 3)
27	BauContact Immobilien GmbH	Wiesbaden	100.0	31.2	1.0
28	BauGrund Immobilien-Management GmbH	Bonn	100.0	0.5	0.0 3)
29	BauGrund TVG GmbH	Munich	100.0	0.2	0.0
30	BauSecura Versicherungsmakler GmbH	Hamburg	51.0	2.5	2.4
31	Capital Funding GmbH & Co. KG	Frankfurt	100.0	0.0	0.0 1) 5)
32	Deutsche Bau- und Grundstücks-Aktiengesellschaft	Berlin	100.0	1.7	-0.1
33	Deutsche Structured Finance GmbH	Frankfurt	100.0	0.1	-4.8
34	Deutsche Structured Finance GmbH & Co. Alphard KG	Frankfurt	100.0	1.2	0.1
35	Deutsche Structured Finance GmbH & Co. Deneb KG	Frankfurt	100.0	3.4	0.3
36	Deutsche Structured Finance GmbH & Co. Titan KG	Frankfurt	100.0	0.0	0.2
37	DSF Aircraft Leasing (Ireland) Limited	Dublin	100.0	0.0	0.0 1)
38	DSF Anteils GmbH	Frankfurt	100.0	0.1	-0.5
39	DSF Beteiligungsgesellschaft mbH	Frankfurt	100.0	0.1	0.1 1)
40	DSF Dritte Verwaltungsgesellschaft mbH	Frankfurt	100.0	0.0	0.0 1)
41	DSF Elfte Verwaltungsgesellschaft mbH	Frankfurt	100.0	0.0	0.0 1)
42	DSF Energia Naturale S.r.l.	Rome	100.0	0.0	0.0 2)
43	DSF Flugzeugportfolio GmbH	Frankfurt	100.0	-0.3	-0.4
44	DSF Fünfzehnte Verwaltungsgesellschaft mbH	Frankfurt	100.0	0.0	0.0 1)
45	DSF German Office Fund GmbH & Co. KG	Frankfurt	94.0	3.6	0.3
46	DSF Immobilienverwaltung GmbH	Frankfurt	100.0	0.0	0.0 1)
47	DSF LUX INTERNATIONAL S.à.r.l	Luxembourg	100.0	0.3	0.4 1)
48	DSF Neunte Verwaltungsgesellschaft mbH	Frankfurt	100.0	0.0	0.0 1)
49	DSF Sechzehnte Verwaltungsgesellschaft mbH	Frankfurt	100.0	0.0	0.0 1)
50	DSF Solar Italien GmbH & Co. KG	Frankfurt	100.0	0.0	0.0 4)
51	DSF Treuhand GmbH	Frankfurt	100.0	0.0	0.0 1)
52	DSF Verwaltungsgesellschaft mbH	Frankfurt	100.0	0.0	0.0 1)
53	DSF Vierte Verwaltungsgesellschaft mbH	Frankfurt	100.0	4.9	0.1
54	DSF Zwölfte Verwaltungsgesellschaft mbH	Frankfurt	100.0	0.3	0.0 1)
55	GEV GmbH	Wiesbaden	100.0	52.9	0.0 3)
56	IMMO Consulting S.p.A.	Rome	95.0	0.7	0.0 2)

1) Preliminary figures as at 31 December 2010 2) Capital/reserves and profit/loss as at 31 December 2009
3) Profit transfer agreement / control and profit transfer agreement
4) Difference financial year 5) 10% of the voting rights, diverging from the equity interest held n/a No data

No.	Company name	Registered office	Share in capital (%)	Equity (Euro mn)	Results (Euro mn)
57	IV Beteiligungsgesellschaft für Immobilieninvestitionen mbH	Wiesbaden	100.0	0.2	0.2
58	La Sessola S.r.l.	Rome	100.0	44.6	-1.7 2)
59	Main Triangel GmbH	Frankfurt	75.0	12.7	-2.6 1)
60	Main Triangel Gastronomie GmbH	Wiesbaden	100.0	0.7	-0.3 1)
61	Mercadea S.r.l.	Rome	100.0	4.0	0.1 2)
62	PLP Holding GmbH	Wiesbaden	100.0	0.0	0.0
63	Real Verwaltungsgesellschaft mbH	Idstein	100.0	27.2	0.7 1)
64	Rehabilitationsklinik Barby Besitzgesellschaft mbH	Barby/Elbe	100.0	-7.5	0.8 1)
65	Rehabilitationsklinik Templin Besitzgesellschaft mbH	Templin	100.0	-3.7	0.4
66	SaPiVerno Sole S.r.l. & Co. S.a.s.	Rome	100.0	0.0	0.0 2)
67	SG Automatisering B.V.	Emmen	100.0	6.9	2.3
68	SG | Detachering B.V.	Emmen	100.0	n/a	n/a
69	SG | Facilitor B.V.	Enschede	51.0	0.7	0.2
70	SG | Professional Services B.V.	Emmen	100.0	0.0	0.0
71	SG | stravis B.V.	Emmen	70.0	0.0	0.0
72	SG | webbsolutions B.V.	Enschede	51.0	0.0	0.0
73	Sole Giano S.r.l. & Co. S.a.s.	Rome	100.0	0.0	0.0 2)
74	Sustainable Solar Future - Hellas Limited Liability Company	Athen	99.0	0.0	0.0 1)
75	Sustainable Solar Future Northern - Hellas Limited Liability Company	Athen	99.0	0.0	0.0 1)
76	Sustainable Solar Thermal Future East - Crete Limited Liability Company	Heraklion	99.0	0.5	0.0 1)
77	Terrain-Aktiengesellschaft Herzogpark	Wiesbaden	99.9	4.7	0.0 3)
78	Vernotico Energia Naturale S.r.l. & Co. S.a.s.	Rome	100.0	0.0	0.0 2)
79	ZAO Toros	Moscow	100.0	-403 mn RUB	80 mn RUB 2)
80	Woodside S.à.r.l.	Paris	100.0	-0.5	-0.1
81	ZMP Zentral Messepalast Entwicklungsgesellschaft mbH	Wiesbaden	100.0	66.3	0.0 3)
82	B & P / DSF Windpark GbR	Frankfurt	50.0	0.1	0.8
83	Bavaria Solar I Verwaltungsgesellschaft mbH	Frankfurt	24.0	0.0	0.0 1)
84	berlinbiotechpark Management GmbH	Berlin	50.0	0.1	0.0 1)
85	berlinbiotechpark Verwaltung GmbH	Berlin	50.0	0.1	0.0 1)
86	Deutsche Operating Leasing AG	Frankfurt	19.4	-1.8	14.2 4)
87	DSF berlinbiotechpark Verwaltungsgesellschaft mbH	Frankfurt	50.0	0.1	0.0 1)
88	DSF PP Justizzentrum Thüringen GmbH & Co. KG	Frankfurt	48.4	0.4	-0.1 2)
89	DSF Vierzehnte Verwaltungsgesellschaft mbH	Frankfurt	50.0	0.1	0.0
90	DSF Zehnte Verwaltungsgesellschaft mbH	Frankfurt	50.0	0.0	0.0 1)
91	Fachklinik Lenggries GmbH	Lenggries	49.0	0.0	0.0 1)
92	Innovative Banking Solutions AG	Wiesbaden	49.0	1.4	-0.9 4)
93	Rehabilitationsklinik Uckermark GmbH	Templin	49.0	n/a	n/a
94	SG2ALL B.V.	Huizen	50.0	0.2	0.1
95	Treu Verwaltungsgesellschaft mbH	Bad Salzungen	49.0	0.0	0.0
96	Treu Verwaltungsgesellschaft mbH Heimstatt & Co. KG	Bad Salzungen	49.0	0.1	0.0
97	Westhafen Haus GmbH & Co. Projektentwicklungs KG	Frankfurt	25.0	-0.3	-0.3 2)
98	Westhafen-Gelände Frankfurt am Main GbR	Frankfurt	33.3	1.5	0.0 2)
99	Windpark Ahlerstedt Verwaltungsgesellschaft mbH	Frankfurt	20.0	0.0	0.0
100	Windpark Borsum Verwaltungsgesellschaft mbH	Frankfurt	20.0	0.0	0.0
101	Windpark Portfolio Verwaltungs GmbH	Freiburg	20.0	0.1	0.0

1) Preliminary figures as at 31 December 2010 2) Capital/reserves and profit/loss as at 31 December 2009
3) Profit transfer agreement / control and profit transfer agreement
4) Difference financial year 5) 10% of the voting rights, diverging from the equity interest held n/a No data

Assets pledged as collateral

Total assets pledged as collateral:

€ mn	31 Dec 2010	31 Dec 2009
Loans and advances to banks	773.4	386.8
Loans and advances to customers	-	-
Debt and other fixed-income securities	3,741.9	3,856.4
Total	**4,515.3**	**4,243.2**

Repurchase agreements

The book value of bonds pledged under repo agreements totalled € 2,642.1 million (2009: € 3,228.4 million) as at 31 December 2010.

Assets and liabilities in foreign currencies

The aggregate equivalent amount of assets denominated in foreign currencies, calculated pursuant to the German Solvency Regulation (*Solvabilitätsverordnung* – "SolvV"), was € 11,342.3 million (2009: € 10,270.0 million) at the balance sheet date, while liabilities totalled € 11,356.3 million (2009: € 10,169.9 million).

Forward transactions

The following forward transactions had been entered into as at 31 December 2010:

• Transactions based on interest rates

Caps, floors, swaptions, interest rate swaps

• Transactions based on exchange rates

Spot and forward foreign exchange transactions, cross-currency interest rate swaps

• Other transactions

Credit default swaps, credit-linked notes, other forward transactions

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

Derivatives used to hedge interest or exchange rate risks are valued together with the underlying transaction; no individual valuation of underlying transaction and derivative is carried out.

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

€ mn	Up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total 31 Dec 2010
31 Dec 2010					
Interest rate instruments					
Interest rate swaps					
Cash inflows	356.6	872.2	3,433.6	1,291.6	5,954.0
Cash outflows	318.7	720.8	3,096.7	1,314.7	5,450.9
Forward Rate Agreements					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Swaptions					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	0.2	-	0.2
Caps, floors					
Cash inflows	1.3	5.0	14.8	0.7	21.8
Cash outflows	1.5	5.0	14.8	0.7	22.0
Currency-related instruments					
Spot and forward foreign exchange contracts					
Cash inflows	2,479.4	11.2	-	-	2,490.6
Cash outflows	2,491.8	11.1	-	-	2,502.9
Cross-currency swaps					
Cash inflows	531.3	2,904.3	4,567.3	280.1	8,283.0
Cash outflows	571.8	3,000.2	4,713.6	270.6	8,556.2
Other transactions					
Credit default swaps					
Cash inflows	0.3	0.7	3.4	1.1	5.5
Cash outflows	-	3	5	-	8.1
Options, futures					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Other derivative transactions					
Cash inflows	-	-	-	-	-
Cash outflows	1.8	-	1.1	-	2.9
Total cash inflows	**3,368.9**	**3,793.4**	**8,019.1**	**1,573.5**	**16,754.9**
Total cash outflows	**3,385.6**	**3,740.0**	**7,831.6**	**1,586.0**	**16,543.2**

€ mn	Up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total 31 Dec 2009
31 Dec 2009					
Interest rate instruments					
Interest rate swaps					
Cash inflows	377.1	895.3	3,897.2	1,510.2	6,679.8
Cash outflows	285.3	741.5	3,581.5	1,440.1	6,048.4
Forward Rate Agreements					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Swaptions					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	0.4	-	0.4
Caps, floors					
Cash inflows	1.4	5.2	14.3	1.0	21.9
Cash outflows	1.7	5.8	14.5	1.0	23.0
Currency-related instruments					
Spot and forward foreign exchange contracts					
Cash inflows	1,881.6	65.5	-	-	1,947.1
Cash outflows	1,915.4	66.2	-	-	1,981.6
Cross-currency swaps					
Cash inflows	661.2	2,691.7	3,941.3	583.7	7,877.9
Cash outflows	650.3	2,554.9	3,872.4	546.0	7,623.6
Other transactions					
Credit default swaps					
Cash inflows	0.8	0.9	6.4	2.5	10.6
Cash outflows	-	3.7	6.0	-	9.7
Options, futures					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Other derivative transactions					
Cash inflows	-	-	-	-	-
Cash outflows	1.2	-	1.6	-	2.8
Total cash inflows	**2,922.1**	**3,658.6**	**7,859.2**	**2,097.4**	**16,537.3**
Total cash outflows	**2,853.9**	**3,372.1**	**7,476.4**	**1,987.1**	**15,689.5**

The following table shows positive and negative market values, aggregated by product level (without taking into account collateral or netting agreements):

Unless a quoted market price is available, derivatives are measured using generally accepted methods on the basis of current market parameters (yield curves, volatility factors, etc.). Methods used include standard methods and models such as discounted cash flow analyses and option pricing models. Structured products are measured after they have been split into their individual components. Fair values including accrued interest are given for derivative financial instruments not recognised at fair value as at 31 December 2010.

€ mn	Market value as at 31 Dec 2010 positive	Market value as at 31 Dec 2010 negative	Market value as at 31 Dec 2009 positive	Market value as at 31 Dec 2009 negative
Interest rate instruments				
OTC products				
Interest rate swaps	1,583.9	1,351.9	1,564.6	1,209.0
Swaptions	-	0.2	-	0.4
Caps, floors	18.5	18.7	18.5	19.5
Forward Rate Agreements	-	-	-	-
Total interest rate instruments	**1,602.4**	**1,370.8**	**1,583.1**	**1,228.9**
Currency-related instruments				
OTC products				
Spot and forward foreign exchange transactions	20.6	32.5	6.1	40.7
Cross-currency interest rate swaps	136.9	426.8	350.4	135.0
Total currency-related instruments	**157.5**	**459.3**	**356.5**	**175.7**
Other transactions				
OTC products				
Credit default swaps	-	25.3	-	23.6
Credit Linked Notes	-	-	-	-
Other derivative transactions	1.1	1.1	1.8	1.8
Exchange-listed contracts	-	-	-	-
Futures	-	-	-	-
Total other transactions	**1.1**	**26.4**	**1.8**	**25.4**
Total	**1,761.0**	**1,856.5**	**1,941.4**	**1,430.0**

Derivatives have been entered into with the following counterparties:

€ mn	Market value as at 31 Dec 2010 positive	Market value as at 31 Dec 2010 negative	Market value as at 31 Dec 2009 positive	Market value as at 31 Dec 2009 negative
OECD public-sector entities				
OECD banks	1,536.3	1,842.1	1,664.0	1,419.9
Non-OECD banks				
Companies and private individuals	224.7	14.4	277.4	10.1
Total	**1,761.0**	**1,856.5**	**1,941.4**	**1,430.0**

Remuneration report

Principles of the remuneration of the Management Board

The Supervisory Board determines the structure and amount of remuneration for members of the Management Board.

In view of the conclusion of the agreement entered into with the Financial Markets Stabilisation Fund (SoFFin), the members of the Management Board waived the portion of the contractually fixed remuneration exceeding € 500,000 as well as the variable remuneration component for the financial years 2009 and 2010, respectively.

Aareal Bank AG has entered into fixed-term service contracts with the members of its Management Board. In addition to fixed salary components, which are paid in twelve identical monthly instalments, the members of the Management Board receive a cash bonus in form of a variable remuneration and are granted phantom shares as a long-term remuneration. The basis for this variable remuneration component is a target system, largely based on net income (of the Group) as reported under International Financial Reporting Standards (IFRSs), as well as qualitative and quantitative targets, which are re-defined annually. The remuneration for Mr Dirk Große Wördemann, who joined the Management Board effective 1 November 2010, is based on the German Regulation Governing Supervisory Requirements for Remuneration Systems of Institutions (*Instituts-Vergütungsverordnung*). Further specifications for variable remuneration will be defined in the context of the further implementation of the abovementioned regulation.

Remuneration

Remuneration of the members of the Management Board is broken down as follows:

€	Year	Fixed remuneration	Cash bonus	Other[1]	Total
Dr. Wolf Schumacher	2010	500,000.00	-	25,260.61	525,260.61
	2009	500,000.00	-	25,269.47	525,269.47
Dirk Große Wördemann [2]	2010	83,333.30	-	3,063.62	86,396.92
	2009	-	-	-	-
Norbert Kickum [3]	2010	416,666.70	-	2,581,107.19	2,997,773.89
	2009	500,000.00	-	29,161.42	529,161.42
Hermann J. Merkens	2010	500,000.00	-	48,965.16	548,965.16
	2009	500,000.00	-	48,901.86	548,901.86
Thomas Ortmanns	2010	500,000.00	-	27,187.71	527,187.71
	2009	500,000.00	-	23,323.02	523,323.02
Totals line	2010	2,000,000.00	-	2,685,584.29	4,685,584.29
	2009	2,000,000.00	-	126,655.77	2,126,655.77

[1] Other remuneration includes payments for company cars in the amount of € 86,234.36 in 2010 (2009: € 73,146.71) as well as benefits related to social security contributions totalling € 44,318.88 (2009: € 43,922.16).
[2] Appointed with effect from 1 November 2010
[3] Retired with effect from 31 October 2010. Other remuneration includes an amount of € 2,545,833.00 as a compensation for the fixed and variable remuneration claims for the remaining term of the employment contract until 31 March 2013.
No further benefits were granted to Norbert Kickum. The settlement of the phantom shares to which Norbert Kickum is entitled was made in accordance with the contractual regulations of the employment contract.

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

Long-term component

In 2010, the members of the Management Board did not receive payments from long-term components pursuant the terms and conditions of the share-based payment transactions, based on the agreement entered into with SoFFin.

	Year	Long-term component	
		Value at award date	Quantity
Euro			
Dr. Wolf Schumacher	2010	0.00	0.00
	2009	0.00	0.00
Dirk Große Wördemann [1]	2010	0.00	0.00
	2009	-	-
Norbert Kickum [2]	2010	0.00	0.00
	2009	0.00	0.00
Hermann J. Merkens	2010	0.00	0.00
	2009	0.00	0.00
Thomas Ortmanns	2010	0.00	0.00
	2009	0.00	0.00

[1] Appointed with effect from 1 November 2010
[2] Retired with effect from 31 October 2010

Pensions, retirement benefits and severance pay

The benefit regulations as agreed in the employment contract apply to the members of the Management Board of Aareal Bank. Accordingly, they are entitled to receive pension payments after completing their 60th year of age, or earlier in case of a permanent disability of service. The pension claims of the Management Board members who joined before 1 November 2010, are vested.

Members of the Management Board who joined the Company before 1 January 2005 are entitled to receive contractual pension payments in the amount of € 72,000, based on older contractual stipulations, before they reach the age of 60 when they have served for a period of five years, in case the bank rejects to extend their service contracts.

The following overview shows the pension claims of the members of the Management Board as at the balance sheet date as well as the related present values and the amounts recognised as provisions:

	2010			2009		
€ 000's	Pension claims p.a	Balance of pension provisions as at 31 Dec 2010	Increase of pension provisions in 2010	Pension claims p.a.	Balance of pension provisions as at 31 Dec 2009	Increase of pension provisions in 2009
Dr. Wolf Schumacher	350	1,961	1,108	350	853	284
Dirk Große Wördemann [1)]	200	28	28	-	-	-
Norbert Kickum [2)]	200	3,065	2,455	200	610	336
Hermann J. Merkens	200	997	558	200	439	109
Thomas Ortmanns	200	871	493	200	378	200
Total	**1,150**	**6,922**	**4,642**	**950**	**2,280**	**929**

[1)] Appointed with effect from 1 November 2010
[2)] Retired with effect from 31 October 2010. As a result of the retirement of Mr Kickum, the pension claims – which previously had been reported on a pro-rata basis until reaching pensionable age – had to be reported immediately in one single amount.

The pension claims are adjusted to take account of the development of standard wages within the private banking sector as from the beginning of actual payments of pensions.

The pension paid to widows amounts to 60 % of the pension of the member of the Management Board, while pensions to orphans and half-orphans amount to 20 % and 10 %, respectively.

Staff expenses incurred in the 2010 financial year in connection with the pension claims of members of the Management Board totalled € 2,877 thousand.

The pension provisions for active and former members of the Management Board and their surviving dependants were increased by a total of € 7,371 thousand (2009: € 1,093 thousand) in the year under review, bringing the total amount of pension provisions to € 18,004 thousand (2009: € 10,633 thousand). Of that amount, € 14,147 thousand relate to former members of the Management Board and their surviving dependants (2009: € 8,354 thousand). Payments to former Management Board members of Aareal Bank AG and their surviving dependants totalled € 579, thousand (2009: € 523 thousand).

As announced in the previous year, we implemented a Contractual Trust Arrangement (CTA) in 2010. For this purpose, we established Aareal Pensionsverein e.V. as trustee. The existing assets for the pension commitments towards members of the Management Board were transferred to Aareal Pensionsverein e.V. (by analogy with the current pension scheme for employees). Aareal Pensionsverein e.V. also protects the pension commitments previously not covered by the German Pension Guarantee Association (Pensionssicherungsverein; PSVaG).

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

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

Euro		Terminated by the company	Terminated by the Board member
Dr. Wolf Schumacher	per month of remaining contract term[1]	141,667	70,833
	One-off payment	350,000	225,000
Dirk Große Wördemann [2]	per month of remaining contract term[1]	120,833	54,167
	One-off payment	225,000	162,500
Norbert Kickum [3]	per month of remaining contract term[1]	120,833	54,167
	One-off payment	225,000	162,500
Hermann J. Merkens	per month of remaining contract term[1]	120,833	54,167
	One-off payment	225,000	162,500
Thomas Ortmanns	per month of remaining contract term[1]	120,833	54,167
	One-off payment	225,000	162,500

[1] Upon request of the member of the Management Board, the benefits may be paid in form of a one-off payment. In this case, the amount is
discounted using the the interest rate of the ECB for one-year deposits of private households in the month of payment.
[2] Appointed with effect from 1 November 2010;
the regulations for the change of control applicable to Mr. Große Wördemann are suspended for the term of the silent participation by SoFFin, pursuant to the employment contract.
[3] Retired with effect from 31 October 2010

Principles of the remuneration of the Supervisory Board

The remuneration of the Supervisory Board is specified in Section 9 of the Memorandum and Articles of Association of Aareal Bank AG. The resolution adopted by the Annual General Meeting on 23 May 2006, which resulted in a change of the remuneration system of the Supervisory Board, currently applies.

The total remuneration of the Supervisory Board comprises a fixed and a variable remuneration component, comparable to the remuneration package of the Management Board. The variable remuneration is performance-related and comprises a short-term and a long-term component.

The fixed remuneration is € 20,000 p.a. for each Supervisory Board member. The Chairman of the Supervisory Board shall receive twice the amount, while the deputy shall receive one and a half times as much as a normal member. The fixed remuneration shall be increased by € 10,000 p.a. for each membership in a Supervisory Board committee (with the exception of the Committee for Urgent Decisions, which is a part of the Risk Committee, as well as the Nomination Committee, which exclusively acts as an advisory committee). The fixed remuneration shall be increased instead by € 20,000 p.a. for Chairmanship of a Supervisory Board committee (also with the exception of the Committee for Urgent Decisions, which is a part of the Risk Committee, as well as the Nomination Committee, which exclusively acts as an advisory committee). The fixed remuneration component of a Supervisory Board member, including the remuneration for the Chairmanship of a Supervisory Board committee, forms a basis for assessing the performance-related remuneration.

The performance-related remuneration only comes into effect if a dividend of not less than € 0.20 per share is paid for the financial year in question.

The short-term performance-related remuneration currently amounts to 12.5 % of the individual assessment basis for each full € 50 million of the consolidated net income attributable to shareholders of Aareal Bank AG as reported in the Group income statement. However, it may not exceed 50 % of the individual assessment basis.

The long-term performance-related remuneration of a Supervisory Board member amounts to 12.5 % of the individual assessment basis for each 10 % increase in the consolidated net income attributable to shareholders of Aareal Bank AG (as reported in the consolidated income statement) over the unweighted average of the consolidated net income attributable to shareholders of Aareal

Bank AG for the three previous full financial years. The long-term profit-oriented remuneration is not paid if the average value is negative.

The maximum long-term performance-related remuneration is capped at 50 % of the individual assessment basis, so that the aggregate variable remuneration may amount to a maximum of 100 % of the fixed remuneration component.

The fixed remuneration is due at the end of each financial year. The variable remuneration component is due after the Annual General Meeting in which a resolution is passed on the appropriation of net income for the relevant financial year. The bank reimburses the VAT amounts to be paid on the remuneration.

In accordance with the methodology presented, the members of the Supervisory Board receive a fixed remuneration for the 2010 financial year in the amount of € 559,300.00, which is the same amount paid in 2009. The Management Board proposes to the Annual General Meeting that the net retained profit of Aareal Bank AG in the amount of € 400,000.00 for the financial year 2010, as reported under the German Commercial Code (HGB), be transferred to other retained earnings and that no dividends be paid. Therefore, as in the previous year, no variable remuneration will be paid to the members of the Supervisory Board.

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

Euro	Year	Fixed remuneration	Variable remuneration	Total remuneration
Hans W. Reich, Vorsitzender	2010	107,100.00	-	107,100.00
	2009	107,100.00	-	107,100.00
Erwin Flieger. stv. Vorsitzender	2010	59,500.00	-	59,500.00
	2009	59,500.00	-	59,500.00
York-Detlef Bülow, stv. Vorsitzender	2010	59,500.00	-	59,500.00
	2009	59,500.00	-	59,500.00
Tamara Birke [1)]	2010	13,784.17	-	13,784.17
	2009	35,700.00	-	35,700.00
Dieter Kirsch [2)]	2010	21,915.83	-	21,915.83
	2009	-	-	-
Thomas Hawel	2010	23,800.00	-	23,800.00
	2009	23,800.00	-	23,800.00
Helmut Wagner	2010	23,800.00	-	23,800.00
	2009	23,800.00	-	23,800.00
Christian Graf von Bassewitz	2010	47,600.00	-	47,600.00
	2009	47,600.00	-	47,600.00
Manfred Behrens	2010	23,800.00	-	23,800.00
	2009	23,800.00	-	23,800.00
Joachim Neupel	2010	59,500.00	-	59,500.00
	2009	59,500.00	-	59,500.00
Dr. Herbert Lohneiß	2010	35,700.00	-	35,700.00
	2009	35,700.00	-	35,700.00
Prof. Dr. Stephan Schüller	2010	47,600.00	-	47,600.00
	2009	47,600.00	-	47,600.00
Wolf R. Thiel	2010	35,700.00	-	35,700.00
	2009	35,700.00	-	35,700.00
Total	**2010**	**559,300.00**	**-**	**559,300.00**
	2009	**559,300.00**	**-**	**559,300.00**

1) Member until 19 May 2010
2) Member since 19 May 2010

The members of the Supervisory Board did not provide any consulting or agency services, or other personal services in 2010. Therefore, no additional remuneration was paid.

Cash-settled share-based payment

a) Description of cash-settled share-based payment

Key executive staff members were granted cash-settled share-based remuneration (so-called phantom shares or virtual shares) as a variable remuneration component. The relevant share plans are subject to slightly different regulations with respect to term and exercise criteria. The definition of executives in key positions within Aareal Bank Group includes members of management or supervisory bodies, plus first-level managers (heads of divisions).

Phantom share plan for members of the Management Board of Aareal Bank AG/ Long-term Component

The following regulations apply in relation to the granting of phantom shares for the members of the Management Board appointed before 1 November 2010.

- The beneficiaries receive a remuneration denominated in euro which will be converted into an equivalent number of phantom shares.
  The conversion is based on the weighted average price during the five (Xetra) trading days after the publication of the annual financial statements adopted by the Supervisory Board.
- One-fourth of the awarded phantom shares becomes exercisable each year. This also applies to the year of allocation. Phantom shares not exercised in a particular year will be accumulated.
- Phantom shares may be exercised within five business days after the publication of a quarterly report.
- There are no exercise thresholds in the form of a minimum share price appreciation target, or other market or performance-related criteria.
- Phantom shares that have not been exercised carry full dividend rights, i.e. the beneficiaries receive for each phantom share not yet exercised a cash payment equivalent to the amount of the approved dividend.

Virtual share plan for key executive staff (excluding members of the Management Board of Aareal Bank AG)

Key executive staff members, **excluding members of the Management Board of Aareal Bank AG**, are granted virtual shares in accordance with the following rules:

- The beneficiaries receive a remuneration denominated in euro which will be converted into an equivalent number of virtual shares. The basis for conversion is the average price of the Aareal Bank AG share on the date of publication of the annual report and the four subsequent trading days (subscription price).
- The shares resulting from such a grant are automatically exercised in the three years following the year of grant, with one third being exercised in each year.
- The basis for exercise is the average price of the Aareal Bank AG share on the date of publication of the annual report and the four subsequent trading days.
- There are no exercise hurdles in form of a minimum stock appreciation target or other market or performance-related criteria.
- With respect to virtual shares that have not been exercised, beneficiaries receive for each virtual share not yet exercised a cash payment equivalent to the amount of the approved dividend.

b) Valuation model and valuation assumptions

Valuation model

The cash-settled share-based payment transactions have the following structure: an option may be exercised at pre-determined dates, subject to a holding period, if applicable. The exercise period varies according to the relevant payment transaction.

According to the terms and conditions of the equity-settled share-based payment transactions, a dividend will be paid for each phantom or virtual share, irrespective of whether the option has been exercised or not. This means that an earlier exercise does not result in a separate claim for cash settlement in the amount of the dividend. Therefore, there is no reason for an earlier exercise of an option due to cash settlement. A Black-Scholes valuation model is used for the valuation of obligations under cash-settled, share-based remuneration transactions.

Valuation assumptions

The following probabilities for elementary events are used for the calculation of the probabilities of the occurrence of the exercise events:

- Death or invalidity: 0.2 % p.a. (members of the Management Board) and 0.175 % p.a. (executive staff)
- Termination of contract by employee: 0 % p.a. (members of the Management Board) and 2 % p.a. (executive staff)
- Termination of contract by employer (due to operational requirements or change of ownership): 0 % p.a. (members of the Management Board) and 2 % p.a. (executive staff)

The vesting of the rights is based on the individual equity-settled share-based payment transactions. It has been assumed, in the event of death or invalidity, that the outstanding option rights may be exercised immediately and in the full amount, irrespective of the extent of the rights earned until that date.

Options are valued using the Black-Scholes model. The relevant valuation parameters are ('+' indicates that value of the option increases when the relevant parameter increases):

- the price of the Aareal Bank share on the valuation date (+)
- the exercise price of the phantom or virtual share on the exercise date (-)
- the term to exercise date (+)
- the volatility of the change (in percent) of the price of the Aareal Bank share (+)
- the risk-free interest rate for a safe investment until the exercise date (+)

The Xetra closing price of the Aareal Bank AG share is determined on the valuation date. The exercise price for each cash-settled share-based payment transaction is nil since the beneficiary receives the full equivalent of a share upon exercise. There is no cash settlement in the amount of the dividend payment with respect to the phantom or virtual shares upon exercise since cash settlements for dividend payments are made irrespective of any exercise. The term of an option in the event tree is always the maximum time as contractually agreed until the exercise event. The exercise events "death/invalidity" or "termination" are always assumed to occur in the middle of future periods. The expected volatility (standard deviation) of the percentage change (return) of the Aareal Bank AG share price is calculated using the standard deviation of historical daily returns over a rolling 200-day reference period, which is equivalent to the lifetime of the option. The yield curve for risk-free German zero-coupon government bonds – as published daily by Deutsche Bundesbank – at the valuation date will be used to discount future payments.

c) Volume of cash-settled share-based payment transactions of key executive staff:

The number of phantom or virtual shares outstanding for **key executive staff** has changed as follows:

	2010 Quantity	2009 Quantity
Balance at 1 January	**831,404**	**599,876**
Granted	41,693	365,159
Expired	0	0
Exercised	300,745	133,630
Other	0	0
Balance as at 31 December	**572,352**	**831,405**
of which: exercisable	265,404	46,346

The phantom or virtual shares granted have a weighted average fair value of € 21.57 as at the balance sheet date.

d) Effects on financial position and performance

The total amount expensed for share-based payments was € 11.6 million (2009: € 5.4 million) during the financial year 2010. The portion of the total amount expensed attributable to members of the Management Board amounts to € 7.2 million (2009: € 3.6 million), and can be broken down to the individual members of the Management Board as follows.

Euro	2010	2009
Dr. Wolf Schumacher	1,786,199	907,956
Dirk Große Wördemann [1)]	-	-
Norbert Kickum [2)]	2,096,497	871,748
Hermann J. Merkens	1,854,944	885,895
Thomas Ortmanns	1,495,867	907,865

1) Appointed with effect from 1 November 2010
2) Retired with effect from 31 October 2010

The liability from share-based payments – reported under provisions – amounts to € 13.8 million (2009: € 5.2 million) as at 31 December 2010.

Other disclosures

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

Total amount and related cover assets pool of outstanding Mortgage Pfandbriefe and Public Sector Pfandbriefe

€ mn	Cover assets pool	Pfandbriefe outstanding	Excess cover
31 Dec 2010			
Mortgage Pfandbriefe			
Nominal value	9,503.9	8,237.4	1,266.5
Present value	10,090.1	8,370.7	1,719.4
Public-sector Pfandbriefe			
Nominal value	3,374.7	3,009.7	365.0
Present value	3,672.2	3,356.3	315.9

€ mn	Cover assets pool	Pfandbriefe outstanding	Excess cover
31 Dec 2009			
Mortgage Pfandbriefe			
Nominal value	9,181.0	7,367.6	1,813.4
Present value	9,862.2	7,651.2	2,211.0
Public-sector Pfandbriefe			
Nominal value	3,179.0	2,810.8	368.2
Present value	3,457.8	3,101.3	356.5

€ mn	Share of derivatives in the cover assets pool 2010	Share of derivatives in the cover assets pool 2009	Share of derivatives in Pfandbriefe 2010	Share of derivatives in Pfandbriefe 2009
Nominal value				
Mortgage Pfandbriefe	42.1	-	145.9	-
Public-sector Pfandbriefe	0.0	-	0.0	-
Present value				
Mortgage Pfandbriefe	12.7	189.3	0.0	0.0
Public-sector Pfandbriefe	80.1	73.7	0.0	0.0

€ mn	Share of further cover assets 2010	Share of further cover assets 2009
Mortgage Pfandbriefe	972.9	1,031.6
Public-sector Pfandbriefe	0.0	0.0

€ mn	Cover assets pool	Pfandbriefe outstanding	Excess cover
31 Dec 2010			
Risk-adjusted present value			
Mortgage Pfandbriefe	10,175.0	8,670.5	1,504.5
Public-sector Pfandbriefe	4,034.8	3,772.3	262.5

€ mn	Cover assets pool	Pfandbriefe outstanding	Excess cover
31 Dec 2009			
Risk-adjusted present value			
Mortgage Pfandbriefe	9,840.9	7,893.0	1,947.9
Public-sector Pfandbriefe	3,853.5	3,634.5	219.0

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

€ mn	Cover assets pool	Pfandbriefe outstanding
31 Dec 2010		
Mortgage Pfandbriefe		
Up to 1 year	1,911.7	1,721.8
Between 1 year and 2 years	1,314.1	1,344.7
Between 2 and 3 years	1,886.1	1,475.4
Between 3 and 4 years	1,523.1	813.7
Between 4 and 5 years	1,063.8	889.5
Between 5 and 10 years	1,516.9	1,586.2
More than 10 years	288.2	406.1
Total	**9,503.9**	**8,237.4**
Public-sector Pfandbriefe		
Up to 1 year	137.9	80.7
Between 1 year and 2 years	169.9	105.5
Between 2 and 3 years	494.1	662.3
Between 3 and 4 years	219.3	209.0
Between 4 and 5 years	91.6	70.4
Between 5 and 10 years	778.1	875.7
More than 10 years	1,483.8	1,006.1
Total	**3,374.7**	**3,009.7**

€ mn	Cover assets pool	Pfandbriefe outstanding
31 Dec 2009		
Mortgage Pfandbriefe		
Up to 1 year	1,329.2	1,196.5
Between 1 year and 2 years	1,620.3	1,713.6
Between 2 and 3 years	1,253.5	1,059.6
Between 3 and 4 years	1,343.5	955.8
Between 4 and 5 years	1,336.7	682.8
Between 5 and 10 years	1,983.4	1,596.7
More than 10 years	314.4	162.6
Total	**9,181.0**	**7,367.6**
Public-sector Pfandbriefe		
Up to 1 year	132.5	133.0
Between 1 year and 2 years	115.3	71.2
Between 2 and 3 years	159.7	146.3
Between 3 and 4 years	362.4	535.9
Between 4 and 5 years	105.5	197.2
Between 5 and 10 years	650.7	765.0
More than 10 years	1,652.9	962.2
Total	**3,179.0**	**2,810.8**

Loans and advances used to cover Mortgage Pfandbriefe

€ mn	Cover assets pool 2010	Cover assets pool 2009
Distribution of the amounts included in cover, measured at nominal value, by amount:		
Up to € 300,000	14.7	14.2
€ 300,000 to € 5 million	756.1	795.5
More than € 5 million	7,718.0	8,371.3
Total	**8,488.8**	**9,181.0**

As at the balance sheet date, the loans and advances used for lending against Mortgage Pfandbriefe included payment arrears of 90 days or more in the amount of € 0.9 million (2009: € 0.1 million), of which € 0.2 million refer to Denmark, € 0,4 million to France, € 0.1 million to Italy, and € 0.2 million to Spain. In the comparable period of the previous year, payment arrears of 90 days or more referred to Germany (€ 0.02 million) and Italy (€ 0.08 million).

Distribution of the amounts measured at nominal value by countries in which the real property collateral is located:

€ mn	Commercial property: Building plots only	Commercial property: Non-income-yielding new-built properties	Commercial property: Office buildings	Commercial property: Retail property	Commercial property: Industrial property	Commercial property: Other	Commercial property: Total	Residential property: Building plots only	Residential property: Non-income-yielding new-built properties	Residential property: Single-family homes	Residential property: Multi-family homes	Residential property: Flats/apartments	Residential property: Total	Total cover assets pool
31 Dec 2010														
Belgium		3.4	182.0	26.7	9.0	36.2	257.3							257.3
Denmark	5.3	11.4	77.2	27.3	13.4	70.0	204.6					2.7	2.7	207.3
Germany		10.8	184.4	84.0	225.1	188.9	693.2			5.3	0.9	738.3	744.5	1,437.7
Estonia			2.3	27.3			29.6							29.6
Finland			33.7	222.2	5.4	20.5	281.8							281.8
France	0.9		438.3	37.7	193.6	102.2	772.7							772.7
United Kingdom			104.7	199.4	87.8	225.5	617.4							617.4
Italy	71.0		592.4	354.1	57.5	89.9	1,164.9		11.8			83.3	95.1	1,260.0
Canada			80.2			126.8	207.0							207.0
Luxembourg			4.5				4.5							4.5
Netherlands			196.4	41.2	160.6	125.3	523.5					16.4	16.4	539.9
Norway				14.8	6.8		21.6							21.6
Poland			166.1	243.3	41.7		451.1							451.1
Sweden			312.2	74.1	244.7	27.2	658.2					82.5	82.5	740.7
Switzerland		56.5	100.2	40.5	3.7	70.1	271.0							271.0
Slovakia					6.6		6.6							6.6
Spain		103.3		295.8	5.5	55.4	460.0							460.0
Czech Republic	3.8		124.4	10.3	15.7	18.2	172.4							172.4
USA		188.7	104.4	252.1	31.6	111.1	687.9					62.3	62.3	750.2
Total	**81.0**	**374.1**	**2,703.4**	**1,950.8**	**1,108.7**	**1,267.3**	**7,485.3**	**0.0**	**11.8**	**5.3**	**0.9**	**985.5**	**1,003.5**	**8,488.8**

€ mn	Building plots only	Non-income-yielding new-built properties	Commercial property: Office buildings	Commercial property: Retail property	Commercial property: Industrial property	Commercial property: Other	Commercial property: Total	Residential property: Single-family homes	Residential property: Multi-family homes	Residential property: Flats/apartments	Residential property: Total	Total cover assets pool
31 Dec 2009												
Belgium		3.6	131.8	26.9	9.0	36.3	204.0					207.6
Denmark	10.8	65.7	94.0	27.6	14.6	24.4	160.6			2.7	2.7	239.8
Germany	1.4	10.8	170.4	79.7	252.2	197.8	700.1	0.8	3.1	795.9	799.8	1,512.1
Finland			35.7	225.8	5.4	20.5	287.4					287.4
France	1.9	2.9	418.0	46.5	194.8	61.3	720.6					725.4
United Kingdom			126.5	147.9	67.4	84.3	426.1					426.1
Italy	71.0	6.3	668.7	337.5	58.5	99.9	1,164.6			95.5	95.5	1,337.4
Canada			66.7			137.9	204.6					204.6
Luxembourg			4.5				4.5					4.5
Netherlands		13.8	150.7		173.2	104.4	428.3			16.4	16.4	458.5
Norway				14.3	6.4		20.7					20.7
Poland		89.3	182.6	153.5	44.5		380.6					469.9
Sweden			327.3	64.9	220.3	19.1	631.6			90.8	90.8	722.4
Switzerland		11.5	125.9	34.1	3.1	59.0	222.1					233.6
Spain		117.9		233.1	2.4	52.7	288.2					406.1
Republic of Slovakia					7.7		7.7					7.7
Czech Republic	3.8		128.0	9.7	16.2	70.0	223.9					227.7
USA		143.4	83.6	226.4	29.3	117.5	456.8			57.8	57.8	658.0
Total	**88.9**	**465.2**	**2,714.4**	**1,627.9**	**1,105.0**	**1,085.1**	**6,532.4**	**0.8**	**3.1**	**1,059.1**	**1,063.0**	**8,149.5**

In the financial year 2010, the bank did not acquire any properties for the purpose of loss prevention (2009: none).

As at 31 December 2010, interest payments were overdue in the amount of € 4.3 million (2009: € 1.6 million) for commercial property and in the amount of € 0.2 million (2009: € 0.1 million) for residential property.

As at 31 December 2010, there were no foreclosures or forced administration procedures pending.

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

€ mn	Sovereigns	Public-sector entities regional	Public-sector entities municipal	Other	Total
31 Dec 2010					
Germany	23.0	1,867.5	29.5	571.6	2,491.6
France	25.0			75.0	100.0
United Kingdom				7.5	7.5
Italy	134.0				134.0
Japan			20.0	50.0	70.0
Lithuania	25.0				25.0
Luxembourg				31.4	31.4
Netherlands	25.0				25.0
Austria	125.2	25.0		70.0	220.2
Poland	50.0				50.0
Portugal		30.0		25.0	55.0
Spain		140.0			140.0
Hungary				25.0	25.0
Total	**407.2**	**2,062.5**	**49.5**	**855.5**	**3,374.7**

€ mn	Sovereigns	Public-sector entities regional	Public-sector entities municipal	Other	Total
31 Dec 2009					
Germany	142.7	2,149.4	40.3	32.0	2,364.4
Italy	89.0				89.0
France	65.0				65.0
United Kingdom				7.5	7.5
Ireland	25.0				25.0
Austria	195.2	25.0			220.2
Spain		148.5	35.0		183.5
Netherlands	25.0				25.0
Hungary	25.0				25.0
Japan	50.0		20.0		70.0
Luxembourg				49.4	49.4
Portugal	25.0	30.0			55.0
Total	**641.9**	**2,352.9**	**95.3**	**88.9**	**3,179.0**

Neither at balance sheet date nor in the comparable period of the previous year did loans and advances used for lending against Public Sector Pfandbriefe include any items with payment arrears of 90 days or more.

Contingencies

By means of a letter of comfort, Aareal Bank AG ensures that Deutsche Structured Finance GmbH, Frankfurt, DSF Beteiligungsgesellschaft mbH, Frankfurt, DSF Zwölfte Verwaltungsgesellschaft mbH, Frankfurt, and Aareal Bank Capital Funding LLC, Wilmington are able to fulfil their contractual obligations.

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

Due to its participating interest in Liquiditäts-Konsortialbank GmbH, Frankfurt/Main, in the nominal amount of € 1 million, Aareal Bank AG has call commitments of up to € 6 million. In addition, Aareal Bank AG has a pro-rata principal liability in the event of non-fulfilment of call commitments by other co-shareholders, who hold aggregate interests of € 63 million.

Consolidated financial statements

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

Loans to executive bodies of Aareal Bank

Loans granted to members of the Supervisory Board amounted to € 1.2 million as at 31 Dec 2010 (31 Dec 2009: € 1.2 million). Loans and advances to members of the Management Board of Aareal Bank AG totalled € 0.0 million (2009: € 0.0 million). Total loans and advances to other related parties amounted to € 1.7 million (2009: € 2.0 million) as at the balance sheet date. Loans extended generally have a term between ten and 18 years, and bear interest at rates between 2.65 % and 5.66 % (2009: 3.06 % to 5.66 %).

Collateral was provided in line with usual market practice. During the year under review, repayments on loans extended to other related parties amounted to € 0.3 million, and repayments on loans extended to members of the Supervisory Board amounted to € 0.1 million.

Employees

The average staffing level is shown below:

Yearly average	1 Jan-31 Dec 2010	1 Jan-31 Dec 2009
Salaried employees	959	977
Executives	32	32
Total	**991**	**1,009**
of which: Part-time employees	164	157

Auditors' fees

The total fees charged by the auditor is as follows:

€ 000's	
Category	
Audit services	2,442.0
Other certification services	23.2
Tax advisory services	117.1
Other services	2,275.0
Total	**4,857.3**

Notice pursuant to sections 21 et seq. of the WpHG

Pursuant to the German Securities Trading Act (WpHG), any investor whose shareholding in a listed company reaches, exceeds or falls short of certain threshold values in terms of voting rights (whether by purchase, sale or by any other means) must notify the company and the German Federal Financial Supervisory Authority. The lowest threshold for this notification duty is 3 %. 62.77 % of Aareal Bank AG shares are held in free float. Aareal Holding Verwaltungsgesellschaft mbH is the company's largest shareholder, with a stake of 37.23 %.

On 04 November 2010, Deutsche Bank AG, London, UK, notified us of the following:

Pursuant to sections 21 (1), 24 WpHG (“German Securities Trading Act”) in conjunction with section 32 (2) InvG (“German Investment Act”), we hereby notify that the percentage of voting rights of our subsidiary DWS Investment GmbH, Frankfurt, Germany, in Aareal Bank AG, Wiesbaden, Germany, fell below the threshold of 5 % on 01 November 2010 and amounts to 4.983 % (2,130,354 voting rights) as per this date.

On 27 May 2010, Deutsche Bank AG, London, UK, notified us of the following:

Pursuant to sections 21 (1) 24 WpHG ("German Securities Trading Act), we hereby notify that the percentage of voting rights of our subsidiary DWS Investment GmbH, Frankfurt, Germany, in Aareal Bank AG, Wiesbaden, Germany, crossed above the threshold of 5 % on 19 May 2010 and amounts to 5.019 % (2,145,854 voting rights) as per this date.

On 21 April 2010, Deutsche Bank AG, London, UK, notified us of the following:

Pursuant to sections 21 (1), 24 WpHG ('German Securities Trading Act') in conjunction with section 32 (2) InvG ('German Investment Act'), we hereby notify that the percentage of voting rights of our subsidiary DWS Investment GmbH, Mainzer Landstraße 178-190, 60327 Frankfurt, Germany, in Aareal Bank AG, Paulinenstraße 15, D-65189 Wiesbaden, Germany, crossed above the threshold of 3 % on 15 April 2010 and amounts to 3.078 % (1,315,854 voting rights) as per this date.

German Corporate Governance Code

The declaration regarding the German Corporate Governance Code, pursuant to section 161 of the AktG, has been submitted and has been published on our website: http://www.aareal-bank.com/investor-relations/corporate-governance/entsprechenserklaerung-gemaess-161-aktg/.

Proposal on the appropriation of profits

The Management Board proposes to the Annual General Meeting that the net retained profit (*Bilanzgewinn*) of € 400,000.00 for the financial year 2010 be transferred to other retained earnings.

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

Supervisory Board

Hans W. Reich, Chairman of the Supervisory Board		
Chairman Public Sector Group, Citigroup Inc.		
Aareal Bank AG	Chairman of the Supervisory Board	
Citigroup Global Markets Deutschland AG & Co.KGaA	Chairman of the Supervisory Board	
HUK-COBURG Haftpflicht Unterstützungskasse kraftfahrender Beamter Deutschlands a. G. in Coburg	Member of the Supervisory Board	
HUK-COBURG-Holding AG	Member of the Supervisory Board	
Erwin Flieger, Deputy Chairman of the Supervisory Board		
Chairman of the Supervisory Boards of Bayerische Beamten Versicherungsgruppe		
Aareal Bank AG	Deputy Chairman of the Supervisory Board	
Bayerische Beamten Lebensversicherung a.G.	Chairman of the Supervisory Board	
Bayerische Beamten Versicherung AG	Chairman of the Supervisory Board	
BBV Holding AG	Chairman of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH	Chairman of the Supervisory Board	
MEAG MUNICH ERGO Kapitalanlagegesellschaft mbH	Member of the Supervisory Board	
Neue Bayerische Beamten Lebensversicherung AG	Chairman of the Supervisory Board	
York-Detlef Bülow*, Deputy Chairman of the Supervisory Board		
Aareal Bank AG		
Aareal Bank AG	Deputy Chairman of the Supervisory Board	
Christian Graf von Bassewitz,		
Banker (ret'd.); former Spokesman of the General Partners of Bankhaus Lampe KG		
Aareal Bank AG	Member of the Supervisory Board	
Balance Vermittlungs- und Beteiligungs-AG	Deputy Chairman of the Supervisory Board	until 13 Dec 2010
Bank für Sozialwirtschaft Aktiengesellschaft	Member of the Supervisory Board	
Deutscher Ring Krankenversicherungsverein a.G.	Deputy Chairman of the Supervisory Board	
OVB Holding AG	Member of the Supervisory Board	
OVB Vermögensberatung AG	Member of the Supervisory Board	since 1 Sep 2010
SIGNAL IDUNA Allgemeine Versicherung AG	Member of the Supervisory Board	
SIGNAL IDUNA Holding AG	Member of the Supervisory Board	
Societaet CHORVS AG	Member of the Supervisory Board	

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

Manfred Behrens
Chairman of the Management Board of AWD Holding AG

Aareal Bank AG	Member of the Supervisory Board	
AWD Allgemeiner Wirtschaftsdienst AG	Chairman of the Board of Directors	
tecis Finanzdienstleistungen AG	Chairman of the Supervisory Board	

Tamara Birke*
Aareal Bank AG

Aareal Bank AG	Member of the Supervisory Board	until 19 May 2010

Thomas Hawel*
Aareon Deutschland GmbH

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

Dieter Kirsch*
Aareal Bank AG

Aareal Bank AG	Member of the Supervisory Board	since 19 May 2010

Dr Herbert Lohneiß
Former Chief Executive Officer of Siemens Financial Services GmbH (ret'd.)

Aareal Bank AG	Member of the Supervisory Board	
UBS Global Asset Management (Deutschland) GmbH	Member of the Supervisory Board	

Joachim Neupel, Chairman of the Accounts and Audit Committee
German Chartered Accountant, tax advisor

Aareal Bank AG	Member of the Supervisory Board	

Prof Dr Stephan Schüller
Spokesman of the General Partners of Bankhaus Lampe KG

Aareal Bank AG	Member of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	
hanse chemie AG	Chairman of the Supervisory Board	
NANORESINS AG	Chairman of the Supervisory Board	
Universal-Investment-Gesellschaft mbH	Member of the Supervisory Board	

Wolf R. Thiel
President and Chairman of the Management Board of Versorgungsanstalt des Bundes und der Länder

Aareal Bank AG	Member of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	

Helmut Wagner *
Aareon Deutschland GmbH

Aareal Bank AG	Member of the Supervisory Board	
Aareon Deutschland GmbH	Member of the Supervisory Board	

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

Management Board

Dr Wolf Schumacher, Chairman of the Management Board		
Aareal Estate AG	Deputy Chairman of the Supervisory Board	until 30 Sep 2010
Aareal Valuation GmbH	Chairman of the Supervisory Board	until 22 Dec 2010
Aareon AG	Member of the Supervisory Board	

Dirk Große Wördemann, Member of the Management Board (since 1 November 2010)		
Aareal Bank Asia Limited	Member of the Board of Directors	since 11 Feb 2011
Aareal Bank Asia Limited	CEO (Chairman)	since 11 Feb 2011
Aareal Capital Corporation	Chairman of the Board of Directors	since 15 Dec 2010
Aareal Financial Service spol. s r.o.	Member of the Supervisory Board	since 06 Dec 2010
Aareon AG	Member of the Supervisory Board	since 03 Feb 2011
Pacific Star Europe GmbH	Managing Director	until 28 Feb 2011

Norbert Kickum, Member of the Management Board (until 31 October 2010)		
Aareal Bank France S.A.	Member of the Board of Directors	until 29 Apr 2010
Aareal Financial Service Polska Sp.z o.o.	Member of the Supervisory Board	until 31 Oct 2010
Aareal Bank Asia Limited	Member of the Board of Directors	until 31 Oct 2010
Aareal Bank Asia Limited	CEO (Chairman)	until 31 Oct 2010
Aareal Capital Corporation	Chairman of the Board of Directors	until 31 Oct 2010
Aareal Financial Service spol. s r.o.	Member of the Supervisory Board	until 31 Oct 2010
Aareon AG	Member of the Supervisory Board	until 31 Oct 2010
Deutsche Structured Finance GmbH	Member of the Advisory Board	until 31 Oct 2010

Hermann Josef Merkens, Member of the Management Board		
Aareal Estate AG	Chairman of the Supervisory Board	
Aareal Bank Asia Limited	Member of the Board of Directors	
Aareal Capital Corporation	Member of the Board of Directors	
Aareal First Financial Solutions AG	Member of the Supervisory Board	
Aareal Property Services B.V.	Chairman of the Supervisory Board	until 30 Sep 2010
Aareal Valuation GmbH	Member of the Supervisory Board	until 22 Dec 2010
Aareon AG	Member of the Supervisory Board	
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Chairman of the Supervisory Board	
Deutsche Interhotel Holding GmbH & Co. KG	Member of the Council of Shareholders	until 08 Dec 2010
Deutsche Structured Finance GmbH	Member of the Advisory Board	
RMS Risk Management Solutions GmbH	Member of the Supervisory Board	

Thomas Ortmanns, Member of the Management Board		
Aareal Bank France S.A.	Member of the Board of Directors	until 29 Apr 2010
Aareal First Financial Solutions AG	Chairman of the Supervisory Board	
Aareon AG	Chairman of the Supervisory Board	
Innovative Banking Solutions AG	Member of the Supervisory Board	

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

Dr Michael Beckers, Bank Director		
Aareal Financial Service Polska Sp.z o.o.	Member of the Supervisory Board	
Aareal Financial Service spol. s r.o.	Member of the Supervisory Board	until 13 Sep 2010
Sven Eisenblätter		
Aareal Valuation GmbH	Member of the Supervisory Board	
Ulf Ekelius, Bank Director		
Aareal Financial Service spol. s r.o.	Member of the Supervisory Board	since 13 Sep 2010
Dr Christian Fahrner, Bank Director		
Innovative Banking Solutions AG	Deputy Chairman of the Supervisory Board	
Ralf Gandenberger, Bank Director		
Terrain-Aktiengesellschaft Herzogpark	Deputy Chairman of the Supervisory Board	
Deutsche Interhotel Holding GmbH & Co. KG	Member of the Council of Shareholders	until 08 Dec 2010
Uli Gilbert		
Terrain-Aktiengesellschaft Herzogpark	Member of the Supervisory Board	
Hans-Ulrich Kron, Bank Director		
Aareal Estate AG	Member of the Supervisory Board	since 01 Oct 2010
Dr Stefan Lange, Bank Director		
Aareal Estate AG	Member of the Supervisory Board	
Aareal First Financial Solutions AG	Member of the Supervisory Board	
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Deputy Chairman of the Supervisory Board	
Terrain-Aktiengesellschaft Herzogpark	Chairman of the Supervisory Board	
Peter Mehta, Bank Director		
Innovative Banking Solutions AG	Member of the Supervisory Board	
Dirk Pasewald		
Aareal Property Services B.V.	Member of the Supervisory Board	since 01 Oct 2010
Markus Schmidt		
Aareal Property Services B.V.	Member of the Supervisory Board	since 01 Oct 2010
Christine Schulze Forsthövel, Bank Director		
Aareal Bank France S.A.	President of the Board of Directors	until 29 Apr 2010
Aareal Financial Service Polska Sp.z o.o.	Member of the Supervisory Board	
Aareal-Financial Service spol. s r.o.	Member of the Supervisory Board	
Martin Vest, Bank Director		
Aareal Bank France S.A.	Member of the Board of Directors	until 29 Apr 2010

Composition of Supervisory Board committees

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

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

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

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

Nomination Committee
Hans W. Reich
Erwin Flieger

Responsibility Statement

Statement pursuant to section 37y of the German Securities Trading Act (WpHG) in conjunction with section 37v (2) no.3 of the WpHG

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

Wiesbaden, 1 March 2011

The Management Board

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

Auditor's Report

We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system, and the management report of the Aareal Bank AG, Wiesbaden, for the business year from 1 January 2010 to 31 December 2010. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law and supplementary provisions of the articles of incorporation are the responsibility of the Company's Board of Managing Directors. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

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

Our audit has not led to any reservations.

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

Frankfurt / Main, 7 March 2011

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Christian F. Rabeling	**ppa. Andreas Hülsen**
Wirtschaftsprüfer	**Wirtschaftsprüfer**
(German Public Auditor)	**(German Public Auditor)**

Report of the Supervisory Board of Aareal Bank AG, Wiesbaden

Dear shareholders,

Aareal Bank once again succeeded in posting positive results for all quarters of the financial year under review – and hence, also for the 2010 financial year as a whole. This means that Aareal Bank AG has generated positive quarterly results on each occasion since the outbreak of the international crisis affecting financial markets and the economy back in 2008. The bank posted a marked increase in operating profit compared with the previous year. From the Supervisory Board's perspective, this positive performance of Aareal Bank AG is a resounding confirmation for the viability of the Group's business model.

Bearing in mind that the environment on property markets was difficult throughout the year, and also given the significant nervousness and volatility on financial markets, the results are very satisfactory. Since the second quarter of 2010, developments on financial markets were seriously influenced by the sovereign debt crisis which affected certain European countries. As such, the ongoing discussions concerning budget deficits meant that sovereign credit spreads for some European countries remained high until the end of the year. The environment for the property sector continued to be challenging throughout the year, even though signs for bottom-building were evident in numerous markets.

Thanks to careful and forward-looking management, Aareal Bank AG continued to have sufficient liquidity at all times during the 2010 financial year, together with a sound funding base. The positive business development permitted Aareal Bank AG to repay a first tranche of the silent participation by SoFFin. At the same time, to be prepared for further market uncertainty, the bank drew on the unutilised portion of the guarantee facility provided by SoFFin to issue a € 2 billion guaranteed bond, which the bank took on its own books.

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

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

Activities of the Supervisory Board

Twelve plenary meetings of the Supervisory Board took place during the financial year under review, of which five were scheduled meetings. Four of the extraordinary meetings were held by way of a conference call. During the meetings, the members of the Supervisory Board received reports and explanations by the members of the Management Board, and discussed these in detail. Proceedings and reports during all scheduled meetings focused on the way the bank dealt with the challenges posed by the sovereign debt crisis affecting individual European countries, and with the impact of continued high levels of financial market nervousness and volatility on the bank's business environment.

The plenary meetings of the Supervisory Board also discussed the partial repayment of SoFFin's silent participation, and the utilisation of the remaining guarantee facility. These measures were coordinated with and approved by the Supervisory Board.

In its discussions, the Supervisory Board also concerned itself with changes to the regulatory framework, in great detail. During the year under review, such changes included resolutions adopted by the G 20 countries and financial markets regulators regarding the new capital requirements for banks (commonly referred to as "Basel III"), the resolutions to establish a European financial markets regulatory authority, the repeated revision to the Minimum Requirements for Risk Management in Banks (MaRisk), and the amendments to the German Corporate Governance Code.

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

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

During the March, September and December meetings, various remuneration issues were presented in the context of the new German Ordinance on Remuneration in Financial Institutions, as well as other regulatory requirements. This included a detailed inventory of remuneration systems throughout Aareal Bank Group, as well as issues concerning Management Board remuneration which were raised by the new regulations.

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

During three meetings in January and February, the Supervisory Board discussed in detail the strategic options available to Aareal Bank Group in a changed market environment.

In its March meeting, the Supervisory Board concerned itself in detail with the financial statements and consolidated financial statements presented for the 2009 financial year, and with the auditors' report. The relevant facts were presented in the Supervisory Board report for the previous year. The meeting also discussed the proposal for the appointment of external auditors to be submitted to the Annual General Meeting, as well as the details of the subsequent instructions to be given to them, including the contents and focal points for the audit during the 2010 financial year, as specified by the Supervisory Board.

Further topics discussed during the March meeting included preparing the Annual General Meeting held in May 2010, as well as the annual reports submitted by Internal Audit and the Compliance Officer. In accordance with the German Act on the Modernisation of the Accounting and Reporting Laws (*Bilanzrechtsmodernisierungsgesetz* – "BilMoG"), the plenary meeting also received a presentation of the internal control system used to manage Group subsidiaries, together with measures planned in this context.

In April, another Supervisory Board meeting was held to discuss strategic issues, following up on topics for which further work had been instructed during the meetings at the beginning of the year.

The May meeting of the Supervisory Board was held after the Annual General Meeting of Aareal Bank AG; this was the constituting meeting of the newly-elected Supervisory Board and its committees. During this meeting, the Supervisory Board also followed up on the Annual General Meeting. Certain aspects of the credit risk strategy were discussed and adopted, and a final report provided on the merger of Aareal Bank France S.A. into the parent company Aareal Bank AG, which had necessitated the early re-election of the Supervisory Board.

The topics of the subsequent extraordinary meetings included discussions and the passing of resolutions regarding the first partial repayment of the silent participation by SoFFin, and the drawdown of the remaining guarantee facility, to guarantee a bond issue.

During the September meeting, the 2010 amendments to the German Corporate Governance Code were presented and discussed, alongside other regulatory changes. Certain aspects of lending approval management were reviewed, and corresponding resolutions passed.

The two meetings in October and November focused on the personnel changes in the Management Board of Aareal Bank AG; specifically, the retirement of Mr Norbert Kickum and the appointment of Mr Dirk Große Wördemann.

During the December meeting, the Management Board reported on the Group's business plan, which it submitted to the Supervisory Board and gave detailed explanations. Corporate governance issues were discussed as well: in this context, the Supervisory Board adopted the Declaration of Compliance, pursuant to section 161 of the AktG, for the year 2010, which was subsequently published on the bank's website. Another key aspect was to bring Aareal Bank AG's rules and regulations in line with the modified corporate governance framework.

In accordance with good corporate governance practice, the Supervisory Board also regularly examines the efficiency of its activities in order to identify any areas requiring improvement. The results of the examination of efficiency conducted during the 2010 financial year were acknowledged by the members of the Supervisory Board, and were discussed in detail. Measures were discussed and initiated in order to realise the minor improvements identified.

Strategy documents were regularly submitted to, and discussed by the Supervisory Board, in accordance with the Minimum Requirements for Risk Management in Banks (MaRisk).

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

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

As part of preparing Supervisory Board decisions, a routine examination is carried out as to whether there are any conflicts of interest. Against this background, during the financial year under review a lending decision was taken by the Committee for Urgent Decisions without the participation of the Chairman of the Supervisory Board, in order to prevent a potential conflict of interest.

Beyond this, the members of the Supervisory Board did not give notice of any conflicts of interest (pursuant to section 5.5.3 of the German Corporate Governance Code) during 2010.

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

Activities of Supervisory Board committees

The Supervisory Board has established five committees in order to perform its supervisory duties in an efficient manner: the Executive Committee, the Risk Committee (previously: Credit and Market Risk Committee), the Committee for Urgent Decisions, the Accounts and Audit Committee, and the Nomination Committee.

The Executive Committee held five meetings, including two extraordinary meetings, one of which was convened as a conference call. The Executive Committee has prepared the plenary meetings of the Supervisory Board, together with proposed resolutions. In its meeting in March 2010, the Executive Committee discussed the merger of Aareal Bank France S.A. into the parent company, and the re-election of the Supervisory Board which became necessary as a result. Discussions also concerned strategic issues related to the SoFFin support measures. The extraordinary meetings focused on the personnel changes to the Management Board, and all issues involved.

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

The committee regularly discussed reports on the bank's risk situation, which were submitted and explained by the Management Board. Having discussed the contents with the Management Board, these were duly noted and approved by the members of the committee. Besides credit and country risks, the committee concerned itself with market risks, liquidity risks, and operational risks. The committee also decided on any other transactions requiring the Supervisory Board's approval pursuant to the company's Memorandum and Articles of Association, or the Managing Board's internal rules of procedure.

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

The Accounts and Audit Committee held six meetings during the year under review. During its meeting in March 2010, the Accounts and Audit Committee received the external auditors' report on the 2009 financial year and discussed the results with the auditors in detail. The committee members read the audit reports provided; they formed their own judgement of the audit results on the basis of these reports, and by way of extensive discussions with the external auditors. In accordance with its duties under the Memorandum and Articles of Association, the Accounts and Audit Committee also discussed the instruction of external auditors and the focal aspects of the audit for 2010 during the same meeting.

Proceedings at the meetings in August and November included information regarding the progress of audit activities for the 2010 financial year; follow-up questions were also discussed. In addition to a further updated report on the audit progress, the updated Group planning was presented and explained to the committee during its December meeting. The committee also received reports submitted by Internal Audit, and by the Compliance Officer, requesting and receiving detailed explanations.

Furthermore, during the committee meetings in February, May, August and November 2010, the Management Board presented the quarterly results for the financial year, as well as the preliminary full-year results for 2009 prior to publication, in accordance with the German Corporate Governance Code; the committee members discussed the reports with the Management Board. As in the financial year under review, the preliminary results for 2010 were discussed at a meeting in February 2011.

In its meeting on 24 March 2011, the Accounts and Audit Committee received the external auditors' detailed report on the audit and audit results for the 2010 financial year, and extensively discussed these results with the auditors and the Management Board.

The Nomination Committee, which was established during the year under review, met for one meeting during 2010. The task of the committee is to coordinate and carry out the search for new shareholder representatives on the Supervisory Board, if a member representing shareholders retires from the Supervisory Board. All members of the Supervisory Board had to be re-elected during the financial year under review, due to the merger of the French subsidiary Aareal Bank France S.A. into the parent company. Fulfilling their duties in this context, during their meeting on 30 March 2010, the members of the Nomination Committee resolved to propose to the Supervisory Board that all existing shareholder representatives be nominated for re-election by the Annual General Meeting for the next term of office. This proposal was accepted by the plenary meeting of the Supervisory Board. The shareholder representatives on the Supervisory Board were re-elected for a further term of office by the Annual General Meeting held on 19 May 2010.

Where members of the Supervisory Board were unable to attend a meeting, they had announced their absence in advance, giving reasons. If material decisions were on the agenda, these

Supervisory Board members submitted written instructions for the casting of their votes, or cast their votes afterwards, in writing.

Transactions of particular importance during 2010

In its meeting on 23 June 2010, the Supervisory Board approved the proposal submitted by the Management Board for a partial repayment in the amount of € 150 million on the silent participation by SoFFin, and to simultaneously utilise the remaining € 2 billion guarantee facility. The € 2 billion SoFFin guarantee was used to issue a new unsecured bond in the same amount, with a maximum term of 36 months, which the bank took on its own books.

The remaining framework guarantee was utilised for purely precautionary reasons; it was designed to retain Aareal Bank AG's ability to react quickly and flexibly to potential market distortions over a medium-term horizon – at any time, and even during a turbulent phase. No decision has been taken to date on the repayment of the remaining SoFFin silent participation.

The process of merging Aareal Bank France S.A. into the parent company Aareal Bank AG was completed during the financial year under review. This measure was a further step in the continuous process to simplify the structure of the Group, and to enhance the efficiency of credit processes. The term of office of the Supervisory Board ended prematurely as a result of this merger, and the necessary election was held. Henceforth, Aareal Bank AG's presence in Paris is a branch office. This organisational change had no effect upon Aareal Bank AG's clients.

Financial statements and consolidated financial statements

The Supervisory Board instructed PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt/Main, who were elected as auditors by the Annual General Meeting 2010, with the audit of the financial statements. The external auditors appointed submitted a statement regarding their independence to the Supervisory Board, who duly noted it. The Supervisory Board has no reason to doubt the accuracy of this statement of independence. Fulfilling their duties as commissioned by the Supervisory Board, PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft audited the financial statements prepared in accordance with the German Commercial Code (HGB) and the consolidated financial statements prepared in accordance with IFRSs, as well as the Management Report and the Group Management Report. Based on the results of their audit, PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft issued an unqualified audit opinion for the financial statements and consolidated financial statements.

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

No objections were raised following the detailed examination of the financial statements and Management Report of Aareal Bank AG, prepared in accordance with the HGB; the consolidated financial statements and the Group Management Report prepared in accordance with IFRSs; the proposal of the Management Board regarding the appropriation of profit; and of the audit report. In its meeting on 24 March 2011, the Supervisory Board approved the results of the audit. The Supervisory Board approved the financial statements and Management Report of Aareal Bank AG, prepared in accordance with the HGB, together with the consolidated financial statements and the Group Management Report prepared in accordance with IFRSs, which are thus confirmed. Having examined and discussed it with the Management Board, the Supervisory Board has endorsed the proposal for the appropriation of profit submitted by the Management Board.

Mr Norbert Kickum, who, as a member of the Management Board, was responsible for Aareal Bank AG's property financing business on international markets, left the bank with effect from 31 October 2010. His departure was for purely personal reasons, by amicable and mutual consent.

The Supervisory Board would like to thank Mr Kickum for his contribution during the challenging past years. Mr Dirk Große Wördemann was appointed to the Management Board of Aareal Bank AG with effect from 1 November 2010. The Supervisory Board looks forward to working with Mr Große Wördemann, and wishes him every success in his new office.

Due to the merger of Aareal Bank France S.A. into the parent company, the term of office of all Supervisory Board members ended prematurely, necessitating a re-election. Given the re-election of employee representatives to the Supervisory Board, the office of Ms Tamara Birke was terminated at the end of the Annual General Meeting of Aareal Bank AG on 19 May 2010. The Supervisory Board would like to thank Ms Birke for her trusting and constructive cooperation over many years. The employees elected Mr Dieter Kirsch to succeed Ms Birke as employee representative to the Supervisory Board. The Supervisory Board wishes Mr Kirsch every success in his new function.

In conclusion, the Supervisory Board would like to thank the Management Board and all of the company's employees for their strong commitment and successful work during the eventful 2010 financial year. Once again, it was thanks to the motivation and contribution of Aareal Bank Group staff that enabled the Company to successfully master the challenges of recent months.

Kronberg, March 2011

For the Supervisory Board

Hans W. Reich (Chairman)

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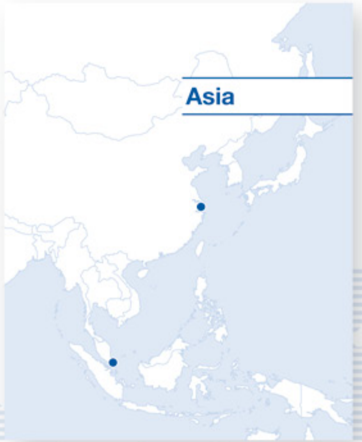
Financial Calendar

10 May 2011	Presentation of interim report as at 31 March 2011
18 May 2011	Annual General Meeting – Kurhaus Wiesbaden
August 2011	Presentation of interim report as at 30 June 2011
November 2011	Presentation of interim report as at 30 September 2011

Structured Property Financing

Structured Property Financing

Consulting/Services



Structured Property Financing

Aareal Bank, Real Estate Structured Finance: Amsterdam, Berlin, Brussels, Copenhagen, Dublin, Hamburg, Helsinki, Istanbul, London, Madrid, Milan, Moscow, Munich, New York, Paris, Prague, Rome, Shanghai, Singapore, Stockholm, Warsaw, Wiesbaden, Zurich | **Aareal Valuation GmbH:** Wiesbaden | **Aareal Estate AG:** Berlin, Wiesbaden

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