Speech by
Hermann J. Merkens
Chairman of the Management Board
of Aareal Bank AG

on the occasion of the

Annual General Meeting
on 25 May 2016
in Wiesbaden

– The spoken text will prevail in the event of any differences –

I. Welcome and introduction

Ladies and Gentlemen,

I would like to take this opportunity to welcome you to this year's Annual General Meeting of Aareal Bank AG. Together with my fellow members of the Management Board, I would like to thank you for the interest in our Company that you express through your attendance today. We truly appreciate the commitment you have shown to the Bank, and with which you have been following its development – in some cases for many years.

Since my appointment to the Management Board in 2001, I have attended numerous Annual General Meetings of Aareal Bank. Yet this is the first Annual General Meeting in my function as Chairman of the Management Board – a role I took over in September last year.

I assumed responsibility for Aareal Bank Group from Dr Wolf Schumacher, who kept you informed about the Bank’s development and performance on these occasions during the last decade, a time during which we trustfully and successfully worked together.

Aareal Bank Group is in excellent shape, and enjoys an excellent position in its markets. Yet, like all companies in our sector, we are facing big challenges: competition is becoming more intense, technological developments are moving faster, volatility in the markets keeps rising, and the regulatory environment continues to be on the move. Accordingly, perpetuating the success which we have undoubtedly enjoyed during recent years will require new responses as well as new strategic emphasis, especially in this changed environment.

This has been the focus of my work during the first months of my new term of office, together with the Bank's executive staff. We presented initial results in February: our "Aareal 2020" programme for the future, through which we will safeguard our successful foundation whilst unlocking new income potential for the Group.

Before discussing this in more detail, allow me to take a look at the financial year under review – a year on which we report to you today.

II. Review of the 2015 financial year

As usual, all figures – together with detailed background information on our performance during the 2015 financial year – are provided in our annual report. At this point, I would like to focus on some key aspects:

- We closed the year with yet another record result.
  Even though we managed to do so again, after 2014 – in the banking sector, it is anything but a matter of course. Without the competence of our employees and their commitment, which has once again been outstanding, we would not have been able to achieve this. In the name of the entire Management Board, I would like to express sincere thanks to our staff.

- Net interest income was a particular growth driver in the year under review: it rose very strongly, mainly due to an unexpectedly high level of early loan repayments, as well as our successful acquisitions over the last couple of years.

- As promised, we have integrated these acquisitions in a value-creating manner. We completed the integration of Corealcredit Bank AG into our Group earlier than expected, and are making good progress in integrating Westdeutsche ImmobilienBank AG, or "WestImmo". All of this has been a huge accomplishment, which was only possible through immense joint efforts. Again, I would like to sincerely thank all those who were involved.

- Given the two acquisitions, higher administrative expenses were inevitable, yet we were able to contain the increase – despite the accelerated integration of Corealcredit.

- I am pleased to report that we continued to perform successfully, in both business segments, during the year under review:

  - Having originated new business of €9.6 billion in the **Structured Property Financing** segment, we clearly exceeded our new business target. Our portfolio volume is now within our target range. We managed to avoid the margin pressure which most of our industry is complaining about to some extent, mainly thanks to having reinforced our expansion on the US market. It is worth noting that allowance for credit losses remained precisely within our expectations.

  - In our **Consulting/Services** segment, our IT subsidiary Aareon continued to expand its strong market position – in Germany as well as in other European countries – and generated stable results. The volume of deposits from housing industry clients, which is a very important source of funding for us, averaged €9 billion over the course of the year, thus getting close to our medium-term target of €10 billion.

In short, 2015 was another challenging year, involving very hard work – but also another very successful year for Aareal Bank Group.

Let me outline what this means in actual figures. I will focus on a few key figures and indicators.

- Consolidated operating profit of €470 million posted yet another strong increase over the previous year's figure of €436 million, reaching the upper end of our forecast, which we last raised in December. The figure includes €150 million in negative goodwill from the acquisition of WestImmo, which was completed on 31 May 2015. Excluding this non-recurring effect, consolidated operating profit was €320 million – the highest adjusted level to date.

- RoE before taxes, excluding the negative goodwill resulting from WestImmo, improved by a full percentage point, to 12.1 per cent. Adjusted for the effects of high early repayments, RoE before taxes stood at a very pleasing 10 per cent.

- Consolidated net income after taxes rose by approximately 12 per cent, to €374 million. Adjusted for negative goodwill from the WestImmo transaction, it was €224 million. Consolidated net income attributable to ordinary shareholders reached a record level of €339 million; adjusted for negative goodwill, it stood at €189 million. €16 million of consolidated net income was allocated to AT1 investors.

- We would like you, dear shareholders, to participate appropriately in these very good consolidated results. The Management Board and the Supervisory Board therefore propose a 38 per cent increase in the dividend per share, to €1.65.

  This equals a distribution ratio, adjusted for negative goodwill from the acquisition of WestImmo, of 52 per cent.

Looking at key balance sheet ratios, the picture is also a positive one. Allow me to remind you that we financed the acquisition of WestImmo completely from the Bank's own funds. Even after completion of the transaction, Aareal Bank’s Tier 1 ratio as at 31 December 2015 was 17.2 per cent, which is comfortable on an international level. Assuming full implementation of Basel III, the Bank's Common Equity Tier 1 (CET1) ratio would have been 13.1 per cent on the same date, up from 12.9 per cent the year before.

This means that, at the end of 2015, we had a buffer of 435 basis points over the so-called SREP ratio required by the European Central Bank. Even though the regulatory environment keeps changing, as I already mentioned, we have established a good starting basis.

Ladies and Gentlemen,

Let me summarise this brief overview of 2015: Aareal Bank Group continued to defy the challenging market and competitive environment throughout the financial year under review. We maintained our positive operating performance, and once again demonstrated our ability to act strategically.

III. The Aareal Bank share

Following a good start into 2015, unfortunately our share price was unable to escape developments in the overall market unscathed during the course of the year.

As you doubtless experienced yourselves, 2015 was yet another very turbulent year for equity markets – whereby external factors once again shaped developments more strongly than corporate news.

Thanks to the tailwinds provided by the European Central Bank's extremely expansive monetary policy, the year got off to a very strong start, recording new highs in the DAX. In this environment, the Aareal Bank share price also hit an all-time high, of just under €41, in April. During the second quarter, however, growing uncertainty about Greece's potential exit from the euro zone in particular put an end to the market rally. Additional factors burdening market performance included discussions about the timing of a potential turnaround in US interest rates. Moreover, the continued slump in crude oil prices – which was also seen as a sign of potential weakness of the global economy – caused persistent market turmoil.

During the course of the year, massive price losses on the Chinese equity markets continued to fuel concerns about economic developments, leading to panic responses on some markets, with some daily record losses being recorded – in the Dow Jones Industrial Average, for example.

At times, general uncertainty reflecting manifold geopolitical risks reached new dimensions, especially following the terrorist attacks in Paris last autumn – a horrible event that has become engraved in Europeans' collective memory. Nonetheless, equity markets managed to clearly pull back from their lows during the fourth quarter. The recovery was mainly driven by prospects of further easing of monetary policy in Europe, which drove market expectations of continued liquidity flows into equities.

With the DAX up by almost 10 per cent and the MDAX up by more than 22 per cent for the year, markets ended 2015 on a conciliatory note. Except for financials: constituents of the German CXPB Banks index closed the year with losses of nearly 10 per cent. Investors remained sceptical vis-à-vis the sector: their concerns included the consequences – now becoming increasingly evident in some segments – of historically low interest levels, unclear future prospects affecting some business models, as well as prevailing regulatory uncertainty.

Aareal Bank could not escape this trend entirely unscathed. However, whilst our share price was unable to fully decouple from movements of European bank shares, with a moderate mark-down of 8.8 per cent, it still slightly outperformed the German banking sector.

As the past year has shown once again: having a sustainably successful operating business, reliably achieving forecasts, carrying out value-creating acquisitions such as WestImmo, and maintaining a convincing strategic direction will not always be reflected in a positive share price performance over the short term – despite all the quality we are delivering. As we have seen, general market movements can outweigh positive corporate developments.

Yet strength in the operating business, strategic clarity and reliability – as Aareal Bank has been showing for many years now – are prerequisites for the share price outperforming competitors or benchmark indices over the long term.

Ladies and Gentlemen,

as members of Aareal Bank's Management Board, we will continue to do everything we can to achieve this. Recent developments are encouraging: at yesterday's closing price of €34.28, the Aareal Bank share has clearly pulled back from the year-to-date lows seen in February. Whilst this mainly reflects the positive response to our 2015 results, presented at the end of February, the market's constructive reaction to our "Aareal 2020" programme for the future, which we presented at the same time, also certainly played a role in this context. The programme also encompasses an adjustment to our dividend policy.

Moreover, our successful first-quarter performance – in an environment that remained challenging – has shown that we are also making good progress during the current year.

IV. Business development and outlook for 2016

Ladies and Gentlemen,

As we reported on the 10th of May, we had a good start into the 2016 financial year – a fact which investors honoured with a marked increase in our share price.

The detailed interim report for the first quarter is available on our website. Hence, at this point I will only provide a brief summary of the key aspects.

- Consolidated operating profit rose by just under 30 per cent compared to the same quarter of the previous year, to reach €87 million. Likewise, consolidated net income attributable to ordinary shareholders also increased significantly, by more than 40 per cent, to €51 million. This shows that we carried over the previous year's positive development into the new financial year.

- Net interest income rose slightly, even though we are moving ahead with the reduction of non-strategic parts of acquired portfolios, as planned.

- Allowance for credit losses of just €2 million for the first quarter was extremely low. Now, whilst this is a nice 'snapshot' which underlines the quality of our portfolio, unfortunately this figure cannot be projected for the year as a whole. We continue to anticipate allowance for credit losses in a range between €80 million and €120 million, expecting the full-year figure in the middle of this range – that is, below the previous year's figure.

- At the beginning of this year, our new business in the Structured Property Financing segment was roughly in line with previous year’s levels. Our pipeline of new deals is stocked well and we maintain our full-year target of €7 billion to €8 billion.
- The increase in net commission income has been encouraging; it was driven in particular by the development at Aareon, which we expect to markedly increase its profit contribution this year. This proves the attractiveness and the potential of our Consulting/Services segment, which is set to be one of the Group's growth drivers in the years ahead.
- As expected, administrative expenses for the first three months were significantly higher than in the previous year. This includes increased running costs, following the acquisition of WestImmo, as well as the European bank levy, which we already recognised in full in the first quarter.

Following the first quarter of the year, we remain optimistic that we will achieve our targets for 2016, even though the business environment will not change fundamentally – in fact, it will remain challenging.

We continue to expect net interest income for the full year 2016 in a range between €700 million and €740 million. We project net commission income in a range between €190 million and €200 million – a marked increase over the previous year, mainly driven by the expected positive developments at Aareon. Administrative expenses are expected to decline to a range between €520 million and €550 million, in spite of high non-recurring effects of investments as well as project and integration costs.

All in all, we see good opportunities to achieve consolidated operating profit of between €300 million and €330 million for the current year. The upper end of this range even slightly exceeds the record level of the past year, as adjusted for negative goodwill from the acquisition of WestImmo – which however also includes income from early repayments, an effect which we have not observed yet in the first quarter of this year. Our guidance for RoE before taxes is around 11 per cent for the current financial year, with earnings per share between €2.85 and €3.19 – based on an expected tax ratio of around 31 per cent.

V. Aareal 2020

Ladies and Gentlemen,

As you can see, we are projecting 2016 to be another successful year for Aareal Bank Group. At the same time, 2016 will be the year during which we will embark upon a new phase in the development of your Company, a year during which we will take important strategic decisions for the future – and a year during which, jointly with the entire management team, we will build the foundations for Aareal Bank Group to remain one of the most successful enterprises within the sector, even in an environment subject to radical change.

How we are positioning ourselves for the trends and challenges of the coming years, and what our plans are to ensure Aareal Bank Group will remain an attractive investment for you – this is outlined in our programme "Aareal 2020 – Adjust. Advance. Achieve.".

The environment we do business in holds opportunities as well as risks – this applies to us as well as to our clients. Let me just highlight a few aspects in this context:

- the sharper competition we are facing, and which our clients face in their markets;
- the volatile market environment – in terms of liquidity, commodity prices, and exchange rates, for example;
- an interest rate environment in which the risk-pricing function of interest rates appears to be largely dysfunctional;
- technological change and digitalisation, which bring about synergies and efficiency gains on a massive scale, enabling new business models, and which may sometimes have disruptive effects – but which also re-define client needs and the resulting requirements for service providers such as ourselves, from scratch, thus offering opportunities;
- geopolitical risks which concern all of us. Just think about the 'Brexit' referendum – the potential exit of the United Kingdom from the European Union, upon which Britons will be voting in a few weeks' time.
- And not least: regulation, which has not yet stopped affecting the banking sector – which is not only a challenge for financial institutions, but also requires bond and equity investors to make investment decisions subject to a high degree of uncertainty.

What all of this means for our medium- to long-term planning is this: we must assume volatility will remain high, and we do not anticipate any tailwinds for our business. What is more, the influencing factors which I have just outlined do not affect us in sequence – they work in parallel. This is something we need to prepare for.

Our ambition is clear: instead of chasing developments, we want to take action – actively and at an early stage, as you have come to expect from us.

Our starting position is a good one: we are generally well-positioned. We have built a viable foundation that will allow us to master the new challenges ahead. We have many strengths, which will continue to benefit us in the future.

In other words: we do not need any fundamental realignment. What we are in the process of doing is to re-calibrate parts of our business model, in order to remain sustainably successful.

Our strategic agenda "Aareal 2020. Adjust. Advance. Achieve." outlines how we are going to proceed. The agenda comprises three strategic directions:

- firstly, **"Adjust"** – or optimise, in order to secure our strong foundation in a changed environment.
- Secondly, **"Advance"** – we want to use our strengths in an even better way in the future, to explore new income potential.
- And thirdly, **"Achieve"** – our goal is to continue creating sustainable value for our stakeholders going forward.

Now what does this mean specifically?

The measures we plan under the heading of **"Adjust"** are designed to adapt our structures and processes – whilst maintaining our fundamental direction – in a manner that will secure our strong basis for the long term, even in the environment I have just described.

- We are optimising our internal organisation. Our goal is to reduce administrative expenses to around €450 million by 2018 – that is, by around 20 per cent compared to the previous year.
- We are optimising our funding mix by boosting our independence from the capital markets, through a further increase in deposits taken from housing industry clients. As already explained, we are targeting a sustained deposit volume of €10 billion, a level which is already in sight.
- Moreover, we anticipate changes to the regulatory framework. We have already made quite some progress in this regard – as you can see in the capital ratios which I presented a moment ago.

The initiatives we have bundled under the second heading of **"Advance"** are focused on exploiting opportunities that arise from changes in our environment – through further development of existing business, but also by way of new, innovative offers in both business segments.

We have devised a multi-aspect action plan to secure our core business in the Structured Property Financing segment, whilst exploring potential for additional income. In this way, we will ensure that Structured Property Financing will remain the solid foundation of our Group in the future.

As part of this drive, we will increasingly expand into markets with attractive risk/return profiles, offering medium-term macroeconomic growth potential. For instance, we plan to increase our North American portfolio to between €6.0 billion and €6.5 billion. Moreover, we will be more active in our portfolio management in the future. This means that we will no longer hold all the business we have acquired on our balance sheet.

But we will be going much further in developing our business model: for instance, we will exploit the potential of digitalisation in our interaction with clients to a much stronger degree than before. We will also identify and realise new digital business opportunities.

The area where we are not only determined to exploit the opportunities of digitalisation, but to also shape the trends, is our second strong pillar: the Consulting/Services segment.

As you are aware, we have undertaken several acquisitions in this segment over recent years, thus building an excellent starting position for generating stronger growth. A case in point is standard software covering special business processes in the housing, commercial property and utility industries. Having achieved market leadership long ago, we now want to leverage this starting position to grow in the Consulting/Services segment. In this way, the segment will evolve into the Group's prime growth driver over the years to come.

Aareon has been a driver of innovation for quite some time – both within its industry, and our Group. Within the framework of "Aareal 2020", we will leverage the know-how we have built in Mainz and other locations to an even wider extent throughout the Group.

Thanks to Aareon, and our long-term client relationships as the lead bank to the German housing industry, we are in an excellent position to successfully shape the digital change our clients are facing – joining forces with them. And we are capable of leveraging the experience gained in the IT business across the entire Group. Aareal Bank Group is thus best placed to assume a leading role in the in the digitalisation of our industries.

Ladies and Gentlemen,

Of course, the "Aareal 2020" programme which I have just outlined is not an end in itself. The associated measures will also pay off: we have set out clearly-defined quantitative targets which we want to achieve over the medium term.

- The Structured Property Financing segment will remain the Group's solid foundation in the future – with a core portfolio between €25 billion and €30 billion, with moderate risk costs and a high degree of efficiency.
- The Consulting/Services segment will be our driver of growth going forward – with a continuously rising profit contribution by Aareon, and additional commission income from the banking business.

Combined with an optimised corporate set-up, we will thus ensure that your company – Aareal Bank Group – will remain an attractive investment for the future.

Based on our current capitalisation, and given the challenging environment which we anticipate, our medium-term target for return on equity before taxes is around 10 per cent. If we are able to free up capital – which we either distribute or invest – our target is approximately 12 per cent. We might even be able to slightly outperform this over the long term.

Furthermore, we are determined to adopt a more dynamic dividend policy, in order to further enhance your participation, as shareholders, in the Company's success.

Ladies and Gentlemen,

Today we have proposed distributing a dividend of €1.65 per share, which is equivalent to a distribution ratio of 52 per cent of adjusted earnings per ordinary share. Over the coming years, we are planning a ratio of 50 per cent as a base dividend, which – depending upon various factors – may be supplemented by an add-on dividend of between 10 per cent and 30 per cent of earnings per ordinary share. This dividend policy will be applicable provided that the resulting dividend payments are consistent with a sustainable long-term business development,

and unless we decide to invest the respective amounts in the interests of the Company – and hence, its shareholders. The policy will also be subject to the proviso that our business environment does not deteriorate significantly.

With our adjusted dividend policy, Aareal Bank Group is likely to have good prospects of becoming one of the most attractive equities, even beyond the banking sector. And I hope that this will be another reason for you to maintain your trust in the Bank.

VI. Conclusion

Ladies and Gentlemen, dear shareholders,

I sincerely hope that over the last few minutes, I was able to give you an idea of how we, at Aareal Bank Group, are facing the challenges of the future.

Our ambition is clear: we want to remain one of the leading enterprises in our sector. In the past, we have not only proven our ability to adapt – we also demonstrated that we see change as an opportunity. Moreover, we are in an excellent position for the tasks ahead:

- We know our markets and our clients better than anyone else.
- We are doing a lot of things right.
- Thanks to Aareon, we already command digital know-how which we can expand upon.
- We have a motivated workforce, and an excellent management team.
- We cooperate closely and on a basis of trust with the Supervisory Board.
- We are strong in our operating business, enjoy a good position in our markets, are solidly financed – and we are ready, willing and able to act.

It is up to us to create the future Aareal Bank Group! This – and nothing less – is the task which I see for myself, together with my fellow members on the Management Board.

And I invite you to join us on this journey.

Thank you for your attention.