Group Management Report

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Group Management Report

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

Fundamental Information about the Group

Business model

Aareal Bank AG, headquartered in Wiesbaden, Germany, is the parent company of the Group. Its shares are admitted to trading on the regulated market (geregelter Markt) of the Frankfurt Stock Exchange. Aareal Bank Group's strategy focuses on sustainable business success.

The strategic business segments of Aareal Bank Group are commercial property financing and services, software products and digital solutions for the property sector and related industries. The strategic business segments are broken down into the three segments Structured Property Financing, Banking & Digital Solutions and Aareon.

Structured Property Financing

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

Aareal Bank manages its sales activities in the individual regions worldwide via a network of sales centres (hubs). In addition to the locally-based experts, the distribution centres for sector specialists covering the financing of hotels, retail and logistics properties, as well as those catering to the specific needs of investment fund clients, are located in Wiesbaden.

There are two regional hubs in Europe: one hub combines sales activities for the euro zone, with a focus on the Benelux countries, France, Germany, Italy and Spain. An additional hub focuses on sales activities outside the euro zone, with a focus on the UK[1] and Central and Eastern Europe. Distribution in Northern Europe is managed from the head office in Wiesbaden. As before, the hubs have a network – comprising branches in London, Paris, Rome, Stockholm and Warsaw – at their disposal. Aareal Bank also has a branch office in Dublin, where it conducts exclusively Treasury business and holds securities. Representative offices are located in Istanbul, Madrid, and Moscow.

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

Funding

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

[1] Hereinafter refers to the United Kingdom of Great Britain and Northern Ireland.

more, it has recourse to institutional money market investor deposits.

Banking & Digital Solutions

In the Banking & Digital Solutions segment, Aareal Bank Group offers its clients from the institutional housing industry, commercial property companies, as well as the energy and utilities industries, amongst other things services for the management of properties for residential use and the integrated processing of payment flows, thus contributing to a more efficient and sustainable structuring of their fundamental business processes. With its BK01 software, it operates a procedure for the automated settlement of mass payments, in the German property industry. The procedure is integrated in licenced ERP systems. In conjunction with payment transactions processed via Aareal Bank's systems, deposits are generated that contribute significantly to Aareal Bank Group's refinancing base. Besides the German property industry, the German energy sector forms a second major client group of the segment for the services mentioned above. This enables the offer of further products, facilitating the cross-sector cooperation of client groups by realising synergies via end-to-end digital processes. Aareal Bank Group is further strengthening its market position with its growing range of digital products and invoicing solutions within this segment. These products include mobile solutions for recording and processing meter readings, a platform solution for managing B2B payment processes and services, as well as a solution for simplifying invoice management of complex payment flows, whose first application was in e-mobility. The Banking & Digital Solutions segment also includes the First Financial Solutions, plusForta and BauGrund subsidiaries. The start-up objego, in which Aareal Bank holds an equity interest as part of a joint venture with ista, is also allocated to this segment.

Aareon

In the Aareon segment, the Aareon sub-group offers the European property industry and its partners user-oriented ERP software and digital solutions that simplify and automate processes, and support sustainable and energy-efficient operations. The integrated digital ecosystem Aareon Smart World, with the country-specific ERP systems at its core, networks property companies and their employees with clients, business partners as well as technical equipment in apartments and buildings across different digital solutions. The ERP systems are a starting point for cross-selling activities for the digital solutions. Aareon consistently invests in expanding Aareon Smart World's portfolio of products. This involves on the one hand the co-creative development of the digital ecosystem and the cooperation with PropTech companies, and targeted acquisitions on the other as part of the international growth strategy. Aareon Group has an international presence with offices in the DACH region, Finland, France, the UK, the Netherlands, Norway and Sweden, and operates a development company in Romania.

Management system

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

The following indicators implemented within the scope of business and return management are Aareal Bank Group's key financial performance indicators:

- **Group**
  - Net interest income (in accordance with IFRSs)
  - Net commission income (in accordance with IFRSs)
  - Loss allowance (in accordance with IFRSs)
  - Administrative expenses (in accordance with IFRSs)

- Operating profit (in accordance with IFRSs)
- Return on equity (RoE) after taxes[1)]
- Earnings per ordinary share (EpS)[2)]
- Common Equity Tier 1 ratio (CET1 ratio) (%) – Basel IV (phase-in)

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

- **Banking & Digital Solutions segment**
  - Average deposit volume from the housing industry
  - Net commission income (in accordance with IFRSs)

- **Aareon segment**
  - Sales revenue (in accordance with IFRSs)
  - Adjusted EBITDA[4)]

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

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

The Banking & Digital Solutions and Aareon segments also have specific management indicators typical for the respective business. The deposit volume from the housing industry and net commission income are key financial performance indicators for the Banking & Digital Solutions segment. Aareon is managed on the basis of target figures commonly applied to software companies, such as sales revenue and adjusted EBITDA[4)].

Report on the Economic Position

Macro-economic environment

Developments surrounding the Covid-19 pandemic defined the global economic performance in 2021 too. Thanks to the rollout of the vaccination campaign at the start of the year and supported by monetary policy as well as fiscal stimulus, many economies recovered strongly in part over the course of the year. This was driven largely by the easing of measures taken to prevent infections,

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

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

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

[4)] Earnings before interest, taxes, depreciation and amortisation excluding strategic investments (venture and M&A activities) and non-recurring effects which led to a recovery in private consumption and in particular to higher revenues in the services sector. However, the global economic recovery lost some momentum again in the second half of the year. Disruptions to supply chains and the spread of Covid-19 mutations halted economic activity again in some countries. Imbalances between supply and demand in conjunction with the economic recovery also contributed to a considerable rise in inflation.

Economy

In the euro zone, real gross domestic product in 2021 climbed by 5.2 % compared with 2020. After infection control measures and regional lockdowns held back economic performance at the beginning of the year, a broad-based upswing in line with the improving pandemic situation was recorded from the second quarter onwards, particularly in the contact-intensive services sector. In addition to a continued high level of capacity utilisation in the manufacturing industry, economic output at the end of the third quarter was only 0.3 percentage points below the pre-pandemic level thanks to rising investments and strong private consumption. However, a large number of stress factors meant that the economy grew by only 0.3 % quarter-on-quarter during the fourth quarter. Pronounced supply chain problems, among other things, impeded efforts to process the high order backlog in the manufacturing industry. Furthermore, weak exports and a deterioration of the health situation owing to another rise in new infection figures led to a marked economic burden, especially in the services sector. Economic growth for the full year 2021 in the largest countries in the euro zone was 7.0 % in France, 6.5 % in Italy, 5.0 % in Spain and 2.8 % in Germany.

The EU governments again supported companies and employees in 2021 with fiscal aid measures. In addition to liquidity and capital aid for companies, income support, debt and contract relief, for example, was provided in some countries. While individual measures were phased out during the year, other programmes, such as easier access to aid for short-time work in Germany, were extended until the end of June 2022. On a European level, the limited recovery fund NextGenerationEU had started raising funds in June 2021 by issuing bonds on the capital markets. The fund's main objective is to address the negative impact of the pandemic by making targeted investments aimed at the digitalisation, decarbonisation and cohesion of the EU.

The recovery reported in some countries within the European Union that are not members of the euro zone was milder than was seen on average in the euro zone member states. Sweden, for example, achieved economic growth of 4.9 % in 2021 and the Czech Republic 3.1 % growth year-on-year. Poland's economy, on the other hand, expanded to a somewhat greater extent by 5.7 %.

Brexit continued to impact on the UK economy, leading to weak exports, despite the trade agreement with the EU. Migration by workers also resulted in a shortage of labour. Other factors, however, had a stimulating effect on the economy: The rapid vaccination progress supported the lifting of measures taken to prevent infections ahead of many European countries and promoted private consumption. An expansive fiscal policy also supported the economic recovery. However, stress factors mounted in the second half of the year in the form of supply chain problems and a renewed deterioration of the health situation, which was reflected by a more cautious stance taken by consumers and companies alike. All in all, economic output in 2021 rose by 7.5 % compared with 2020.

Supported by an expansive fiscal policy, economic output in the US increased by 5.7 % in 2021 compared with the previous year and in the second quarter had already exceeded the pre-crisis level of the fourth quarter of 2019. Job creation on the labour market continued, so that employment levels at the end of 2021 were only around 2 % lower than the pre-crisis level in February 2020. Growth was driven by private consumption, which was supported by the withdrawal of the measures taken to prevent infections, the reduction in the people's high levels of savings, one-off state payments made to the households and pandemic-related unemployment support. The economic development halted slightly at the start of the third quarter, as supply chain problems impacted on industrial production. The high level of new infections related to the spread of the Delta and Omicron variants also inhibited consumer confidence and private consumption. In Canada, economic performance at the end of 2021 was 4.7 % higher than in the previous year.

Following a weak start, gross domestic product in China increased by 8.1 % in the year as a whole, thus benefiting from the global economic recovery. Restrictive lending and a zero-Covid policy, where isolated infection cases were met with drastic measures, had a dampening effect. Large-scale quarantine regulations and the closure of tourist attractions and hotels in the peak tourist season depressed private consumption. Additionally, some parts of the country experienced production restrictions in the second half of the year due to a shortage of energy. Since June, financial problems of several large conglomerates, especially from the construction sector, impacted on investment activity and the economy. Economic output in Australia was up 4.3 % on the previous year, despite repeated regional lockdowns in 2021. The recovery in private consumption and higher investments played an essential part in this development.

Annual rate of change in real gross domestic product

%	2021[1]	2020[2]
Europe		
Euro zone	5.2	-6.5
Belgium	6.1	-5.7
Germany	2.8	-4.9
Finland	3.6	-2.8
France	7.0	-8.0
Italy	6.5	-9.0
Luxembourg	6.0	-1.8
Netherlands	4.6	-3.8
Austria	4.7	-6.8
Spain	5.0	-10.8
Other European countries		
Denmark	3.8	-2.1
United Kingdom	7.5	-9.4
Poland	5.7	-2.5
Russia	4.4	-3.0
Sweden	4.9	-3.1
Switzerland	3.6	-2.5
Czech Republic	3.1	-5.8
North America		
Canada	4.7	-5.2
USA	5.7	-3.4
Asia/Pacific		
Australia	4.3	-2.2
China	8.1	2.2
Maldives	17.2	-32.0

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

The labour markets in many countries were influenced by state aid programmes for part or all of the year. The services sector in particular benefited during the year from the reopening of customer and consumer-related sectors, and reported a marked growth in employment. The unemployment rate in the euro zone was at 7.0 % at the end of 2021 and therefore below the pre-crisis level at year-end 2019. At 3.9 % in the US at the end of 2021, it was just slightly above the pre-crisis level and significantly lower than the figure of 6.7 % at year-end 2020.

Financial and capital markets, monetary policy and inflation

In addition to the monetary policy responses to the Covid-19 pandemic and the global economic recovery, high inflation rates and rising inflation expectations impacted on the international financial markets, especially from the second half of 2021 onwards. The most important central banks continued to pursue a very expansive monetary policy to support the economy. Their targeted goal was not to jeopardise the fragile economic development through higher volatility on the capital markets and higher interest rates.

The European Central Bank (ECB) continued to follow the path of a very accommodating monetary policy adopted in 2020, in order to promote favourable financing conditions for the real economy in times of heightened uncertainty and support the economic recovery. The main refinancing rate and deposit rate remained at 0 % and -0.5 % respectively in the two-tier system based on the deposit volume. The ECB also continued to provide the banks with liquidity through targeted long-term refinancing operations (TLTRO 3), to support bank lending to companies and private households. Provided that banks participating in these refinancing operations realise positive net lending to non-financial enterprises and private individuals in the euro zone within a specified reference period, this represents an attractive refinancing option. A new strategy with a symmetrical inflation target of 2 % was agreed in July, whereby the ECB is not forced to take immediate action in case of a temporary overshooting of the inflation rate, therefore allowing for more scope and flexibility in monetary policy. In December the ECB's Governing Council resolved to reduce net purchases under the Pandemic Emergency Purchase Programme (PEPP) for bonds issued by public and private borrowers and to discontinue it in March 2022. The ECB will reinvest maturing principal payments from bonds purchased under the PEPP at least until the end of 2024. The ECB reserves the right to reinstate the PEPP again if this is necessary to overcome new pandemic shocks. Net purchases under the Asset Purchase Programme (APP) will be doubled temporarily to € 40 billion monthly in 2022 and then gradually reduced again to € 20 billion.

The US Federal Reserve Bank (Fed) also maintained its expansive monetary policy stance in 2021. The federal funds rate therefore remained unchanged at 0 % - 0.25 % and the purchase programme for government bonds and mortgage-backed securities was continued. These measures were designed to free up liquidity in the banking system, so as to support lending to households and the corporate sector. Against the background of the recovery on the US labour market and heightened upside risks of inflation, the Fed made the decision in November to reduce their net monthly purchases. In January 2021, the Fed started to accelerate the tapering of net purchases as agreed in December, ultimately discontinuing purchases in the first quarter of 2022. Aside from this, some of the economic subsidy programmes started by the Fed in 2020 to contain the impact of the Covid-19 pandemic were already discontinued in the first half of 2021.

The Bank of England responded to a tight labour market and rising inflation, by raising the bank rate by 0.15 percentage points in December to 0.25 %, while leaving the target value for the programme for purchasing government and corporate bonds unchanged at GBP 895 billion.

Short-term interest rates[1] in the euro area at year-end 2021 were almost unchanged from the end of 2020. The same applied to the US dollar, the Swedish krona, the Australian dollar and the Canadian dollar interest rates, whereas pound sterling interest rates rose moderately. Long-term interest rates[2] rose in all of the currency areas that are relevant to Aareal Bank. This was due to heightened inflation expectations and the outlook for or communication of monetary policy tightening, and was less pronounced for the euro area than for other currency areas. Yields on ten-year government bonds also painted a uniform picture and rose year-on-year.

Expectations of inflation developments and future monetary policy in the individual currency areas also shaped the currency markets. The euro lost value vis-a-vis the US dollar in the course of the year, with significant volatility observed at times. At the end of the year, the exchange rate was USD 1.13 to the euro and therefore below the rate of 31 December 2020 (USD 1.23 to the euro). The euro weakened against the Canadian dollar over the same period, from CAD 1.56 per euro to CAD 1.44 per euro. The euro fell initially against the pound sterling in the first quarter, followed by a relatively stable performance. The exchange rate fell from GBP 0.90 to the euro at the end of 2020 to GBP 0.84 to the euro at year-end 2021. The

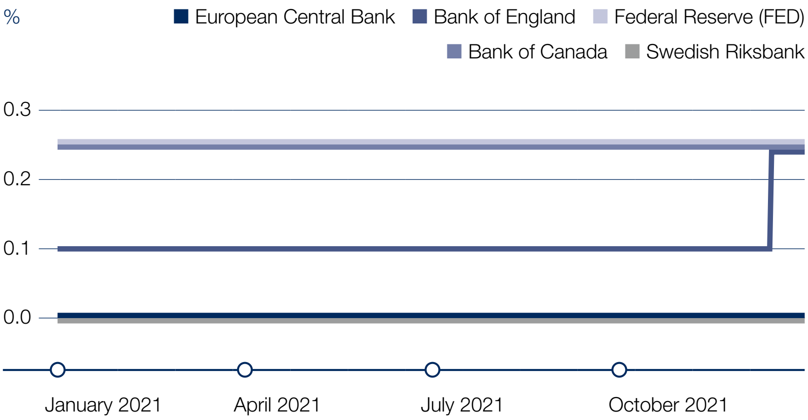
[1] Calculated on the basis of 3-month Euribor or the corresponding LIBOR or other comparable rates for other currencies.
[2] Calculated on the basis of ten-year swaps in the respective currencies.

euro remained virtually unchanged relative to the Swedish krona, and appreciated from SEK 10.03 to the euro to SEK 10.25. During the same period, the euro remained almost unchanged to the Australian dollar and was trading at AUD 1.56 per euro at the end of 2021.

In 2021, inflation rose worldwide and significantly in some regions, having fallen to very low and even negative levels at times in the previous year as a result of the Covid-19 pandemic. Basis effects arising from the curbing of economic activity in 2020 were largely instrumental for the rise, with inflationary pressure increasing in the course of the year. Besides higher energy costs and prices of goods, as a result of disruptions to worldwide supply chains, the rise in the price of services also played an essential part in this development. Especially in the sectors that were hit particularly hard by the crisis, such as the hospitality industry, high demand here met with limited supply. Inflation in the euro zone rose by 5.0 % year-on-year at the end of 2021. The increase was 5.4 % in the UK and 7.1 % in the US. In the US, wage growth as a result of the shortage of labour impacted increasingly on the inflationary trend.

The average volume of the new euro benchmark covered bonds was never as low as in 2021, due for one to monetary policy measures taken, such as the ECB's TLTRO. Most new covered bond issues featured slightly positive yields again vis-a-vis 2020. The yield differentials between covered bonds and German government bonds widened considerably in 2021.

Key rate developments in 2021[1)]



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

Regulatory environment

Following the phasing out of a large number of regulatory relief measures that were granted on a temporary basis, as an immediate response to the outbreak of the Covid-19 pandemic, the environment for banks continues to be defined by highly dynamic regulatory requirements, as well as by changes in banking supervision. This includes, in particular, the implementation of the final draft of the Basel III framework into EU law (known as "Basel IV"), which was resolved by the Basel Committee (BCBS). The EU Commission submitted proposals on this on 27 October 2021, which shall now be finalised as part of the trilogue procedure. The proposed first-time application of the new regulation is 1 January 2025 and therefore two years later than planned by the BCBS.

After BaFin published the sixth amendment to the Minimum Requirements for Risk Management (MaRisk) in 2021, a first draft of the seventh amendment is expected in 2022. The focus here will be on implementing the EBA guidelines on loan origination and monitoring, new requirements for banks' proprietary property business and the risk management of sustainability risks.

Moreover, both national and European regulators are imposing various new requirements – including in connection with IT/information security risks, or regarding the prevention of money laundering/terrorist financing and tax evasion. Furthermore, politics and the banking supervision deem it necessary to establish sustainability more strongly with society, and as a regulatory requirement within the economy. To this end, a standard taxonomy was introduced in the EU, which creates the basis for the classification of economic activities with regard to sustainability targets. The taxonomy forms the basis for a large number of disclosure requirements for financial and non-financial entities. Initial, minor disclosure requirements for ESG matters are applicable as of 31 December 2021 for the first time, with the scope increasing over time. The ECB will also carry out a climate stress test exercise for the first time in 2022.

The ECB's Supervisory Review and Evaluation Process (SREP) ensures a common approach on the supervisory review of banks, within the framework of Pillar 2. The SREP is built around a business model analysis and an assessment of governance, capital and liquidity risks. The results of the individual areas are aggregated in a score value, from which the ECB derives supervisory measures on holding additional capital and/or additional liquidity buffers. In 2020, the ECB took a pragmatic SREP approach, which was mainly focused on the assessment of Covid-19-related risks. As a result, the score values and the requirements for additional capital and liquidity buffers remained unchanged except in justified individual cases. As a result, there were no changes for Aareal Bank. The SREP followed the regular ECB/EBA systematic approach again in the past 2021 financial year. An EBA/ECB stress test was also conducted in 2021. This led to adjustments or changes in the Bank's SREP score values and to the requirements for additional capital and liquidity buffers.

Sector-specific and business developments

Structured Property Financing segment

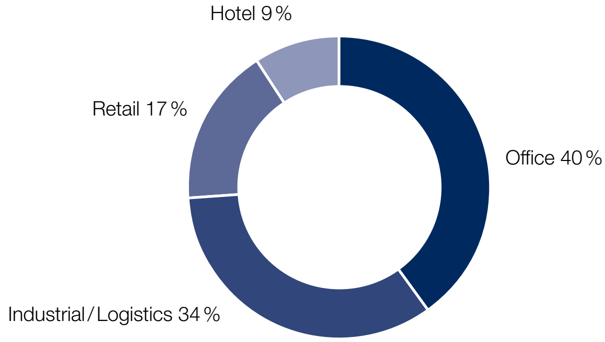
Economic development in 2021 was also reflected in the commercial property markets. The gradual normalisation of the business environment was impacted regionally and in particular at the start of the year by restrictions imposed in the course of the Covid-19 pandemic. However, it supported transaction activity on the whole, and the global transaction volume increased year-on-year under these circumstances. However, there were differences between the regions. While the volume increased by 81 % and 27 %, respectively, in North America and in the Asia/Pacific region, and was therefore above the pre-crisis year 2019 in both cases, the increase compared with 2020 was slightly more moderate in Europe (14 %).

There were regional differences between property types as well: In Europe, demand for logistics and hotel properties was strong in 2021. Transaction volumes in this area increased year-on-year, while volumes for office properties were flat and volumes for retail properties were lower. In the Asia/Pacific region as well as in North America, the volume of property transferred was greater than in the previous year for all property types. One factor common to all regions is that the lifting of the pandemic-related restrictions enabled hotel properties, in particular, to recover from the very low level of the previous year.

Lenders focused their interest on residential and logistics properties, foodstores, as well as on office properties in preferred locations. Increasing interest was seen in the demand for hotel financing, which was focused on the premium hotels with renowned branding. Competition in commercial property financing remained intense overall, which was reflected in partly falling margins in the course of the year. The high level of investor interest in the logistics sector ensured that the margins for office and logistics properties converged and were at the same level in some markets at the end of the year.

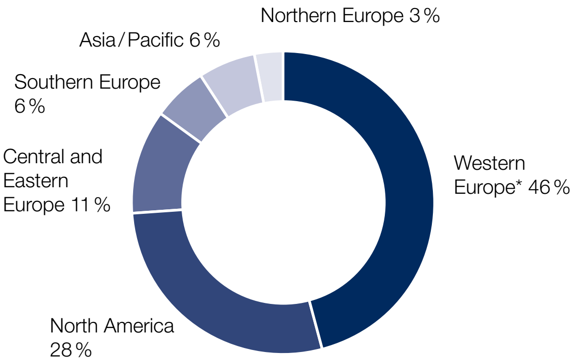
Share of transaction volume observed worldwide in 2021

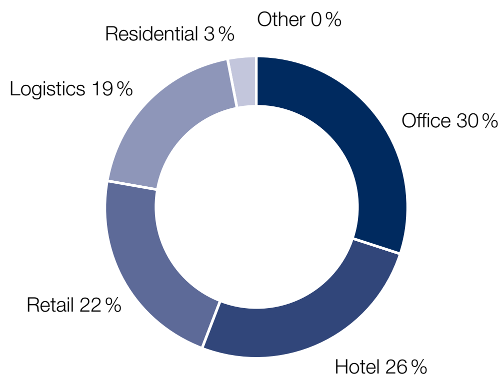
%



New business[1] 2021

by regions | by type of property (%)





* Incl. Germany

While the loan-to-value ratios remained largely stable in the first half-year, the significant interest in funding in the second half of the year led to rising upward pressure on the loan-to-value ratios in some markets.

In an environment that is shaped by the economic recovery but remains defined by uncertainties, Aareal Bank generated new business[1] of € 8.5 billion (2020: € 7.2 billion), which is slightly above the communicated target corridor of € 7 billion to € 8 billion The share of newly-originated loans was 63 % (2020: 76 %) or € 5.4 billion (2020: € 5.5 billion). Renewals amounted to € 3.1 billion (2020: € 1.7 billion). The first "green" loan was granted in June: a hotel financing concluded in Australia. This was followed by additional financings in Australia, Europe and the US in the second half of the year, so that "green" financings totalling around € 430 million were concluded in the year as a whole. Green financings meet the high energy efficiency requirements of the "Aareal Green Finance Framework" and the client undertakes to meet these requirements throughout the term of the loan. The criteria for classification as a green building comprise the EU taxonomy criteria, an above-average sustainability rating by recognised rating agencies or compliance with conservative energy efficiency criteria. All in all, Aareal Bank Group's property financing portfolio has grown to € 30 billion at year-end 2021.

At 66 % (2020: 59 %), Europe accounted for the largest share of new business, followed by North America with 28 % (2020: 37 %) and the Asia/Pacific region with 6 % (2020: 5 %).[2]

With a share of 30 %, office properties accounted for the largest share in new business in terms of property type (2020: 36 %), followed by hotel property with 26 % (2020: 22 %), ahead of retail property with 22 % (2020: 11 %) and logistics property with 19 % (2020: 27 %). Residential property, which accounted for a 3 % (2020: 4 %) share of new business, and other property and financings, remained roughly unchanged from the previous year.

Europe

Transaction volumes rose by around 14 % in Europe. Transaction volumes declined in Germany and France, while volumes increased year-on-year in

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

[2] New business is allocated to the individual regions on the basis of the location of the property used as collateral. For exposures not collateralised by property, the allocation is based on the borrower's country of domicile.

Italy, Spain, Sweden and the UK. Demand for logistics property remained strong across Europe, while the volume of retail properties transferred was lower than in 2020. The only exceptions are good-quality office properties in particularly good locations; demand for these remained strong. Although the volume of logistics transactions was lower in 2021 than of office and residential property, the gap between these sectors has narrowed significantly compared to previous years. Investor positions changed only marginally compared with the previous year. Cross-border investors remained on the buy side for the most part, while private investors tended to be sellers. Institutional investors and REIT structures assumed a more balanced position overall.

Average rents in the prime office property segment rose slightly during 2021, while some sub-markets, e. g. Stockholm and London, saw more distinct rent increases. In the case of retail properties, rents declined on average, albeit no longer to the same extent as in the previous year. Within the same market, the development varied greatly in some cases, depending on the retail segment. In the UK market, for example, which was impacted in particular by the Covid-19 pandemic, higher rents for shopping centre properties were observed again in individual cities compared with 2020. Rents for logistics properties benefited from the ongoing strong demand in the entire segment and could continue the positive development of the last few years.

Prime yields for office properties changed only marginally year-on-year and thus remained low. Thanks to the persistently strong demand, the trend of falling yields for logistics properties continued, so that lower yields than for office properties are meanwhile seen in some markets. Yields declined by up to 115 basis points in the most important markets. The development on the retail property market varied within the property type. Prime yields for high-street properties remained stable on average, while rising by 10 to 25 basis points in places for shopping centres. They even increased by around 65 basis points on average in the UK. Increases in yields were generally more pronounced in secondary locations. Yields in the supermarket and local supplier segment fell by around 25 basis points on average compared with the previous year, with the focus mainly on Western Europe.

For hotel properties in Europe, occupancy and revenue per available room rose during the year, when measures taken to protect against the spread of the infection were eased, even though the level reached at the end of the year was nowhere near the pre-crisis level. Because of the international travel restrictions that applied for quite some time, domestic demand was the main factor driving hotel performance in the whole of Europe.

The Bank originated new business of € 5.6 billion (2020: € 4.2 billion) in Europe during the year under review. As in previous years, Western Europe accounted for the largest share of around € 3.9 billion (2020: € 2.5 billion). This was followed by Central and Eastern Europe, where new business of € 1.0 billion (2020: € 1.0 billion) was generated mostly in Poland, € 0.5 billion (2020: € 0.2 billion) in Southern Europe and € 0.2 billion (2020: € 0.5 billion) in Northern Europe.

North America

Transaction volumes in North America were up by around 81 % in 2021 compared with the previous year. In terms of volume and number of transferred properties, transactions still lagged behind the previous year's figures in the first quarter, before transaction activity performed in line with the pre-crisis year 2019 as the year progressed and even exceeded 2019 levels in the fourth quarter. Cross-border and institutional investors were on the buy side for the most part. In contrast, REIT structures and private investors were mostly on the sellers' side.

Rents offered for prime office properties in US metropolitan areas stagnated on average in 2021. Developments did, however, vary from market to market. Rents in San Francisco fell by around 5 % on average, while remaining stable, for example, in the major cities of Atlanta and Chicago and slightly easing in New York and Washington compared with the previous year. With the exception of New York and San Francisco, rental development in secondary locations in these markets stagnated too. Rents for shopping centres increased on average for the country as a whole, but also developed differently depending on the metropolitan areas. Increases of 4 %, 2 % and 6 % respectively were observed in Chicago, New York and Atlanta, while rents eased by 9 % in San Francisco. This means that, overall, the negative trend from the previous year has reversed. The rents for logistics properties rose significantly by around 10 % on average on a national level. An increase was reported in all the important individual markets.

Yields on prime and secondary office properties have remained almost unchanged since the start of the year and have fallen slightly on average in the metropolitan areas, owing to the availability of liquidity and the readiness to provide financing in the market. Yields on retail property declined slightly during the course of the year on a national average, but again, differences were observed between metropolitan areas. While yields remained stable for example in Chicago, Dallas and San Francisco, they went down in Philadelphia, as the year progressed. Falling yields could also be observed on a national average for logistics properties.

Hotel occupancy and revenues in North America have improved significantly during the year. Occupancy ratios and revenues per available room in the luxury & upper upscale category in the US have increased continuously between January and December. Revenues per available room increased by around 60 % on average throughout the country between December 2020 and December 2021. In Canada, average revenues increased by around 30 % during the same reference period.

In North America, new business of € 2.4 billion (2020: € 2.7 billion) was originated in 2021, almost all of which was attributable to the US.

Asia / Pacific region

Transaction volumes for commercial property in the Asia / Pacific region were roughly 27 % higher in 2021 than in the previous year. The increase in transaction volumes in Australia was particularly strong at 106 %, while growth was more moderate in China (18 %). Cross-border and institutional investors were on the buy side for the most part, while REIT structures and private investors were predominantly sellers.

Prime rents for logistics properties in the Australian metropolitan areas of Sydney, Melbourne and Adelaide showed a rising trend in 2021 compared with the previous year. Rents for retail properties developed differently depending on the Chinese metropolitan areas; they increased significantly in Shanghai but stagnated in Beijing.

The previous year's trend for yields for logistics properties in Australia's important markets continued in 2021, with yields declining by between 80 and 115 basis points. In contrast, yields of retail properties in Shanghai and Beijing were flat year-on-year.

Hotels in the Asia / Pacific region recovered significantly in part in 2021, thanks to strong domestic demand for travel and comprehensive support measures provided by the government to the tourism sector. Individual markets, such as Sydney and Melbourne, lagged behind, as travel and overnight stays in Australia were halted by renewed lockdown measures and contact restrictions. Markets that depend heavily on international demand for travel generally recovered at a slower pace. Nevertheless, the Maldives recorded a strong increase of foreign tourists compared with 2020. Overall, around 1.3 million tourists visited the Maldives in 2021, after around 0.6 million tourists in 2020. From August, monthly tourist figures even returned to the levels of the corresponding month in the pre-crisis year 2019.

The Bank originated new business of € 0.5 billion in the Asia / Pacific region in the reporting year 2021 (2020: € 0.3 billion).

Banking & Digital Solutions segment

The residential and commercial property sectors are proving to be stable market segments, even in the second year of the Covid-19 pandemic. In the top 7 cities in particular, rents rose again by around 4 % in the first half of 2021, and by as much as 6 % in the other large and mid-sized cities, while in the student cities the increase declined to 2 % due to a temporary fall in demand. No material defaults of rental payments have been observed. In the commercial property sector, rents fell by 2.2 % as a result of a partial drop in local demand in some segments and the discontinuation of businesses in certain product groups, especially in prime locations. Rents in peripheral locations were flat. New-build rents in the fourth quarter rose by 1.1 % in the municipal districts and by 1.0 % in rural areas. Year-on-year (compared with the fourth quarter of 2020), the increase in Germany amounts to 4.4 %.

We once again strengthened our range of property industry services in the current year and, together with our Aareal First Financial Solutions subsidiary, extended the range of digital solutions for the housing industry and its clients.

With the Aareal Exchange & Payment Platform (AEPP), we offer a solution that enables companies to integrate alternative payment methods in the automatic administrative processes. AEPP also opens up the opportunity to implement new customer services and to invoice efficiently. AEPP was expanded by further payment methods such as PayPal and credit cards in the reporting period, with the alternative payment methods being made accessible also for companies from the energy industry.

plusForta, the Group's specialist for tenant deposit guarantees, launched heysafe, the first completely digital deposit guarantee solution.

At present, around 4,200 corporate clients throughout Germany are using our process-optimising products and banking services. The segment's volume of deposits averaged at € 12 billion in the 2021 financial year (2020: € 11.0 billion) and was thus in line with our forecast, which we raised in the third quarter. All in all, this reflects the strong trust our clients continue to place in Aareal Bank. Despite accounting for expected effects from the current court ruling on general terms and conditions clauses, net commission income was increased, as planned, to € 28 million (2020: € 26 million).

Aareon segment

Aareon is a provider of ERP software and digital solutions for the European property industry and its partners. The company digitalises the property sector with user-oriented software solutions that simplify and automate processes, support sustainable and energy-efficient operations, and interconnect all process participants. Aareon pursues an international growth strategy based on expanding the operating business, realising the VCP (Value Creation Programme) that was developed in 2020 and the inorganic growth through mergers & acquisitions.

As in 2020, the 2021 financial year was also defined by the Covid-19 pandemic. This impacted in particular on Aareon's "traditional" consulting business. Some projects were not executed at all, or only executed with delays, and the provision of on-site consultation was often impossible due to access restrictions. This revenue could not be offset fully by "Green Consulting" (virtual consulting). The product business, on the other hand, was increased. Clients with a higher level of digitalisation were already at an advantage in managing the crisis. Client events and bigger events, such as Aareon Live as a German industry event with more than 1,000 participants, were held virtually for the most part. All in all, the Covid-19 pandemic further reinforced the importance of digitalisation in the property industry.

Thanks in particular to higher recurring revenues in the operating business and because of acquisitions carried out in 2021, Aareon increased its sales revenue to € 269 million in 2021 (2020: € 258 million) and generated an adjusted EBITDA[1] of € 67 million (2020: € 62 million). Nevertheless, revenue was impacted by the effects of the

[1] Earnings before interest, taxes, depreciation and amortisation before new products, Value Creation Programme (VCP), ventures, M&A activities and non-recurring effects

longer-than-expected Covid-19 pandemic on the consulting business as well as by the further transformation into a SaaS company. Revenue was therefore at the lower end of the forecast of € 270 million to 274 million, which was adjusted at the end of the third quarter (original forecast: € 276 million to 280 million). In contrast, the adjusted EBITDA was slightly above the forecast of € 63 million to 65 million. Sales revenue from the ERP business (excluding consulting business) increased year-on-year by 3 %, while digital solutions (excluding consulting business) posted an increase of 23 %.

Sales revenue from the ERP business in the DACH region was roughly unchanged from the previous year, due to lower consulting revenue as a result of the pandemic. Sales revenue generated with Wodis Sigma declined for the same reason. In the course of realising the Value Creation Programme (VCP), Aareon launched a campaign for the new Wodis Yuneo product generation in June 2021 in order to further increase the focus on the trend of using software as a service and hence on the transformation to a SaaS company. In this context, process-oriented product packages were offered simultaneously, which are oriented to the clients' individual needs and simplify the offer structure for the clients. Accordingly, the share of recurring sales revenue increased. Sales revenues from SAP® ERP software solutions, including Blue Eagle, and from RELion for the commercial property business, were on par with the previous year due to low consulting revenue. In October 2021, Aareon extended its ERP product offer by acquiring the Bremen-based GAP Gesellschaft für Anwenderprogramme und Organisationsberatung mbH (GAP-Group) and the ERP immotion® system, thus creating further potential for cross selling the digital solutions. BauSecura's insurance business developed favourably. Sales revenue from the international ERP business exceeded the previous year's level, due above all to Aareon France and Aareon Nederland. In the Netherlands, the transformation of the business model to a SaaS operation continued. Sales revenues generated with the Dutch REMS ERP solution for the commercial property business increased slightly year-on-year. With the 100 % acquisition of BriqVest B.V. (Twinq), Oosterhout, a Dutch provider of software for managing property, in May 2021, Aareon tapped the market segment for residential property management in the Netherlands. From the 2022 financial year onwards, Twinq will be integrated into Aareon Nederland. Demand was strong for the new release of Prem'Habitat, which was launched in 2020 in France. In the Nordics, sales revenue expectations could not be met due to the delayed delivery of Aareon Xpand's new release and the focus on the core market Sweden. Aareon UK's sales revenues were in line with the previous year's level. Aareon tapped the market for small and medium-sized property managers in the UK in 2021 with the acquisition of Arthur Online and Tilt. Arthur Online has already acquired a large number of new clients, while good progress is being made in migrating clients from the Tilt software to that of Arthur Online.

The business volume with the digital solutions was increased further in 2021. Demand was strong in the DACH region and abroad in particular for the WRM (Workforce Relationship Management) and CRM (Customer Relationship Management) digital solutions. With the marketing launch of the Digital Agency, Aareon offers its clients in Germany a platform that reflects the entire tenant life cycle. The development of the AI-based virtual assistant Neela (CRM solution) was continued in 2021 together with cooperation partners and pilot clients. The Mareon service portal for tradesmen connectivity (SRM) celebrated its 20th anniversary in 2021. Mareon has been delivering a reliable, relevant contribution to revenue for many years. Even before the new German Heating Costs Ordinance came into force, Aareon had offered its clients an EED-compliant solution for the property industry's new information duties to their tenants through the interaction between the CRM app/portal and occupant change management (CRM). Aareon acquired PropTech wohnungshelden GmbH in August 2021. wohnungshelden's CRM software solution enables housing companies to digitalise their entire rental process, thus complementing Aareon's existing product portfolio for the rental process. In the Building Relationship Management (BRM) segment, Aareon and its cooperation partners have developed PrediMa, a digital predictive maintenance solution. Revenue for epiqr and AiBATROS® was significantly down year-on-year due to the lower demand for consulting services in light of the Covid-19 pandemic. In the international business, demand for digital solutions was particularly strong in the Netherlands and in France, while sales revenue in the Nordics was down on the previous year. The BRM solutions of the UK company Tactile Ltd. (Fixflo), which was acquired in May 2021, have already made a significant contribution to sales revenue. The cross-selling has started here too. This acquisition also contributed towards developing the market segment for smaller and medium-sized property managers.

Financial Position and Financial Performance

Financial performance

Group

Consolidated operating profit for the 2021 financial year came to € 155 million and was thus significantly above the previous year (€ -75 million) and within the upper third of the communicated earnings forecast range, despite a non-recurring adverse tax effect and the conclusion of the de-risking exercise in Italy. Consolidated net income amounted to € 68 million (2020: € -69 million).

Net interest income increased by 17 % to € 597 million, primarily driven by a higher lending volume compared to the previous year, higher margins in the lending business and improved refinancing costs (2020: € 512 million), and exceeded the expectations, which had been raised once more during the third quarter.

Loss allowance of € 133 million was significantly below the previous year's figure (€ 344 million), which was largely affected by Covid-19, but was still on an elevated level as expected. Loss allowance resulted from individual new loan defaults (Stage 3) and one addition to an existing exposure (Stage 3) recorded in order to adequately account for the uncertainty surrounding the Covid-19 pandemic (especially given the currently rampant Omicron variant) as regards the loans concerned, by applying corresponding scenario weightings. Moreover, the Bank used the reversal of loss allowance for a defaulted loan to conclude the

Consolidated net income of Aareal Bank Group

€ mn	1 Jan - 31 Dec 2021	1 Jan - 31 Dec 2020
Net interest income	597	512
Loss allowance	133	344
Net commission income	245	234
Net derecognition gain or loss	23	28
Net gain or loss from financial instruments (fvpl)	-30	-32
Net gain or loss from hedge accounting	-5	6
Net gain or loss from investments accounted for using the equity method	-2	1
Administrative expenses	528	469
Net other operating income/expenses	-12	-11
Operating profit	**155**	**-75**
Income taxes	87	-6
Consolidated net income	**68**	**-69**
Consolidated net income attributable to non-controlling interests	1	5
Consolidated net income attributable to shareholders of Aareal Bank AG	67	-74

accelerated de-risking in Italy; on aggregate, this required additional loss allowance of € 13 million.

Net commission income also increased to € 245 million (2020: € 234 million) on the back of sales growth at Aareon and in the Banking & Digital Solutions segment, in line with expectations which were slightly adjusted in the third quarter.

Net derecognition gain of € 23 million (2020: € 28 million) was largely attributable to market-driven effects from early loan repayments. Effects from de-risking measures of € 3 million in the securities portfolio were compensated by repurchases in the Treasury business of € 3 million within the scope of market support (2020: € 7 million).

The net loss from financial instruments (fvpl) and from hedge accounting in the aggregate amount of € 35 million (2020: € -26 million) was largely due to credit-risk-induced valuation losses on defaulted property loans which are reflected in net gain or loss from financial instruments (fvpl). As with loss allowance, this item was still burdened by the effects of Covid-19 and formed part of our loss allowance forecast.

Administrative expenses rose to € 528 million (2020: € 469 million) and were therefore within the range we had projected at the start the year. As expected, this is due on the one hand to business expansion and investments into new products, Aareon's Value Creation Programme (VCP), ventures and M&A activities, as well as to lower cost savings, as expected, related to the Covid-19 pandemic, compared to the previous year, on the other hand – with the marked share price increase being one of the factors involved.

Net other operating income/expenses of € -12 million (2020: € -11 million) was burdened by € 11 million in interest on tax back payments. Income from properties held by the Bank was largely balanced overall: lower current income as a result of Covid-19 was offset by a € 3 million write-up on a property held. The previous year's figure included a Covid-19-related impairment of a property held by the Bank.

All in all, consolidated operating profit for the 2021 financial year totalled € 155 million (2020: € -75 million), with a RoE before taxes of 5.3 % (2020: -4.1 %). Taking into consideration income taxes of € 87 million (2020: € -6 million) and non-controlling interest income of € 1 million, consolidated net income attributable to shareholders of Aareal Bank AG amounted to € 67 million (2020: € -74 million). Results were burdened by the consideration of new findings on the tax treatment of a legacy fund investment which was sold in 2012. As a result, the expected tax rate for the year under review increased to 56 %, and the above-mentioned € 11 million in expenses on tax back payments needed to be recognised in net other operating income/expenses. The capitalisation of deferred taxes had a positive impact on the previous year's income tax expenses. Assuming the pro rata temporis accrual of net interest payments on the AT1 bond, consolidated net income allocated to ordinary shareholders stood at € 53 million (2020: € -90 million). Earnings per ordinary share (EpS) amounted to € 0.89 (2020: € -1.50), and RoE after taxes 2.1 % (2020: -3.6 %). Thus, despite the tax effect, EpS were in line with the adjusted and original forecast, while RoE after taxes slightly exceeded it.

Structured Property Financing segment

At € 154 million, operating profit generated in the Structured Property Financing segment was clearly higher than in the previous year (€ -99 million).

Net interest income increased to € 560 million, mainly due to a year-on-year increase in the lending volume, higher margins in the lending business and improved refinancing costs (2020: € 474 million).

Loss allowance of € 133 million was significantly below the previous year's figure (€ 344 million), which was largely affected by Covid-19, but was still on an elevated level as expected. Loss allowance resulted from individual new loan defaults (Stage 3) and one addition to an existing exposure (Stage 3) recorded in order to adequately account for the uncertainty surrounding the Covid-19 pandemic (especially given the currently rampant

Structured Property Financing segment result

€ mn	1 Jan-31 Dec 2021	1 Jan-31 Dec 2020
Net interest income	560	474
Loss allowance	133	344
Net commission income	8	8
Net derecognition gain or loss	23	28
Net gain or loss from financial instruments (fvpl)	-30	-32
Net gain or loss from hedge accounting	-5	6
Net gain or loss from investments accounted for using the equity method	0	2
Administrative expenses	256	227
Net other operating income/expenses	-13	-14
Operating profit	**154**	**-99**
Income taxes	82	-14
Segment result	**72**	**-85**

Omicron variant) as regards the loans concerned, by applying corresponding scenario weightings. Moreover, we recognised a reversal of loss allowance for a defaulted loan to conclude the accelerated de-risking in Italy; on aggregate, this required additional loss allowance of € 13 million.

Net derecognition gain of € 23 million (2020: € 28 million) was largely attributable to market-driven effects from early loan repayments. Effects from de-risking measures of € 3 million in the securities portfolio were compensated by re-purchases in the Treasury business of € 3 million within the scope of market support (2020: € 7 million).

The net loss from financial instruments (fvpl) and from hedge accounting in the aggregate amount of € 35 million (2020: € -26 million) was largely due to credit-risk-induced valuation losses on defaulted property loans which are reflected in net gain or loss from financial instruments (fvpl). As with loss allowance, this position was still burdened by the effects of Covid-19.

Administrative expenses rose to € 256 million (2020: € 227 million). As expected, this is due to lower cost savings related to the Covid-19 pandemic compared to the previous year, including the much better share price development.

Net other operating income/expenses of € -13 million (2020: € -14 million) was burdened by € 11 million in interest on tax back payments. Income from properties held by the Bank was largely balanced overall: lower current income as a result of Covid-19 was offset by a € 3 million write-up on a property held. The previous year's figure included a Covid-19-related impairment of a property held by the Bank.

Overall, operating profit for the Structured Property Financing segment was € 154 million (2020: € -99 million). Taking into consideration income taxes of € 82 million (2020: € -14 million), the segment result amounted to € 72 million (2020: € -85 million). Given said non-recurring tax effect, income taxes rose above the increased expected tax rate for the current year. The capitalisation of deferred taxes had a positive impact on the previous year's income tax expenses.

Banking & Digital Solutions segment

Net interest income in the Banking & Digital Solutions segment amounted to € 43 million (2020: € 39 million). Net interest income continues to be burdened by the negative margins from the deposit-taking business due to the persistently low level of interest rates.

Despite accounting for expected effects from the current court ruling on general terms and conditions clauses, net commission income was increased, as planned, to € 28 million (2020: € 26 million).

Compared with the previous year and in relation to the planning, administrative expenses increased to € 73 million (2020: € 68 million) as a result of higher overall provisions recognised for the annual bank levy and contributions to the deposit guarantee scheme due to a deposit protection event (Greensill) and other effects.

Overall, segment operating profit was € -4 million (2020: € -3 million). Taking income taxes into consideration, the segment result amounted to € -3 million (2020: € -2 million).

Aareon segment

Net interest income amounted to € -6 million, reflecting partially debt-financed M&A activities (2020: € -1 million).

Net commission income at Aareon increased to € 221 million (2020: € 213 million), mainly thanks to higher recurring operating income and acquisitions completed in 2021. Sales revenue from digital solutions (excluding the consulting business) grew at a particularly high rate of 23 %, while the effects

Banking & Digital Solutions segment result

€ mn	1 Jan - 31 Dec 2021	1 Jan - 31 Dec 2020
Net interest income	43	39
Loss allowance	0	0
Net commission income	28	26
Administrative expenses	73	68
Net other operating income/expenses	-1	0
Operating profit	**-4**	**-3**
Income taxes	-1	-1
Segment result	**-3**	**-2**

Aareon segment result

€ mn	1 Jan - 31 Dec 2021	1 Jan - 31 Dec 2020
Net interest income	-6	-1
Loss allowance	0	0
Net commission income	221	213
Net gain or loss from financial instruments (fvpl)	–	0
Net gain or loss from investments accounted for using the equity method	-1	-1
Administrative expenses	211	188
Net other operating income/expenses	2	4
Operating profit	**5**	**27**
Income taxes	6	9
Segment result	**-1**	**18**

of the longer-than-expected Covid-19 pandemic on the consulting business as well as the further transformation into a SaaS company had a negative impact.

Administrative expenses increased as expected to € 211 million (2020: € 188 million) due to business expansion and high investments into new products, the Value Creation Programme (VCP), ventures and M&A activities.

Overall, segment operating profit was € 5 million (2020: € 27 million). Taking income taxes into consideration, the segment result amounted to € -1 million (2020: € 18 million).

Financial position – assets and liabilities

Consolidated total assets of Aareal Bank Group increased to € 48.7 billion as at 31 December 2021 (31 December 2020: € 45.5 billion), particularly reflecting the increase in the lending volume. Funding was covered by a higher level of deposits from the housing industry, and other capital market issues including European Commercial Paper (ECP).

Cash reserve and money market receivables

The cash reserve and money market receivables position contains excess liquidity invested at short maturities. As at 31 December 2021, this comprised predominantly cash funds and deposits with central banks and money-market receivables from banks.

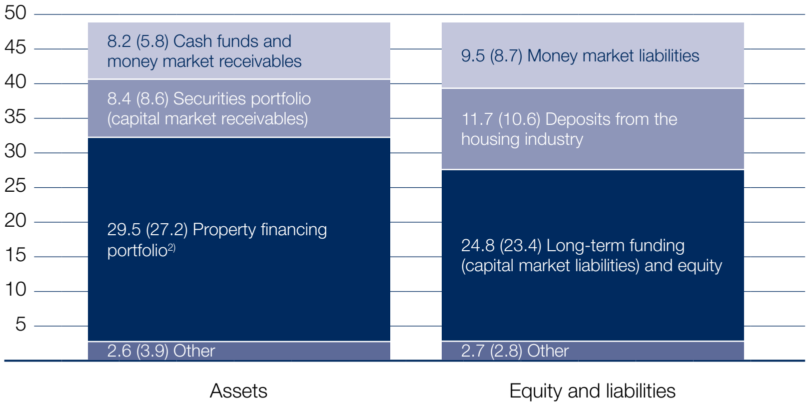
Property financing portfolio

As at 31 December 2021, the volume of Aareal Bank Group's property financing portfolio[1] stood at € 29.5 billion (previous year: € 27.2 billion). Including the former WestImmo's private client and local authority lending businesses it amounted to € 30.0 billion. Thus, the target portfolio size, which was raised by € 1 billion to approximately € 30 billion in the third quarter, was achieved.

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

Statement of financial position – structure as at 31 Dec 2021 (31 Dec 2020)

€ bn



[2] Excluding € 0.3 billion in private client business (31 December 2020: € 0.3 billion) and € 0.3 billion in local authority lending business by the former Westdeutsche ImmobilienBank AG (WestImmo) (31 December 2020: € 0.3 billion), and excluding loss allowance

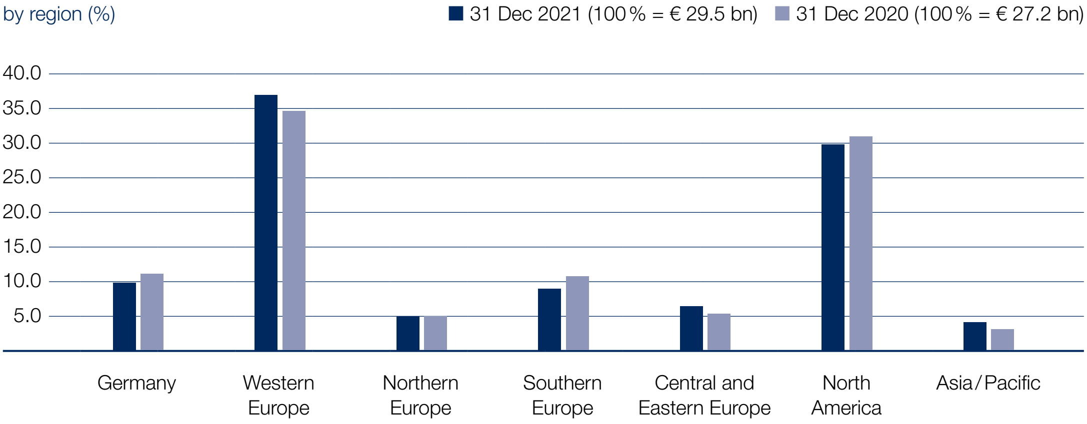
At the reporting date (31 December 2021), Aareal Bank Group's property financing portfolio was composed as shown in the following tables, compared to year-end 2020.

Portfolio allocation by region and continent did not change significantly compared with the end of the previous year. Whilst the portfolio share of exposures in Western Europe rose by around 2.2 percentage points, it was down by around 1.7 percentage points for Southern Europe, due to accelerated de-risking in Italy. It remained relatively stable for all other regions. LTVs, which had slightly increased in the previous year due to the Covid-19 pandemic, declined across all regions, except for Asia/Pacific.

The breakdown of the portfolio by property type did not change significantly during the reporting period. The share of hotel properties increased by around 1.8 percentage points compared to year-end 2020. The share of office, retail, logistics and residential properties, as well as other financings in the overall portfolio remained almost unchanged compared to year-end 2020. LTVs, which had slightly increased in the previous year due to the Covid-19 pandemic, declined across all property types.

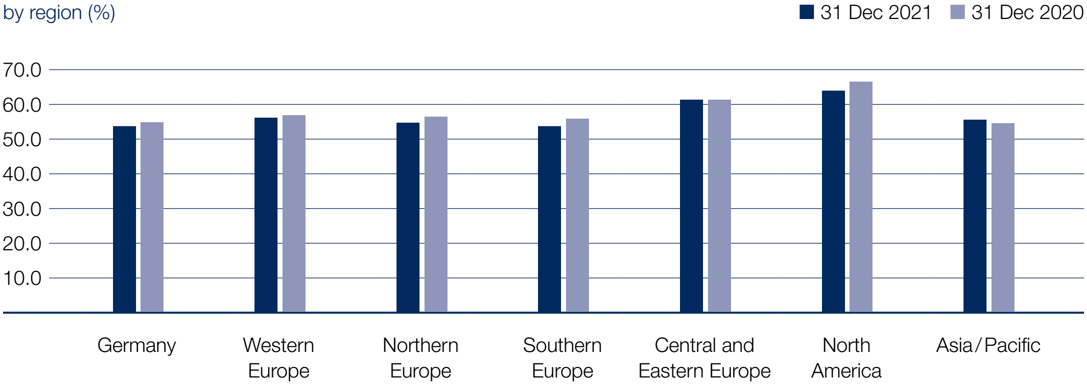
Property financing volume[1] (amounts drawn)

by region (%)



Average LTV of property financing[1]

by region (%)



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

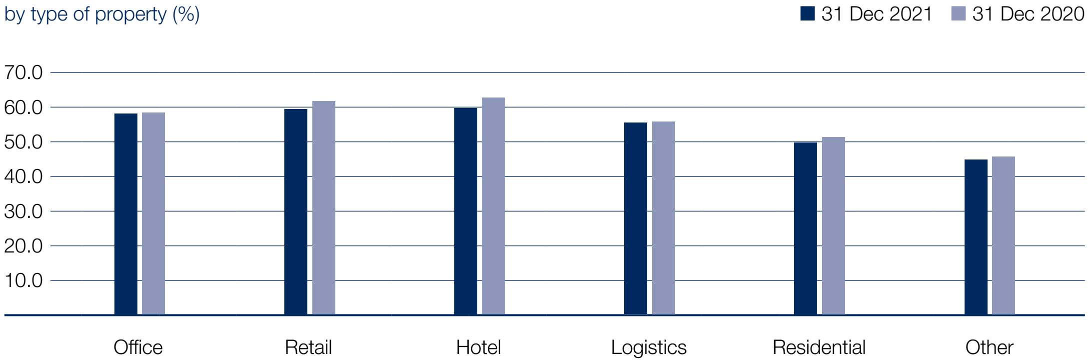
Property financing volume[1] (amounts drawn)

by type of property (%)

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

Average LTV of property financing[1)]

by type of property (%)



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

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

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

Treasury portfolio

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

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

As at 31 December 2021, the total nominal volume of the Treasury portfolio[2)] was € 7.4 billion (31 December 2020: € 7.2 billion).

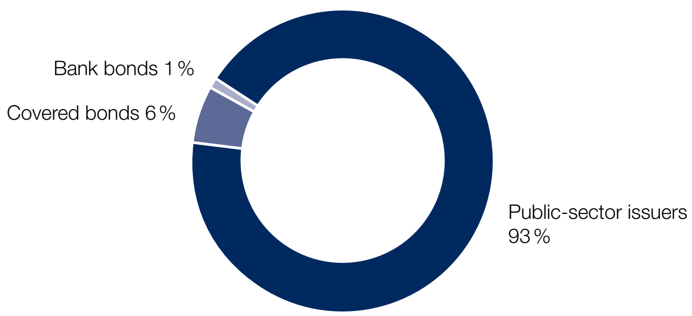
The portfolio comprises the asset classes public-sector borrowers, covered bonds and bank bonds (financials), with the public-sector asset class currently accounting for the largest share of the portfolio at around 93 %.

The high creditworthiness requirements are also reflected in the rating breakdown in the portfolio. 99.8 % of the portfolio has an investment grade rating[3)], and 86.6 % of the positions have an AAA to AA- rating (2020: 83.3 %).

Treasury portfolio as at 31 December 2021

%

Total volume (nominal): € 7.4 bn



2) As at 31 December 2021, the securities portfolio was carried at € 8.4 billion (31 December 2020: € 8.6 billion).

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

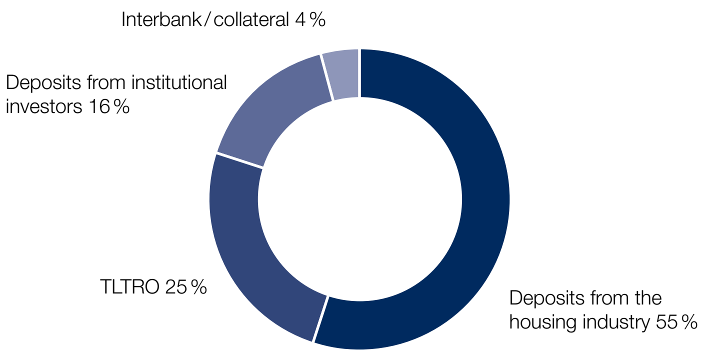
The portfolio currently comprises almost exclusively (98 %) securities denominated in euros and its average remaining term on the reporting date was 6.2 years.

Given the high requirements as regards liquidity of the positions as part of their use for the liquidity portfolio, 94 % of the portfolio can be pledged as collateral with the ECB and 82 % fulfils the requirements for inclusion as "High Quality Liquid Assets" (as defined in the Liquidity Coverage Ratio (LCR)).

Money market funding mix as at 31 December 2021

%

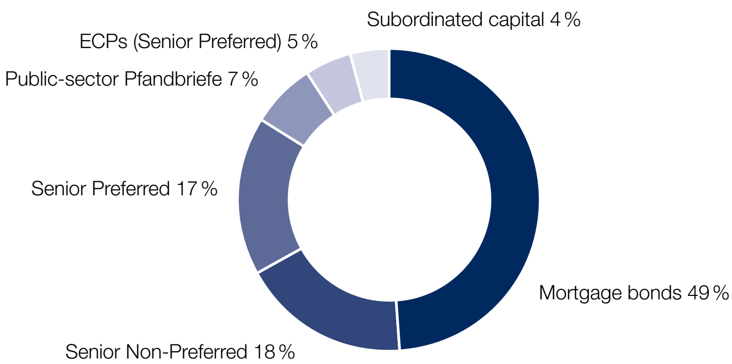
Total volume: € 21.2 bn



Capital market funding mix as at 31 December 2021

%

Total volume (nominal): € 21.1 bn



Financial position – liquidity

Money-market liabilities and deposits from the housing industry

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

As at 31 December 2021, Aareal Bank had € 11.7 billion at its disposal in deposits generated from the business with the housing industry (31 December 2020: € 10.6 billion). Money market liabilities, including targeted longer-term refinancing operations (TLTROs) of Deutsche Bundesbank, amounted to € 9.5 billion (31 December 2020: € 8.7 billion).

Long-term funding and equity

Funding structure

Aareal Bank Group continues to be solidly funded, a development visible by its major share of long-term funding. This encompasses registered and bearer Pfandbriefe, promissory note loans, medium-term notes, other bonds and subordinated capital. According to its legal characteristics, we recognise European Commercial Paper (ECP) as debt even though their maturity is usually less than one year. Subordinated capital includes subordinated liabilities and the Additional Tier 1 (AT 1) bond.

As at 31 December 2021, the notional volume of the long-term refinancing portfolio was € 21.1 billion. Book values of the long-term refinancing portfolio totalled € 20.9 billion.

Refinancing activities

During the financial year 2021, Aareal Bank Group was able to place € 3.5 billion on the capital market, comprising € 2.3 billion of Pfandbriefe, € 1.2 billion of senior preferred and a low volume of senior non-preferred issues. TLTRO 3 borrowing was increased by € 1.0 billion to € 5.3 billion. In addition, the ECP programme was launched successfully in the year under review, and a total volume of € 1.1 billion was raised on the market, including € 0.5 billion of "green" ECP issues, which meet the high requirements of our "Aareal Green Finance Framework".

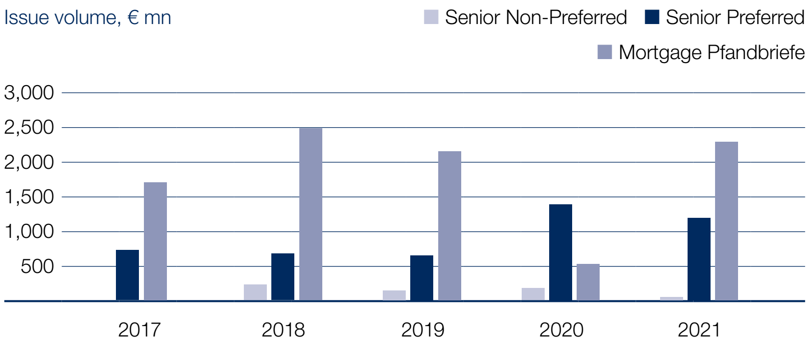
Since we conduct our business activities in a range of foreign currencies, we have secured our foreign currency liquidity over the longer term by means of appropriate measures.

Equity

Aareal Bank Group's total equity as disclosed in the statement of financial position amounted to € 3,061 million as at 31 December 2021 (31 December 2020: € 2,967 million), comprising € 300 million for the Additional Tier 1 (AT 1) bond. Please also refer to the statement of changes in equity, and to our explanations in Note 58 of the consolidated financial statements.

At 18.2 %, the Common Equity Tier 1 ratio (CET 1 ratio) – Basel IV (phase-in) – was markedly above the target value of 16 % in the year under review, as expected.

Issuing activities – 2017 to 2021



Regulatory indicators[1)]

€ mn	31 Dec 2021	31 Dec 2020
Basel IV (phase-in)[2)]		
Common Equity Tier 1 (CET1) capital	2,327	2,286
Tier 1 (T1) capital	2,627	2,586
Total capital (TC)	3,021	3,395
%		
Common Equity Tier 1 ratio (CET1 ratio)	18.2	17.3
Tier 1 ratio (T1 ratio)	20.5	19.6
Total capital ratio (TC ratio)	23.6	25.7
Basel III		
Common Equity Tier 1 ratio (CET1 ratio)	22.2	18.8

1) Aareal Bank AG utilises the rules set out in section 2a of the KWG in conjunction with Article 7 of the CRR, pursuant to which regulatory indicators of own funds may only be determined at Group level. In this respect, the following disclosures relate to Aareal Bank Group.
31 December 2020: excluding planned dividend of € 1.50 per share in 2021 and including pro rata temporis accrual of net interest payments on the AT1 bond;
31 December 2021: excluding planned dividend of € 1.60 per share in 2022 for the 2021 financial year, including € 1.10 per share not distributed in 2021, and the pro rata temporis accrual of net interest payments on the AT1 bond. The appropriation of profits is subject to approval by the Annual General Meeting.
The SREP recommendations concerning the NPL inventory and the ECB's NPL guidelines for the regulatory capital of new NPLs and an additional voluntary and preventive capital deduction for regulatory uncertainties from ECB tests were taken into account.

2) Underlying RWA estimate in accordance with the current version of the CRR plus revised AIRBA requirements for commercial property lending, based on the European Commission's draft for the European implementation of Basel IV dated 27 October 2021. The calculation also includes a buffer (maintaining the scaling factor of 1.06 for AIRBA risk weights, and the 370 % risk weight for the IRBA equity exposure class), to account for the uncertainty surrounding the final wording of CRR III as well as the implementation of further regulatory requirements such as EBA requirements for internal Pillar 1 models. When Basel IV enters into force on 1 January 2025, RWA will be calculated based on the European requirements, which will have been finalised by then, and the higher of the revised AIRBA and the revised CRSA (standardised approach for credit risk) phase-in output floor.

Our Employees

The ongoing Covid-19 pandemic continued to confront our staff with changes in the year under review. After the first lockdown, we introduced a rolling attendance system with varying attendance ratios, depending on infection rates. Implemented alongside a strict hygiene concept, this allowed both working at the office and mobile work in the year under review. Where appropriate and compatible with the local regulations, this system was implemented at our international locations correspondingly. After another year with SARS-CoV-2, we have further strengthened those ways of cooperation in an exceptional situation and mastered the crisis well thanks to the measures and decisions taken.

Qualification and training programmes

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

With the new training and continuing professional development approach Learning@Aareal, which was introduced already in 2020, Aareal Bank supports employees through targeted offers that are focused on the corporate and human resources strategy, and Aareal Bank's USP (unique selling point).

Learning@Aareal is integrated in Aareal Bank's strategic development approach, which uses a skill matrix as the basis for talent development at an organisational level. By linking skill matrix, Learning@Aareal, clear selection procedures and management and expert career paths, we are facilitating the sustainable development of our employees, which, since 2021, has been supplemented by the mandatory development dialogue for all managers and employees. In this dialogue between employees and their managers, individual development measures are agreed upon for a medium- to long-term horizon covering 36 months so that employees will develop competencies and invest their talent in a forward-looking way.

This development dialogue promotes and develops both soft skills and hard skills (technical, methodological and digital skills) based on the current task – in the interests of the Company and the employee. In this context, networking knowledge contributes to the permanent development of the organisation and guarantees that specialist knowledge is secured through sustainable succession planning.

This integrated qualification and professional development approach also helps to further improve the balance between work and family life, which is one of Aareal Bank's core concerns. As a matter

Employee data as at 31 December 2021

	31 Dec 2021	31 Dec 2020	Change
Number of employees at Aareal Bank Group	3,170	2,982	6.3%
Years of service	10.9 years	10.8 years	0.1 years
Staff turnover rate	5.8%	4.5%	1.3%

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

of consequence, 50 % of the training content is available in digital format, therefore facilitating permanent learning regardless of time or location.

Personnel development at Aareon continued in digital format during the Covid-19 pandemic. Via an e-learning management system, training on housing industry topics (held by EBZ Bochum) and on management, agile project management, soft skills, communication and health were provided. Other offers included intercultural training, specific consulting courses and a digital coaching programme, which lasts several months.

A digital language learning portal helped to further build language and communications skills at both Aareal Bank and Aareon, within the scope of internationalisation. This learning portal was expanded in 2021 and allows all employees throughout the Group to improve their language skills, anywhere (even at home) and at any time.

Another personnel development measure was to conduct the cross-mentoring programme again at both Aareal Bank and Aareon. Due to strong demand, two parallel groups embarked on the programme in 2021, which is designed to promote knowledge transfer between the companies by facilitating the targeted exchange of staff.

Promoting the next generation

Promoting the next generation through training is a central element of Human Resources work at Aareal Bank Group. The specialist knowledge required in our business segments requires us to invest continuously – and in a targeted manner – in training the next generation. For this reason, talent recruitment and training are integral parts of our sustainable succession planning and our structured knowledge management. In 2021, we continued to expedite talent recruitment and training and were able to fill almost half of the vacancies with young professionals.

Aareal Bank's programme aimed at promoting the next generation comprises not only trainee programmes, but also the dual studies Business Informatics and Business Administration in cooperation with DHBW Mannheim and RheinMain University, as well as the on-the-job Bachelor's degree Business Administration in cooperation with the University of Applied Sciences Mainz. Moreover, Aareal Bank promotes dual courses of study and offers vocational training for IT applications developers, in cooperation with other companies in the region. Aareal Bank closely collaborates with universities in the region through various initiatives, which are being expanded continuously. In addition to the successful transfer of specialist knowledge and the gathering of new perspectives, the specific measures taken at Aareal Bank to empower young professionals have already reduced the average age.

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

In the course of the measures for promoting the next generation, Aareon supports the JOBLINGE initiative aimed at socially deprived young citizens. In addition, Aareon is cooperating with several universities, offers placements and supports students as part of the German scholarship of the Johannes Gutenberg University in Mainz.

Remuneration system

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

Work-life balance

Aareal Bank Group places great importance on supporting its employees to achieve compatibility between career and family. This is emphasised by a broad range of dedicated support services such as partnerships with childcare institutions or service providers for the provision of private childcare, holiday programmes for employees' children, the availability of parent-child workrooms, flexible working policies, part-time positions and the option of mobile working or alternating teleworking for all employees. Another component of improving the work-life balance of the employees consists of services that make it easier to combine working life with the care of close relatives. This includes, among other things, the offer of counselling and support in the event of illness as well as nursing care for close relatives (available throughout Germany), as well as the option of participating in various training courses in the Bank for better compatibility between family, care and work.

As an innovative company that promotes the digital transformation process holistically and manages the related process of change for its employees, Aareon had already implemented numerous measures as part of the "work4future" project concluded in 2020. The works agreement on mobile working was already implemented in 2019, increasing our employees' work flexibility. Then, a digital collaboration tool was introduced for internal communications, which brought employees even closer together in the Covid-19 pandemic, despite social distancing. This was supported through various campaigns and regular posts by members of the Management Board. Aareon has been awarded the "berufundfamilie" certificate for being very family-friendly. It was first awarded this certificate already in 2008. In September 2021, Aareon was moreover awarded the certificate as attractive employer according to the Great Place to Work® standard for Germany and France.

Health

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

In order to protect and promote the health of its employees in a targeted manner, Aareal Bank Group offers a comprehensive range of health-promoting measures in the areas of information, prophylaxis, exercise and ergonomics, nutrition, mental health and relaxation that are always based on employees' current needs. Despite the restrictions imposed by the pandemic in the reporting year, successful formats continued to be applied in the Bank. These included preventative, individual health consultations on various topics, consultations with the company doctor including screenings, flu vaccinations, skin screenings, colorectal cancer screening and ergonomics advice, as well as business yoga that was continued digitally. In June and July, Aareal Bank also offered all its employees their first Covid-19 vaccinations, which were administered on the Bank's premises.

In company health management, Aareon implemented numerous measures for supporting employees in the digital working worlds in 2021 – this was particularly relevant against the background of the Covid-19 pandemic. Space concepts were developed to meet the requirements of a modern and inspiring working environment, with many open spaces, niches and meeting islands supporting this new form of cooperation.

Risk Report

Aareal Bank Group Risk Management

The ability to correctly assess risks, and to manage them in a targeted manner, is a core skill in banking. Accordingly, being able to control risks in all their relevant variations is a key factor for a bank's sustainable, commercial success. This economic motivation for a highly-developed risk management system is continuously increased by extensive regulatory requirements for risk management.

Aareal Bank regularly reviews the appropriateness and effectiveness of its corporate governance systems (including risk governance systems). The regular review of the Risk Appetite Framework and the credit risk strategies carried out during the first quarter of 2021 did not indicate any material adjustments.

The Bank's risk management also incorporates sustainability risks, i.e. ESG risks from the environmental, social and governance areas. Aareal Bank considers sustainability risks to include overarching risks or risk drivers that are influenced directly or indirectly by environmental or social issues, or by monitoring processes. All material sustainability risks were able to be classified as a form of existing financial and non-financial risks. In line with this, they are managed implicitly as part of the risk types under which they are classified. ESG risks have been a component of the regular risk inventory process since 2021. Physical climate risk and transition risk in terms of investor behaviour that have an impact on credit, liquidity, property and reputational risk, were identified as the major short-term risk factors. This is complemented by the major mid- to long-term risk factors of the transition risk in relation to the regulatory environment and technology as well as governance factors such as fraud, sustainability management and data protection. In addition, there is client behaviour as an overarching factor.

Risk management – scope of application and areas of responsibility

Aareal Bank AG, as the parent entity of the Group, has implemented extensive systems and procedures to monitor and manage the Group's risk exposure.

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

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

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

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

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

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

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

Strategies

The business policy set by the Management Board, and duly acknowledged by the Supervisory Board, provides the conceptual framework for Aareal Bank Group's risk management. The Risk Appetite Framework, which also outlines the key elements of the risk culture put in place, is defined consistently with the business strategy and building on the defined risk appetite. Taking the Risk Appetite Framework as a basis, and strictly considering the Bank's risk-bearing capacity, we have formulated detailed strategies for managing the material types of risk, in terms of capital as well as liquidity. Taken together, these represent the Group's risk strategy. These strategies are designed to ensure a professional and conscious management of risks. Accordingly, these strategies include general policies, to ensure a uniform understanding of risks across all parts of the Group. They also provide a cross-sectional, binding framework applicable to all divisions. The Bank has implemented adequate risk management and risk control processes to implement these strategies, and to safeguard the Bank's risk-bearing capacity.

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

Management Board, duly noted, and approved by the Supervisory Board.

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

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

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

Risk-bearing capacity and risk limits

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

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

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

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

We are using the ICAAP economic perspective, whose purpose is to safeguard Aareal Bank Group's economic substance and thus, in particular, to protect creditors against economic losses. The procedures and methods are part of the Supervisory Review and Evaluation Process (SREP) and are applied in order to identify and quantify potential economic losses, and to determine the required capital backing.

The purpose of internal capital is to serve as a risk-bearing component under the economic perspective. Within Aareal Bank Group, the current regulatory Tier 1 capital serves as the basis for determining economic aggregate risk cover. Accordingly, available internal capital comprises Common Equity Tier 1 (CET1) capital, supplemented by Additional Tier 1 (AT1) capital. Tier 2 capital, as well as projected results to be incurred during the risk analysis horizon, are not taken into account.

Moreover, the value-oriented approach adopted under the economic perspective requires suitable adjustments to be made to regulatory Tier I capital, in order to bring aggregate risk cover into line with the economic assessment. Specifically, this may entail adjustments regarding conservative valuation, hidden encumbrances, or a management buffer.

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

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

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

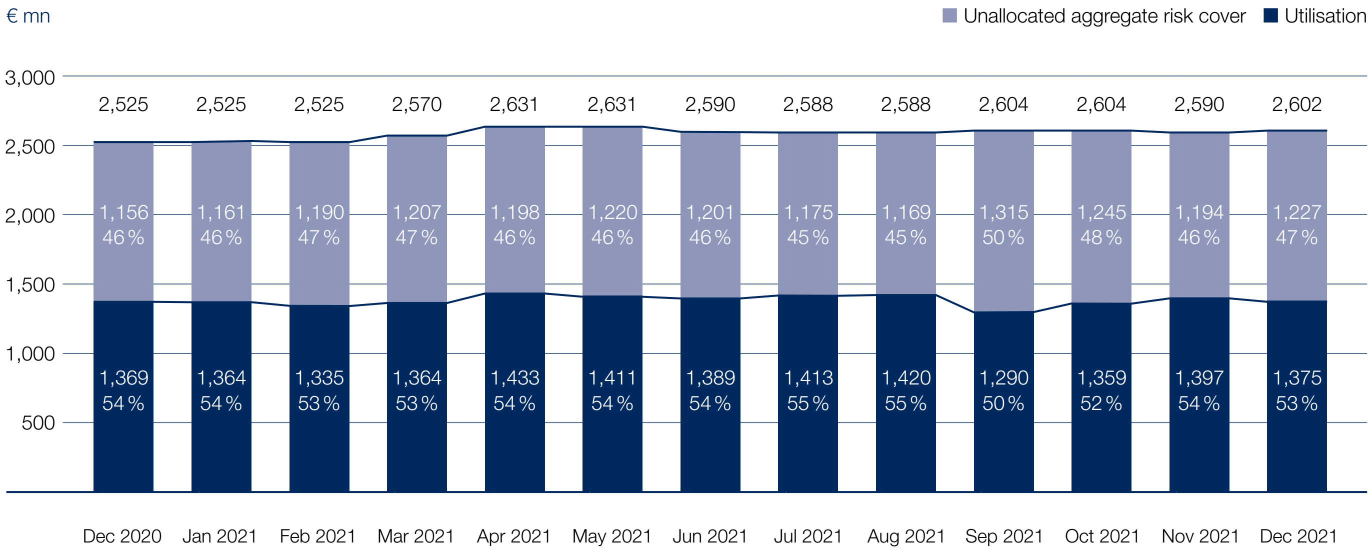
A detailed monthly report provides information regarding the utilisation of individual limits for the material types of risk, as well as on the overall limit utilisation. These are being monitored as part of daily reporting. No limit breaches were detected during the period under review.

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

€ mn	31 Dec 2021	31 Dec 2020
Tier 1 capital (T1 in accordance with Basel III)	2,622	2,586
Economic adjustments	-20	-61
Aggregate risk cover	**2,602**	**2,525**
Utilisation of aggregate risk cover		
Loan loss risks	574	637
Interest rate risk in the banking book (IRRBB)	136	68
Market risks	373	415
Operational risks	93	102
Investment risks	62	35
Property risks	79	76
Business and strategic risks	58	36
Total utilisation	**1,375**	**1,369**
Utilisation (% of aggregate risk cover)	**53 %**	**54%**

Utilisation of aggregate risk cover during the course of 2021

€ mn



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

Since risk cover potential is an inadequate measure to assess the risk-bearing capacity in terms of monitoring the Bank's ability to meet its payment obligations (liquidity risk in the narrower sense), we have defined special tools within the framework of the Internal Liquidity Adequacy Assessment Process (ILAAP) for managing and monitoring this type of risk. These tools are described in detail in the section "Liquidity risks".

Stress testing

Within the scope of ICAAP and ILAAP, scenario analyses are carried out in all perspectives, as a core element of our risk management system. This involves conducting stress tests for all material risks, using both historical parameters as well as hypothetical stress testing scenarios. To also be able to assess cross-relationships between the various types of risk, we have defined multi-factor stress scenarios, so-called "global" stress tests. For instance, the impact of the crisis affecting financial markets and the economy, which broke out in 2007, on individual types of risk and aggregate risk is analysed within the scope of a historical scenario. In the hypothetical scenario, current potential developments are derived from factors such as political developments, and are combined with significant macro-economic deterioration. The stress testing methodology implemented also takes into account the impact of any risk concentrations. Stress scenarios are analysed both from an economic and a normative perspective, with the respective cross-relationships being taken into consideration – meaning that any economic risks which may materialise (from a normative view) over the analysis period being incorporated in the normative perspective, unless they are sufficiently covered already. The Bank is currently working on integrating climate risks in stress testing. The integration process is scheduled to be completed in 2022.

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

Lending business

Division of functions and voting

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

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

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

The RiskExCo, which has delegated authority to the Heads of Risk Controlling, Credit Transaction Management and Credit Portfolio Management (organisational units which are independent of the Sales units), is responsible for the approval of counterparty, issuer, or country limits.

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

Process requirements

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

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

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

Early risk detection procedures

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

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

A CRE Credit Risk Committee (CRC) has been established in order to enhance the Bank's procedures for the early detection of risks. The CRC promotes the risk culture by identifying and addressing risk-relevant issues concerning individual credit exposures; the committee is also involved in each credit exposure with mandatory rating that is subject to higher risk exposure. Specifically, the CRC decides upon the exercise of discretion regarding classification of exposures as “normal”, “intensified” or “problem loan” handling, as well as approval of action plans. The transfer of know-how is enhanced through the cross-divisional representation on the CRC. Contractual measures related to Covid-19 – such as the waiver of certain agreements, deferrals of repayments, or the provision of liquidity facilities – are being reported to the Management Board on a regular basis, and closely monitored.

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

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

Risk classification procedures

Aareal Bank employs risk classification procedures tailored to the requirements of the respective asset class for the initial, regular, or event-driven assessment of counterparty credit risk. Responsibility for development, quality assurance, and monitoring implementation of risk classification procedures, and for annual validation, lies with two separate divisions outside the Sales units which are independent from each other.

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

Property financing business

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

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

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

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

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

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

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

Financial institutions

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

Sovereign states and local authorities

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

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

Trading activities

Functional separation

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

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

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

The detailed assignment of responsibilities is outlined below.

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

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

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

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

Process requirements

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

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

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

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

Loan loss risks

Definition

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

Credit risk strategy

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

The credit risk strategy will be reviewed, at least once a year, as to its suitability regarding the Bank's risk-bearing capacity and its business environment; amendments will be made as necessary. In this context, we also incorporate ESG criteria to assess the properties' sustainable intrinsic value. The associated process is instigated by senior management, and implemented by Risk Controlling, which submits a proposal, which has been agreed upon with all divisions to senior management. The credit risk strategy adopted is subsequently discussed by the Supervisory Board.

Designed in principle for a medium-term horizon, the credit risk strategy is adapted when necessary to reflect material changes in the Group's credit risk and business policies, or in the Group's business environment.

Risk measurement and monitoring

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

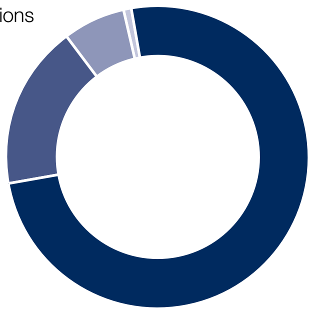
Processes in the credit and trading businesses are designed to consistently respect the clear functional division of Sales units ("Markt") and Credit Management ("Marktfolge"), up to and including senior management level. The independent Risk Controlling division is responsible for identifying, quantifying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

Aareal Bank employs different risk classification procedures tailored to the requirements of the respective type of business for the initial, regular, or event-driven assessment of counterparty credit risk. Forward-looking as well as macro-economic information is taken into consideration for risk classification procedures, and in the valuation of collateral. The respective procedures and parameters are subject to regular review and adjustment. Responsibility for development, quality assurance, and monitoring implementation of procedures, is outside the Sales units.

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

Breakdown of on-balance sheet and off-balance sheet business (gross carrying amounts)

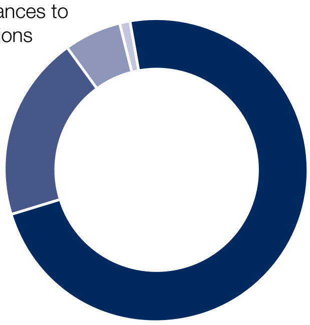
by rating procedure, € bn 31 Dec 2021



* Including the private client business of former WestImmo

Breakdown of on-balance sheet and off-balance sheet business (gross carrying amounts)

by rating procedure, € bn 31 Dec 2020



* Including the private client business of former WestImmo

We use two different credit risk models to measure, control and monitor concentration and diversification effects on a portfolio level. These are supplemented by limits on individual and sub-portfolio level to facilitate operating management. Based on these instruments, the Bank's decision-makers are regularly informed of the performance and risk content of property financing exposures, and of business with financial institutions. The models in question allow the Bank to include in particular, rating changes and correlation effects in the assessment of the risk concentrations.

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

Against the background of the Covid-19 pandemic, Aareal Bank was in close contact with most property financing clients with mandatory rating, and has amended contractual arrangements to clients' updated business plans to the extent necessary and possible. Given the lockdown, this primarily affected financings of hotels and shopping centres, as well as involving waivers of certain contractual agreements without impact on payments (covenants). Our clients and sponsors have provided a significant portion of the required liquidity from their own resources. In addition, funds obtained from government assistance were used and a few clients reduced their exposures. The gross carrying amount of the on-balance-sheet lending business under government moratoria amounted to € 4 million, whilst the gross carrying amount of on-balance sheet lending business subject to Covid-19-related forbearance measures amounted to € 6.6 billion.

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

When accounting for these measures, we have taken the recommendations made by the IASB, and by relevant regulatory authorities such as the EBA, the ECB and ESMA, into consideration – with the objective of providing a realistic assessment of expected losses. Intensified handling triggers recognition of loss allowance, in the amount of lifetime expected credit loss for the financial instrument concerned (Stage 2). The same applies for financings for which a forbearance measure has been granted.

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

On-balance sheet commercial property finance business with mandatory rating

	31 Dec 2021					31 Dec 2020				
€ mn	Stage 1	Stage 2	Stage 3	fvpl [1]	Total	Stage 1	Stage 2	Stage 3	fvpl [1]	Total
Class 1	–	–	–	–	**–**	–	–	–	–	**–**
Class 2	116	–	–	–	**116**	73	–	–	–	**73**
Class 3	203	3	–	–	**206**	249	4	–	–	**253**
Class 4	694	–	–	–	**694**	1,142	–	–	–	**1,142**
Class 5	3,602	105	–	160	**3,867**	3,684	9	–	249	**3,942**
Class 6	4,800	185	–	138	**5,123**	3,920	426	–	184	**4,530**
Class 7	4,337	331	–	67	**4,735**	2,991	297	–	253	**3,541**
Class 8	3,034	1,158	–	82	**4,274**	3,140	574	–	38	**3,752**
Class 9	1,004	2,545	–	48	**3,597**	2,565	1,271	–	14	**3,850**
Class 10	908	3,366	–	39	**4,313**	707	2,961	–	17	**3,685**
Class 11	38	731	–	–	**769**	453	514	–	–	**967**
Class 12	–	77	–	–	**77**	1	16	–	–	**17**
Classes 13-15	–	74	–	–	**74**	–	–	–	–	**–**
Defaulted	–	–	1,503	64	**1,567**	–	–	1,547	95	**1,642**
Total	18,736	8,575	1,503	598	29,412	18,925	6,072	1,547	850	27,394

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

Off-balance sheet commercial property finance business with mandatory rating

	31 Dec 2021					31 Dec 2020				
	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
€ mn										
Classes 1-3	–	–	–	–	–	–	–	–	–	–
Class 4	8	–	–	–	8	29	–	–	–	29
Class 5	157	–	–	–	157	69	–	–	10	79
Class 6	70	–	–	–	70	168	–	–	–	168
Class 7	102	–	–	–	102	87	0	–	14	101
Class 8	15	9	–	–	24	123	9	–	–	132
Class 9	113	47	–	–	160	158	41	–	–	199
Class 10	65	66	–	–	131	12	80	–	–	92
Class 11	23	8	–	–	31	30	11	–	–	41
Classes 12-15	–	1	–	–	1	–	–	–	–	–
Defaulted	–	–	6	–	6	–	–	1	5	6
Total	553	131	6	–	690	676	141	1	29	847

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

On-balance sheet loans and advances to financial institutions

	31 Dec 2021					31 Dec 2020				
	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
€ mn										
Class 1	619	–	–	–	619	853	–	–	–	853
Class 2	160	–	–	–	160	213	–	–	–	213
Class 3	373	–	–	–	373	26	–	–	–	26
Class 4	212	–	–	–	212	108	–	–	–	108
Class 5	21	–	–	–	21	48	–	–	–	48
Class 6	93	–	–	–	93	26	–	–	–	26
Class 7	708	–	–	–	708	677	–	–	–	677
Class 8	424	3	–	–	427	320	–	–	–	320
Class 9	30	–	–	–	30	–	–	–	–	–
Class 10	27	–	–	–	27	33	–	–	–	33
Classes 11-18	–	–	–	–	–	–	–	–	–	–
Defaulted	–	–	–	–	–	–	–	–	–	–
Total	2,667	3	–	–	2,670	2,304	–	–	–	2,304

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

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

	31 Dec 2021					31 Dec 2020				
€ mn	Stage 1	Stage 2	Stage 3	fvpl [1]	Total	Stage 1	Stage 2	Stage 3	fvpl [1]	Total
Class 1	3,400	–	–	–	**3,400**	3,622	–	–	–	**3,622**
Class 2	1,777	–	–	–	**1,777**	1,674	–	–	26	**1,700**
Class 3	656	–	–	–	**656**	778	–	–	62	**840**
Class 4	69	–	–	–	**69**	76	–	–	–	**76**
Class 5	64	–	–	–	**64**	36	–	–	–	**36**
Class 6	1	–	–	–	**1**	177	–	–	–	**177**
Class 7	187	–	–	–	**187**	151	–	–	–	**151**
Class 8	0	–	–	–	**0**	1	–	–	–	**1**
Class 9	620	186	–	–	**806**	404	556	–	–	**960**
Classes 10-20	–	–	–	–	**–**	–	–	–	–	**–**
Defaulted	–	–	–	–	**–**	–	–	–	–	**–**
Total	6,774	186	–	–	6,960	6,919	556	–	88	7,563

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

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

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

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

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

Credit risk mitigation

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

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

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

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

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

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

Credit risk mitigation for trading activities

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

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

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

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

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

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

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

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

Collateral for derivative transactions is usually provided in cash. Repo transactions are usually collateralised through securities, pledged on a daily basis.

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

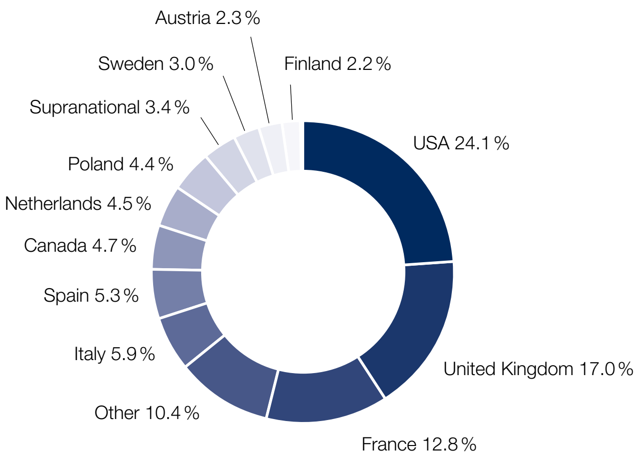
Country risks

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

The diagram below illustrates the risk exposure by country (comprising receivables and off-balance sheet obligations) in the Bank's international business, at year-end. In the property financing business, country exposures are allocated by location of the property used as collateral. For exposures not

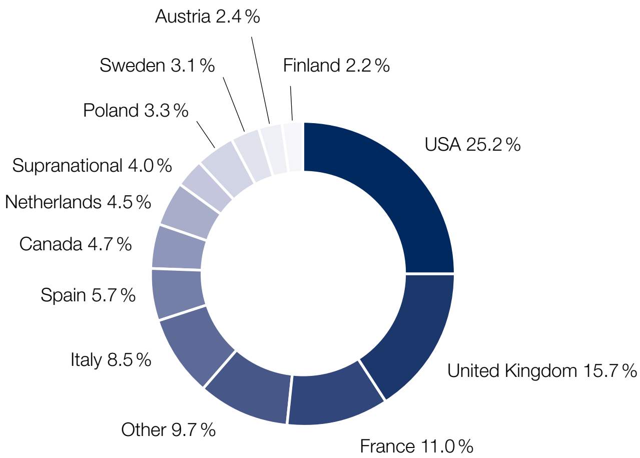
Breakdown of country exposure in the international business

% 31 Dec 2021



Breakdown of country exposure in the international business

% 31 Dec 2020



collateralised by property, the allocation is based on the borrower's country of domicile. This reflects the exposure of the property finance business, as well as the activities of Treasury.

Interest rate risk in the banking book

Definition

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

Specifically, for Aareal Bank this includes:

- risks arising from maturity transformation in the event of yield curve shifts (so-called gap risk), which, in turn, are broken down into:
  - risks from cash flows which are sensitive to interest rates, relative to the general yield curve (interest rate risk or repricing risk);
  - risks arising from the valuation of future cash flows, relative to the general yield curve (yield curve risk);
- risks from cash flows which are sensitive to interest rates, in terms of spreads to the general yield curve (basis risk);
- risks from explicit and implied options (option risk);
- risks arising from changing valuation of pension liabilities (pension risk);
- risks from fluctuations in the value of fund assets (fund risk); and
- risks from changes in Aareal Bank's specific funding spreads (funding risk).

Risk measurement and monitoring

Risk Controlling informs the members of the Management Board responsible for Treasury and risk monitoring about the risk position and the present-value exposure to interest rate risk in the banking book on a daily basis (the "economic value of equity" perspective). This is supplemented, on a monthly basis, by an analysis of possible deviations of planned income in the event of adverse interest rate scenarios (the earnings perspective). Underlying interest rate scenarios applied for measuring potential planning deviations comprise upside and downside interest rate shocks as well as increases and decreases in forecast interest rates used for planning interest income over time.

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

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

By their very nature, VaR calculations are based on numerous assumptions regarding the future development of the business, and the related cash flows. Key assumptions used include current account balances and deposits at notice which are factored into calculations for a period of up to ten years (2.75 years on average), using the average residual amount of deposits observed , in the past. Loans are taken into account using their fixed-interest period (for fixed-rate exposures), or using their expected maturity (variable-rate exposures). Aareal Bank Group's consolidated equity is not taken into account as a risk-mitigating item. This tends to overstate VaR, demonstrating our goal to pursue a conservative approach adopted in our risk measurement processes.

The change in net interest income in the relevant interest rate shock scenarios is determined in addition, and in accordance with the EBA guidelines EBA/GL/2018/02 on managing interest rate risk in the banking book (IRRBB). Net interest income equals the difference between interest income and interest expenses on all interest-bearing assets and liabilities in the banking book, including derivatives and off-balance sheet items in accordance with IFRSs. In contrast to a present-value analysis, net interest income is not limited to modelled earnings contributions of existing assets and liabilities as at the planning/forecast date, but additionally includes income and expenses from planned new business and renewals. Changes essentially reflect the diverging developments of forward interest rates prior and after an interest rate shock, as well as the resulting modelled impact on client behaviour.

Interest rate sensitivity

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

Present-value impact of an interest rate shock

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

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

Furthermore, present value changes are determined (and their ratio to Tier 1 capital shown) for six early-warning indicators, applying the prescribed scenarios. The ratio of the aggregate result to Aareal Bank Group's Tier 1 capital is clearly below the prescribed threshold of 15 %.

Net interest income is a metric derived from the income statement. To measure income risk, changes in net interest income due to a 200 basis point parallel yield curve shift over the next twelve months are determined. In this context, assumptions regarding client behaviour and the competitive environment in such a scenario are especially subject to idealised model parameters.

Changes in present value

	31 Dec 2021		31 Dec 2020	
	-200 bp	+200 bp	-200 bp	+200 bp
€ mn				
EUR	-23	101	9	49
GBP	8	-16	19	-21
USD	84	-43	62	-39
Other	10	-9	8	-18
Total	**79**	**33**	**98**	**-29**
Percentage ratio to regulatory capital	**2.6**	**1.1**	**2.9**	**0.9**

€ mn	31 Dec 2021	31 Dec 2020
Parallel shock up	29	-32
Interest rate coefficient for parallel shock up (%)	1.1	1.2
Parallel shock down	80	98
Interest rate coefficient for parallel shock down (%)	3.1	3.8
Steepener shock	64	50
Interest rate coefficient for steepener shock (%)	2.4	1.9
Flattener shock	-26	2
Interest rate coefficient for flattener shock (%)	1.0	0.1
Short rates shock up	-22	-39
Interest rate coefficient for short rates shock up (%)	0.8	1.5
Short rates shock down	81	92
Interest rate coefficient for short rates shock down (%)	3.1	3.6
Tier 1 capital (T1 in accordance with Basel III)	**2,622**	**2,586**

Market risks

Definition

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

Specifically, for Aareal Bank this includes:

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

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

Commodities are irrelevant for the Bank's business. Currency risks are controlled through derivatives.

Additional elements of market risk are:

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

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

Risk measurement and monitoring

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

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

A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. Determined on a daily basis for the Group, the VaR figure takes into account the correlation between individual risk types. Statistical parameters used in the VaR model are calculated directly from a historical data pool maintained within the Bank, which covers at least 250 days[1]. The loss potential is determined applying a 99.9 % confidence interval.

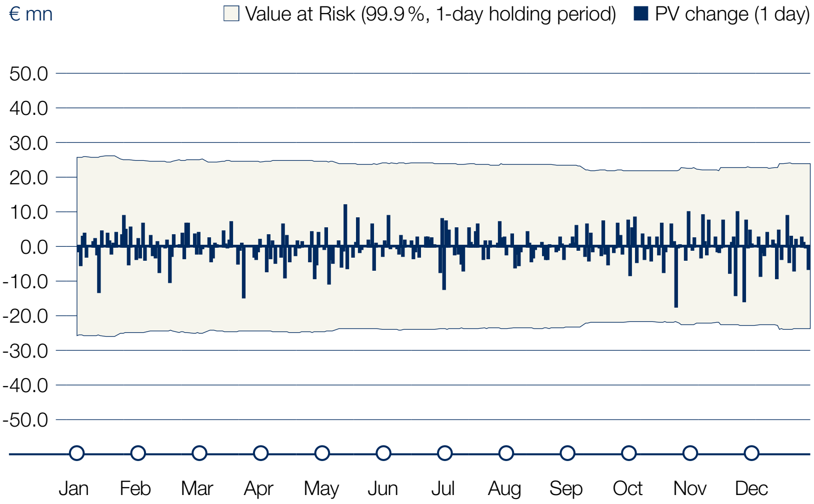
Backtesting

The quality of forecasts made using statistical models is checked through a monthly backtesting process. The quality of the statistical procedure used to measure risk is checked using a binomial test, whereby daily profits and losses from market fluctuations are compared with the upper projected loss limit (VaR) forecast on the previous day (known as "clean backtesting"). In line with the selected confidence level of 99.9 %, only a small number of events are expected to break out of the VaR projection.

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

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

Present values and 1-day VaR during the course of 2021



Operational risks

Definition

The Bank defines operational risk as the threat of losses caused by inappropriate internal procedures, human resources and systems (or their failure), or through external events. This definition also includes legal risks. To the extent that they are caused by operational risks, model and reputational risks are also taken into consideration within this type of risk. ESG risk factors have also been taken into account within operational risk since 2021. Systemic risks (or their impact on operational risks) are not affected by this.

Risk measurement and monitoring

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

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

- Self-assessments: analysis thereof can provide management with indicators of any potential risks within the organisational structure.
- Risk inventories that include a periodic systematic identification and compilation of all relevant risks.

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

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

Data are collected on a decentralised basis and all material operational risks of the Group compiled centrally.

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

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

Aareal Bank's legal department monitors any litigation the Bank is involved in (whether in court or out-of-court), and deals with any legal issues of fundamental importance. where necessary, using the support of external lawyers.

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

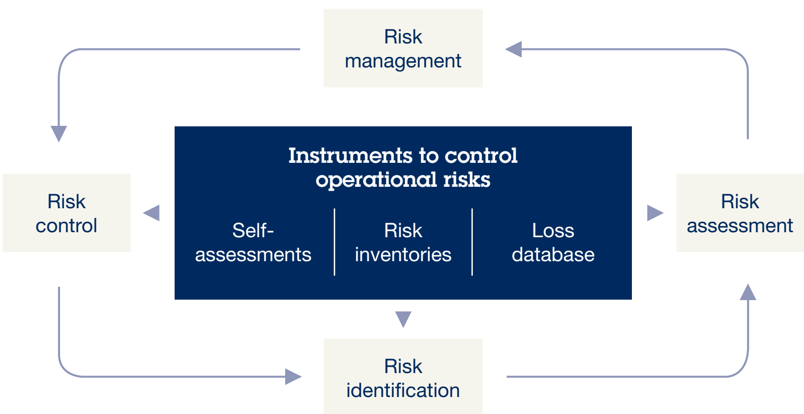
The legal department reports to the Management Board, (at least) on a quarterly basis, as well as on an event-driven basis. Moreover, information about legal risks is included in operational risk reporting.

Operational risk is quantified using the regulatory standardised approach. Supplementary operational risk management tools – in particular, the monitoring of indicators, analyses of loss events, scenario analyses and the self-assessment – do not indicate potential elevated risk either; nor were any material risk concentrations evident. Even though loss cases are recorded in the loss database on an ongoing basis, the aggregate impact of such losses during the year under review amounted to less than 20 % of the regulatory capital to be maintained for operational risks.

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

Tools to control operational risk are supplemented by a system to manage and monitor outsourced activities and processes (outsourcing), whereby the

Management of operational risks



relevant organisational units regularly assess the performance of outsourcing providers, using defined criteria. The results of this process, and actions taken, are communicated to the Bank's senior management within the scope of operational risk reporting, thus allowing for risk-mitigating steps to be taken where needed.

Investment risks

Definition

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

Risk measurement and monitoring

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

The existing procedures used to measure and monitor risk exposure are supplemented by subjecting the equity portfolio to regular stress testing.

Strategy Development, as well as Finance & Controlling and Risk Controlling, are responsible for measuring and monitoring investment risk exposure.

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

Property risks

Definition

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

Due to the special character of property risk (involving marketing risks, for example), special methods and procedures are employed to deal with investment risk. All relevant property holdings are subject to regular audits, including a review and assessment of their risk situation.

Risk measurement and monitoring

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

Business and strategic risks

Definition

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

Risk measurement and monitoring

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

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

Liquidity risks

Definition

Liquidity risk in the narrower sense is defined as the risk that current or future payment obligations cannot be met in full or on time. Aareal Bank Group's liquidity risk management system is designed to ensure that the Bank has sufficient cash and cash equivalents to honour its payment obligations at any future point in time. The risk management processes have been designed to cover not only the liquidity risk in the narrower sense (insolvency risk), but also market liquidity risk and refinancing risk, including cost risk which is measured and limited accordingly as a component of the IRRBB. All elements have been integrated in an overarching ILAAP, which maps liquidity risks in both the normative and the economic perspective. Within the framework of Group planning, in addition to ICAAP risk parameters taken into account for capital planning purposes, ILAAP risk parameters for a three-year horizon are also considered.

Risk measurement and monitoring

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

Cash flow forecast

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

Liquidity run-off profile

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

Stress testing

Moreover, we employ stress tests and scenario analyses to assess the impact of sudden stress events onto the Bank's liquidity situation. The various standardised scenarios used, which include at least one historic, one idiosyncratic and one combined scenario, are evaluated based on the liquidity run-off profile.

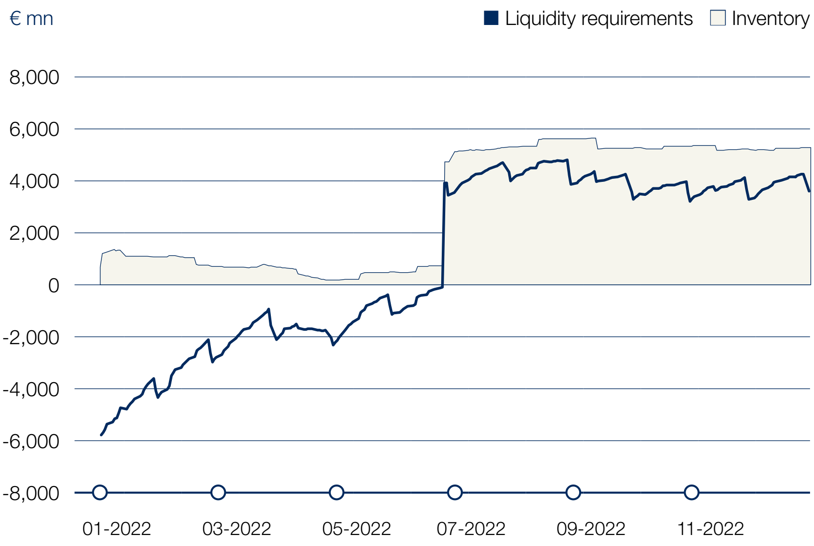
We generally consider the withdrawal of deposits from the housing industry as the most significant scenario. Even in this stress scenario, liquidity is sufficient to cover the expected liquidity needs under stress conditions.

Time to illiquidity

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

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

The following chart shows the projected development of the liquidity stock, together with aggregate liquidity requirements (incorporating planned portfolio developments, and including security add-ons for adverse future events) until the end of 2022. The chart demonstrates that the liquidity stock will always exceed liquidity requirements, even under adverse conditions. The increase in the liquidity stock from June 2022 onwards reflects the maturity of Targeted Longer-term Refinancing Operations (TLTROs), together with related collateral.



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

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

Concentration limits
Besides the pure measurement of risk indicators, we also monitor concentrations of liquid assets and of funding sources, determining the percentage share of the ten largest counterparties and/or positions, relative to the total portfolio.

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

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

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

Long Term LAB
The long-term liquidity run-off profile (Long Term LAB) provides a forecast of the economic perspective and enables an outlook of the liquidity run-off profile (liquidity risk model) over a period of up to three years. This liquidity run-off profile compares the expected liquidity requirements and available liquidity for different scenarios at various points in time in the future; thus, any potential liquidity shortfalls or liquidity reserves arising in the future are identified with regard to the liquidity run-off profile.

Accounting-Related Internal Control and Risk Management System

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

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

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

Organisation of the accounting-related ICS and RMS

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

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

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

The Supervisory Board is responsible for monitoring the Management Board. Within the scope of financial reporting, it approves the single-entity financial statements of Aareal Bank AG as well as the consolidated financial statements and group management report. Measures taken by the Supervisory Board to ensure an efficient performance of its control functions include the establishment of an Audit Committee, which is primarily responsible for financial reporting issues and monitors the effectiveness of Aareal Bank's Internal Control System. It analyses and assesses the presented financial statements and internal risk reports as well as the annual report submitted by Internal Audit. In addition, the Audit Committee is responsible for determining the focal points of the audit, as well as for evaluating the auditors' findings. The Audit

Committee includes an expert in the fields of accounting or auditing, pursuant to section 100 (5) of the German Public Limited Companies Act (Aktiengesetz – "AktG").

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

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

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

Components of the accounting-related ICS and RMS

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

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

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

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

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

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

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

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

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

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

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

Report on Expected Developments and Opportunities

Macro-economic environment

The economy, financial markets, and commercial property are all exposed to a number of risks, with some downside risks dissipating or diminishing in 2021, evident in the availability of Covid-19 vaccines, for instance, and the ongoing economic recovery in many economies. However, there are risks that could still have a negative impact, particularly the ongoing Covid-19 pandemic with its emerging or potential new viral mutations and associated economic restrictions. Doubts about the cohesion of the European project, increased government and private debt, geopolitical risks such as the conflict in Ukraine, persisting disruptions in the supply chain, continued high inflation as well as the consequences of the transition of the economy towards climate neutrality pose other significant risks.

An ongoing Covid-19 pandemic due to high rates of new infections and virus mutations or a sluggish vaccination progress could slow down or halt the recovery of individual regions. Extension or reintroduction of infection control measures could have adverse consequences on demand and the services sector in particular. Countries with major deficits as regards vaccination progress are likely to face the biggest social and economic challenges in view of potential new waves of infection.

The political shift away from European cohesion poses a significant threat not only to the EU, but also to Europe, in the long term. This refers to governments in Central and Eastern Europe with nationalist attitudes. The Covid-19 pandemic has also elevated the risk of a rise in populism in several countries. The reform backlog and structural economic problems in some euro zone countries present further uncertainties, risk and stress factors. While the EU's recovery package specifically seeks to support these countries, there is still the risk that the measures in place will not be used efficiently or will not be enough to fully address structural problems at play and the negative impact of the Covid-19 pandemic.

Rising national debt as a result of the massive fiscal support provided, but also as a consequence of the previous year's economic slump, is a global problem. While central banks continue to provide favourable refinancing conditions, risk premiums for highly indebted sovereigns could rise as bond-buying programmes come to an end. Non-financial corporate debt has expanded in many advanced economies, mainly due to an increase in bond issuance.

However, the risk of disruption to free trade remains, despite some easing and the recent lack of further tightening. In addition, further geopolitical risks such as cyberattacks, terrorism and political or military conflicts are likely to have a significant impact on markets and their participants. Sanctions related to the conflict in Ukraine could mean that our remaining (collateralised) exposure to Russia of around € 200 million, which is being further reduced, may not be serviced due to political interventions (transfer risk).

The global value creation and supply chains currently face considerably more severe effects than would be expected in a recovery cycle based on historical experience. If the existing supply bottlenecks remained or even deteriorated, this would represent a significant risk factor, eventually decelerating growth of the economy as a whole, but in particular growth of production output in the manufacturing sector.

The strong global demand for goods and services as pent-up savings are being used for consumption, high capital expenditure and the pick-up in energy prices have already significantly accelerated the rise in price levels and, in some economies, lifted them to the highest rate in several decades. If this demand encounters bottlenecks on the supply side due to capacity constraints and disruptions in the supply chains also in the future, prices of some goods and services may rise further, contributing to rising inflation and possibly to persistently higher inflation expectations. A sustained high inflation rate might lead to tighter monetary policy in the medium term.

The efforts of many countries and companies to limit global warming requires a radical transformation of the entire economy. The macro-economic impact of this transformation process is uncertain, and the actual effects depend on a number of factors. Similarly, this change entails costs that will likely be borne by companies and end-consumers alike. Decarbonisation of the economy, for instance, not only involves energy supply, but also requires significant changes in industry, transport, construction and agriculture.

Relating to macro-economic development, these factors are also significant for the financial and capital markets, and could trigger further disruption on these markets if they were to materialise to a considerable extent.

Economy

After the global upswing in 2021, with sometimes very high growth rates, economic recovery is expected to continue in 2022, albeit at a slower pace. Despite the fact that some risk factors represent an immediate threat and new virus mutations may emerge, the situation for public health is expected to normalise over the year and many supply chain problems should disappear. Contact-intensive industries in particular should continue to benefit from the recovery, and the shift in consumption from manufacturing to services should also continue. All in all, this potential for catch-up and strong private consumption support the assumption that the global economy will resume strong real growth in 2022, which will be defined by significant shifts in key macro-economic trends. Structural budget deficits in industrialised countries will narrow next year as support measures continue to come to an end, making fiscal policy more restrictive. However, private consumption of excess savings may soften the impact of tighter fiscal policy. Depending on the willingness of private households to spend, the main growth impulse should thus be returned from fiscal policy to the private sector.

Real gross domestic product in the euro zone is expected to increase significantly again in 2022. In this context, private consumption is likely to be the most important growth driver with a considerable share of the savings accumulated by households expected to be spent. With growth in world trade having reached its temporary peak in 2021, a slowdown in goods exports is expected. Supported by the EU investment package, rising investment spending should stimulate growth. Since each member state has chosen its own focus for investment and is affected to varying degrees by the consequences of the Covid-19 pandemic, the subsequent recovery of the EU member states will vary from country to country.

For the UK as well, a strong economic recovery is expected for 2022. This is due to rising business investment, the conversion of part of household savings into consumption, and pent-up demand that still exists in the wake of the sharp economic downturn in 2020. In addition, a strong increase in exports is expected, in contrast to the euro zone. While the recovery in 2021 still benefited from extraordinary fiscal policy measures, this stimulus will be gradually withdrawn in 2022, which will see the recovery enter a new phase.

We also expect the US economy to grow significantly in 2022. Extensive fiscal stimulus, employment recovering to pre-crisis levels and private consumption will be the main drivers of this growth. Exports are also expected to grow faster than imports in 2022 for the first time since 2013. Driven by private consumer spending and rising exports, we also expect Canada's real GDP to increase significantly in 2022.

Due to the downturn in the construction sector and the zero-Covid policy, which is burdening production and private consumption, we expect China's growth to be weaker in 2022 than in 2021. It also represents a return to China's transition economy with growth rates slowing relative to pre-pandemic levels. Based on private consumption and an increase in industrial production, Australia's economy is expected to grow significantly in 2022. However, declining investment is likely to result in a slightly lower growth rate than in 2021.

Financial and capital markets, monetary policy and inflation

The risks and uncertainties referred to above are also significant for the financial and capital markets and could once again cause considerable disruption. However, we remain confident that the funding markets will continue to offer favourable funding conditions.

Due to ongoing uncertainties and to ensure that the recovery is not interrupted, we expect monetary policy to remain expansive overall and continued low interest rates in 2022. However, given current labour market and inflation developments, the major central banks have started to tighten their monetary policies. This is a sign that the focus of monetary policy is now on price stability and no longer mainly on stimulating the economy.

Apart from discontinuing net asset purchases, the Fed announced in January 2022 that it expects to raise its key interest rate soon in 2022 against the backdrop of an inflation rate of well above 2% and a strong labour market. Following an initial rate hike in December 2021, the Bank of England is also forecast to raise its bank rate again in 2022. In contrast, the ECB will probably stick to a more expansive monetary policy approach in 2022. Although it has announced that it will terminate net purchases under the PEPP in March 2022, the ECB is likely to buy a higher number of bonds under the APP at the same time. Since the ECB will, by its own admission, first terminate the net purchases of the programme before raising interest rates, it is not expected to raise interest rates in the euro zone in 2022. However, it is expected that deposit rates might be raised as early as 2022.

Several factors are likely to cause inflationary pressures in 2022 to fall below the high levels reached at the end of 2021, even if new highs can be expected in the meantime, depending on the region. Supply-side bottlenecks in the manufacturing sector should ease as supply chains are repaired. In addition, a progressive reduction in the consumption backlog, the expiry of base effects and an easing of energy price rises will probably contribute to a decline in price increases. Inflation rates, however, are likely to remain higher than before the onset of the coronavirus pandemic.

Regulatory environment

The Covid-19 pandemic also impacted the regulatory environment, at least temporarily. For example, as an immediate reaction to the outbreak of the pandemic, various regulatory initiatives were deferred and temporary relief resolved for financial institutions. Nonetheless, the trend towards a tighter regulatory framework is set to persist in the years ahead, too. For instance, the finalisation of the Basel III framework, adopted by the Basel Committee's Group of Governors and Heads of Supervision (GHOS), will bring about extensive changes to the approaches used for determining risk-weighted capital requirements ("Basel IV"). The EU Commission submitted a proposal on this in October 2021, which will now be finalised as part of the trilogue procedure. The proposed first-time application of the new regulation is 1 January 2025 and therefore two years later than planned by the BCBS.

The EU also adopted a package of measures to overhaul its anti-money laundering and countering of terrorist financing frameworks. Aside from a new EU regulation and a revision of the applicable EU directives, it stipulates the creation of a new anti-money laundering and terrorist financing authority from 1 January 2023 onwards, which is to be fully established by 2025.

In addition, over the next few years, the regulatory environment will be increasingly defined by growing requirements with regard to sustainable business and ESG (Environmental, Social, Governance) risk management. One of the main foundations here is the introduction and further expansion of the EU taxonomy for the classification of economic activities. Initial, minor disclosure requirements for ESG matters are applicable as of 31 December 2021 for the first time, with the scope increasing over time. The ECB will also carry out a climate stress test exercise for the first time in 2022.

ESG risk management will also play an increasingly important role in the context of risk management and the SREP. In addition, the supervisory authorities are also considering taking ESG factors into account when determining regulatory capital requirements.

In addition, several countries have already announced to (re-)introduce the countercyclical capital buffer previously suspended in almost all countries due to the Covid-19 pandemic. For example, the package of macroprudential measures as resolved by the German Federal Financial Supervisory Authority (BaFin) in January 2022 provides for a reinstatement of the countercyclical capital buffer for risk exposures located in Germany as well as the first-time introduction of a sector-specific systemic risk buffer for loans collateralised by residential properties in 2023. This will result in increasing capital buffer requirements for the Bank.

Sector-specific and business developments

Structured Property Financing segment

Commercial property is generally expected to benefit in 2022 from the assumed continued strong economic momentum and the increasing normalisation of business operations in most sectors of the economy. The Bank anticipates competition in the commercial property financing markets to remain intense, particularly in regions and for property types that were already in high demand in 2021. However, given the attractive yields and lower risks, property types that were hit harder by the pandemic are also expected to experience higher demand. Loan-to-value ratios for new business are likely to remain stable for the most part and only tend to increase slightly for commercial properties that are in particularly high demand. Intense competition is expected to put downward pressure on commercial property financing margins this year.

Uncertainty remains for commercial property in the wake of the Covid-19 pandemic, mainly due to the pandemic development and further economic recovery, which will vary depending on the region. This uncertainty relates in particular to possible new infection control measures, which are likely to have varying effects depending on the country and type of property, albeit not at the same level as in the past. A renewed tightening of contact bans, travel restrictions and business closures of a temporary nature could have a negative impact on cash flows in 2022, particularly for hotel and retail properties.

Moreover, other uncertainty factors and risks in the macro-economic environment are also relevant for commercial property markets. Various factors are expected to have an impact on how commercial property values develop in 2022. While very low interest rates in combination with positive rental developments support property prices, rising political uncertainty, economic downturns or investor reticence as a result of emerging risks can all have a negative impact on these prices. Rising interest rates also pose risks. For example, the increase in the cost of capital associated with rising interest rates can result in a lower valuation of commercial properties if the higher cost of capital is not offset by rent increases.

With regard to commercial property, we expect stable to rising market values in the current year, followed by rising interest rates as a result of tighter monetary policy, which is likely to preclude any further increase in market values. Considering the assumed economic recovery, most commercial properties should continue their positive development and return to their pre-crisis values in the years to come. This development will be influenced not only by the quality and location of the property, but also increasingly by compliance with sustainability criteria (ESG).

With a view to retail properties, we expect a slower recovery, as the structural change in shopping behaviour is having a dampening effect on the outlook of value-driving rental revenues, depending on location and segment. Also depending on location and segment, we see hotel properties recovering to more or less pre-crisis levels over the coming years, driven by increasing travel activity. We expect a similar development with student housing, where demand from international students should recover over the next few years as a result of the return to face-to-face teaching. As for office properties, we believe market values will rise over the next few years. However, value appreciation will be lower than in the pre-crisis period, as rental growth is expected to weaken. Logistics properties continue to be assessed positively, as we expect the trend of rising market values of these properties to prevail.

Overall, the forecast is subject to far greater uncertainty than usual on account of the Covid-19 pandemic, also against the background of the rapid spread of the highly contagious Omicron variant, and any potential new waves of infection and contact restrictions in 2022.

As a matter of principle, it is worth noting that estimation uncertainty – concerning the economy, markets and the impact on Aareal Bank – is currently still at a high level. Due to this higher estimation uncertainty, we have simulated two "bad case" scenarios in addition to our "swoosh" scenario. In the so-called "bad case 1" and "bad case 2" scenarios, loss allowance for the overall portfolio increases by approximately 15 basis points and 10 basis points, respectively, compared to our "swoosh" scenario in 2022. In line with current Group planning, these scenarios are based on the following macro-economic factors:

%	2021	2022	2023	2024
"Swoosh" scenario				
Gross domestic product (year-on-year change in %)				
Euro zone	5.1	3.9	2.7	1.5
US	5.6	4.0	2.5	1.9
UK	7.2	4.4	2.8	1.5
Unemployment (%)				
Euro zone	7.7	7.4	7.3	7.2
US	5.4	3.8	3.6	3.5
UK	5.7	4.4	4.1	3.8
Portfolio-weighted property price development (2021 basis = 100%)	100 %	102 %	102 %	101 %
"Bad case" scenario #1				
Gross domestic product (year-on-year change in %)				
Euro zone	5.1	1.4	3.4	2.0
US	5.6	1.3	3.4	2.1
UK	7.2	2.3	3.5	1.6
Unemployment (%)				
Euro zone	7.7	8.1	8.0	7.5
US	5.4	4.3	3.9	3.7
UK	5.7	4.9	4.6	4.1
Portfolio-weighted property price development (2021 basis = 100%)	100 %	92 %	93 %	96 %

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%	2021	2022	2023	2024
"Bad case" scenario #2				
Gross domestic product (year-on-year change in %)				
Euro zone	5.1	2.9	1.3	0.9
US	5.6	2.4	1.2	1.4
UK	7.2	3.6	1.2	0.4
Unemployment (%)				
Euro zone	7.7	7.5	7.6	7.5
US	5.4	4.1	4.0	3.9
UK	5.7	4.5	4.6	4.6
Portfolio-weighted property price development (2021 basis = 100%)	100 %	99 %	96 %	94 %

In the Structured Property Financing segment, we aim to originate new business of between € 7 billion and € 8 billion for the 2022 financial year, so that Aareal Bank Group's property financing portfolio will amount to approximately € 31 billion at the end of 2022, subject to exchange rate fluctuations. To manage our portfolio and risk exposure, we also use syndications.

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

Banking & Digital Solutions segment

The German housing and commercial property industries are expected to remain solid in 2022, in spite of the Covid-19 pandemic, and we expect rents to remain largely steady overall. Growth in the residential and logistics segments will remain particularly robust. Since the retail trade in everyday consumer goods is also largely stable, mixed-use properties represent opportunities for growth in the commercial property market.

Urbanisation is set to continue to rise over the coming years as well, with the ongoing trend towards smaller households due to demographic change, thus placing additional pressure on housing providers to modernise. Housing shortages continue to be a problem, as construction work is unable to keep pace with the influx of new residents. We expect cost pressure for the German housing industry to increase as a result of the climate targets, despite government support programmes.

Even though the Bank's market share in the institutional housing industry is already high based on the number of residential units, we see excellent opportunities for acquiring new clients and enhancing our existing client relationships in the course of the 2022 financial year. We plan to achieve this by continuing to invest in the expansion of the "Housing Industry Ecosystem", the cross-sector development of interface products, and the expansion into adjacent ecosystems, such as companies from the utilities and waste disposal industries. The focus here remains on, for example, the functional expansion of the Aareal Portal corporate client platform as regards the digitalisation of client communication and account processing.

In our view, the range of services that connect alternative online payment solutions to existing systems, thus helping to overcome process breaks (even across industry sectors), are particularly interesting. The Aareal Exchange & Payment Platform, which integrates alternative payment methods with existing accounting systems, has been available since 2020 with an interface to viacash and was expanded in May 2021 to include additional payment methods such as PayPal and credit cards. We also see potential in technical solutions for automating billing processes as part of electromobility in the network of charging stations. The corresponding Aareal Connected Payments product was launched successfully on the market in 2020. Further growth is anticipated from the integrated rental security product Aareal Aval and from Aareal Meter, a solution that uses mobile meter reading and subsequent data capture without disrupting traffic to provide a digital solution to a labour-intensive analogue process gap.

Against this background, we are aiming for renewed net commission income growth in our core activities and expect the average deposit volume from the housing industry to remain around € 12 billion. The persistently low interest rate environment, which is relevant for the results from our deposit-taking business, will continue to burden segment results. However, the importance of this business goes way beyond the interest margin generated from the deposits, which is under pressure in the current market environment. This is because the deposits from the housing industry represent a strategically important, stable and alternative source of funding for Aareal Bank.

Aareon segment

Aareon will accelerate its growth strategy in the 2022 financial year, to become a "Rule of 40" entity in the medium term, by 2025. This indicator is calculated on the basis of revenue growth and EBITDA margin (earnings before interest, taxes, depreciation and amortisation). The sum of the two should add up to 40 % in order to achieve a balance between growth and profitability. In this context, the Aareon Flight Plan will be implemented further. This plan includes investments in existing and new products, as well as measures from the Value Creation Programme. Inorganic growth will also be achieved through mergers & acquisitions. Measures from the Value Creation Programme include the expansion of sales activities, such as the marketing of process-oriented product packages – which combine an ERP product with various digital solutions – that started in 2021, the accelerated transformation of the in-house operating model to a software as a service (SaaS) operating model, and the switch to a subscription-based rental model.

Aareon's consolidated sales revenues for the 2022 financial year are expected to increase significantly to between € 305 million and € 325 million (2021: € 269 million). While this should be realised through the expansion of the operating business, the acquisitions made during the year in 2021 will also contribute to this increase. Revenue growth from ERP products is expected to be in the low double-digit percentage range. Plans to continue to expand the SaaS business, coupled with the rental model as a payment option, will lead to markedly lower licence revenues. However, recurring revenues will contribute significantly over the short to medium term. Adjusted EBITDA[1] is expected to be significantly higher than the previous year between € 73 million to € 78 million (2021: € 67 million) and will include adjustments of between € 13 million and € 15 million (2021: € 24 million).

Demand for the new Wodis Yuneo product generation in the DACH region is expected to increase further. The ERP system Wodis Yuneo, launched in September 2020, will be a revenue driver in 2022 both as a subscription model and as software as a service. Aareon expects revenues from SAP® solutions and Blue Eagle to be in line with the previous year. Revenue from the RELion ERP solution, which is focused on the commercial property industry, is expected to be markedly higher than in 2021, mainly due to a resurgence in consulting services. The business volume generated from Aareon Cloud Services and BauSecura insurance management will be in line with the previous year's level. The ERP system immotion®, which was added to the product portfolio through the acquisition of the GAP Group, will contribute to the strong development of ERP sales revenues in 2022. Aareon's market share of SaaS in the Netherlands will increase significantly, driven by the acquisition

[1] "Earnings before interest, taxes, depreciation and amortisation" before new products, Value Creation Programme (VCP), ventures, M&A activities and non-recurring effects

of BriqVest B.V. (Twinq) in May 2021, which opens up a new market segment. Revenue is expected to increase strongly in France. A major client project is due to be implemented in the 2022 financial year. In the UK market, the QL ERP software distributed by Aareon UK is expected to be available in a SaaS-capable version from 2022 onwards, strongly boosting recurring revenues. The UK market segment of small and medium-sized clients is expected to continue its high rate of client acquisition. We also forecast an increase in recurring revenues for the Nordic countries. The software solution offered here will henceforth be promoted as standard software, which is why consulting revenues will be on the previous year's level.

Digital solutions will make a decisive contribution towards realising the growth potential. Among the main drivers here are the digital solutions acquired through the takeovers in 2021 and the cross-selling of digital solutions to our existing clients. Since 2021, some of the digital solutions have been sold in various process-oriented product packages together with an ERP product. SaaS revenues are expected to increase particularly for WRM (Workforce Relationship Management) and CRM (Customer Relationship Management) products due to additional products being rolled out, including a new generation of the "Mobile" solution in the UK. Higher revenues with SRM (Supplier Relationship Management) products should be achieved thanks to greater volumes of tradesmen's orders that are settled via the Mareon service portal, as well as new business generated by Aareon's occupant change management solution. In 2022, Aareon anticipates very strong revenue growth from the BRM (Building Relationship Management) solution of CalCon Deutschland GmbH, which was acquired in 2020, when on-site consultancy services will resume without pandemic-related restrictions.

Aareon will continue in 2022 with its development drive in new products and services. The virtual assistant Neela is being developed further as planned and new functional features being added. The first pilot clients are in the introduction or test phase and will go live in 2022. This also applies to the Aareon Smart Platform and Smart Partner solutions, which will be offered in all countries in 2022. Further investments in new products are also planned for 2022. In addition, the capacities built up for M&A and post-merger integration will be used to further accelerate Aareon's inorganic growth in 2022, and to successfully integrate the acquisitions already made. For this purpose, Aareal Bank will provide its subsidiary with an additional € 100 million, bringing its credit line for acquisitions to a total of € 350 million for the planning period up to 2024.

Business strategy

Aareal Bank Group's strategy focuses on sustainable business success. Environmental, social and governance aspects are therefore key elements of its business strategy. These aspects will be complemented with ESG targets in 2022. The medium-term strategic development is being pursued under the guiding principle of "Aareal Next Level". The general strategic orientation will continue – with large-volume, international commercial property financing on the one hand, and consulting services and digital solutions for the institutional housing sector in Europe and related industries on the other. Based on the "Aareal Next Level" strategy, individual business activities will be developed in a targeted manner, in order to sharpen their own independent profiles, accelerate the Group's growth overall and create value for the shareholders and other stakeholders. Specifically, the Bank wants to increasingly exploit opportunities for profitable growth, in order to further accelerate the pace of growth in all three segments – also leveraging its solid, crisis-tested capital position.

The Structured Property Financing segment continues to focus on the controlled, risk-conscious expansion of its portfolio volume within its target range, in accordance with ESG requirements and taking advantage of its flexible approach with regard to countries, property types and financing structures. We will continue to use syndications as one of the tools for active portfolio management.

Within the Banking & Digital Solutions segment, Aareal Bank aims to expand its equity-light business in particular, and thus increase net commission income, mainly by expanding its product offering leveraging its USPs in payments and digital solutions, and through further strategic partnerships.

Aareon's position as a provider of ERP Software and digital solutions for the European property industry and its partners is set to be expanded further – with the clear objective of developing Aareon into a "Rule of 40" enterprise. Together with its partner Advent International, the Group wants to further boost the pace of Aareon's growth, through initiatives for organic growth within the framework of the Value Creation Programme. An institutionalised M&A pipeline and credit lines support inorganic growth.

Besides the growth initiatives for the three segments, Aareal Bank Group will use additional levers to sustainably raise profitability, including an optimisation of the funding mix and the capital structure. In addition, numerous measures are being implemented to enhance the efficiency of the organisational structure, processes and infrastructure.

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

Group targets

Besides the strategic initiatives and measures within the framework of "Aareal Next Level", Aareal Bank Group's focus in the 2022 financial year will remain on coping with the impact of the Covid-19 pandemic in the best way possible – together with its clients. With a view to the "swoosh"-shaped economic development, Aareal Bank Group anticipates further marked recovery during the current year[1].

Based on this assumption and despite continued elevated loss allowance required due to the pandemic, Aareal Bank Group expects consolidated operating profit in a range between € 210 million and € 250 million for the 2022 financial year as a whole (2021: € 155 million), thus almost reaching levels achieved prior to the Covid-19 pandemic. On this basis, earnings per share (EpS) are expected to amount to between € 2.00 and € 2.50 (2021: € 0.89), while RoE after taxes should range between 4.5 % and 6 % (2021: 2.1 %).

Aareal Bank Group expects income to continue to rise significantly over the previous year. Net interest income is expected to rise further, to between € 600 million and € 630 million (2021: € 597 million), reflecting the higher (and further growing) loan portfolio and despite the partial cessation of TLTRO benefits. Net commission income should also rise significantly, thanks in particular to Aareon's growth, to between € 270 million and € 290 million (2021: € 245 million).

Loss allowance, which remains elevated (compared to normalised risk costs) due to Covid-19 effects, is expected to be in a range between € 100 million and € 140 million (2021: € 169 million). This also includes credit risk-induced valuation adjustments of defaulted property loans, which are reported in net gain or loss from financial instruments (fvpl).

Administrative expenses are expected to be above the previous year's level, in a range of between € 540 million and € 570 million (2021: € 528 million), due to strong growth at Aareon.

In the Structured Property Financing segment, we plan to achieve a portfolio size of around € 31 billion by the end of the year, market conditions per-

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

mitting and subject to exchange rate fluctuations. Aareal Bank plans new business volume of € 7 billion to € 8 billion on this basis.

For the Banking & Digital Solutions segment, Aareal Bank assumes slight growth in net commission income for the core activities and expects an average deposit volume from the housing industry of around € 12 billion.

It is expected that Aareon will see a marked increase in sales revenue in the region of € 305 million to € 325 million for the current year (2021: € 269 million). Adjusted EBITDA[1] is also likely to see a further increase to between € 73 million and € 78 million (2021: € 67 million).

Aareal Bank envisages achieving consolidated operating profit of around € 300 million and a cost/income ratio[2] below 40 % already in 2023, provided the pandemic has been fully overcome by then.

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

Takeover Disclosures in Accordance with Section 315a (1) of the German Commercial Code (HGB)

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

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

Restrictions affecting voting rights or the transfer of shares

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

Shareholdings exceeding 10 % of voting rights

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

Shares with special rights granting the holder supervisory powers

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

[1] "Earnings before interest, taxes, depreciation and amortisation" before new products, Value Creation Programme (VCP), ventures, M&A activities and non-recurring effects

[2] Structured Property Financing segment; in line with common practice in the banking sector, bank levy and contributions to the deposit guarantee scheme are not included.

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

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

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

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

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

Authorisation of the Management Board to issue or repurchase shares

Authorised capital

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

Conditional capital

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

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

Authorisation to purchase treasury shares

The General Meeting authorised the Management Board by way of a resolution dated 27 May 2020, pursuant to section 71 (1) no. 7 of the AktG, to purchase and sell treasury shares for the purposes of securities trading, at a price not falling below or exceeding the average closing price of the Company's share in Xetra trading (or a comparable successor system) during the three trading days on the Frankfurt Stock Exchange prior to the relevant purchase or prior to assuming a purchase obligation by more than 10 %. This authorisation expires on 26 May 2025. The volume of shares acquired for this purpose must not exceed 5 % of the issued share capital of Aareal Bank AG at the end of any given day.

Furthermore, the Management Board was authorised by means of a resolution of the General Meeting held on 27 May 2020, pursuant to section 71 (1) no. 8 of the AktG, to purchase treasury shares in a volume of up to 10 % of the share capital for any permitted purposes. This authorisation expires on 26 May 2025. Such purchases may be effected via stock exchanges or public purchase offers made to all shareholders, taking into account the prices as specified in the respective Annual General Meeting's resolution, which are in turn based on the Company's stock exchange share price. This authorisation may be exercised – also by the direct or indirect subsidiaries of Aareal Bank AG – in full or in part, on one or more occasions.

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

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

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

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

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

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

Separate Combined Non-Financial Report

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

Corporate Governance Statement

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

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