Group Management Report

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Fundamental Information about the Group

Business model

Aareal Bank AG, headquartered in Wiesbaden, Germany, is the parent company of the Group. 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 structured 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.

The Bank combines its local market expertise with sector-specific expertise provided by sector experts in Wiesbaden. The sector expert teams cover hotel, retail, and logistics property financing, and cater to the specific needs of investment fund clients. A new "Alternative Living" expert team that was established in 2023 deals with modern housing concepts such as co-living or student housing.

In addition to the sector specialists in Wiesbaden, our network continues to comprise branch offices in Paris, Rome, London, Stockholm and Warsaw. Aareal Bank also has a branch office in Dublin, where it exclusively conducts Treasury business and holds securities. Besides a representative office in Istanbul, representative offices were located in Madrid (until 31 July 2023) and Moscow (until 30 November 2023).

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" Pfandbrief rating confirms the quality of the cover assets pools. To cater to a broad investor base, Aareal Bank uses a wide range of other funding instruments, including senior preferred and senior non-preferred bonds, as well as other promissory notes and debt securities. Depending on market conditions and investor demand, the Bank places large-sized public issues or private placements. In the Banking & Digital Solutions segment, the Bank also generates deposits from the housing industry, which represent a strategically important additional source of funding. Furthermore, it has recourse to institutional money market deposits, and to retail deposits via a trust model.

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 industry, solutions for the integrated processing of payment flows, especially for housing properties, thus contributing to a more efficient and sustainable structure of its clients' fundamental business processes. Aareal Bank Group's BK01 software provides 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 account systems (BK@1), deposits are generated that contribute significantly to Aareal Bank Group's funding base. Besides the

German property industry, the German energy sector forms a second major client group of the segment for the services mentioned above. The segment offers further services to these industries, such as digital tenant deposit solutions, and end-customer communications, andalongside AI-supported invoicingsolutions for invoices and dunning solutions round off Aareal Bank's offering in the processes. The Banking & Digital Solutions segment which comprises the subsidiaries CollectAIincludes the collect.AI and plusForta subsidiaries.

Aareon

In the Aareon segment, the property management system supplied by the Aareon sub-group offers European property industry clients software as a service (SaaS) solutions for automated and connected end-to-end processes. Aareon commands a strong position in the countries where it is active (Germany, Sweden, France, the UK, the Netherlands and Spain). Its ERP systems and other software solutions assist clients along their way to progressive digitalisation. Furthermore, the open "Aareon Connect" ecosystem provides clients with easy access to a wide range of specialised third-party solutions, helping them to build their own enterprise-specific digital ecosystem. Aareon places great importance on the continuous user-oriented and forward-looking development of the property management system. That is why the company deploys significant investment in research and development in order to improve its solutions. In this way, Aareon is a continuous driver of digitisation and value creation in the industry.

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**
  - Operating profit (in accordance with IFRSs)
  - Return on equity (RoE) after taxes[1)]
  - Earnings per ordinary share (EpS)[2)]
  - Common Equity Tier I ratio (CET I 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)]

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1) RoE after taxes = consolidated net income excluding consolidated net income attributable to non-controlling interests and AT1 coupon / average equity (IFRS) excluding non-controlling interests, AT1 bond and dividends

2) EpS = consolidated net income excluding consolidated net income attributable to non-controlling interests and AT1 coupon / number of ordinary shares

3) New business = newly-originated loans plus renewals

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

The Group's existing risk management system is used to manage and monitor the individual 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.

The Structured Property Financing segment 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 identify – and to respond to – market changes at an early stage. Active portfolio management allows 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 volume of housing industry deposits 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.

Report on the Economic Position

Macro-economic environment

Driven by a challenging market environment, the global economy put in a mixed performance during 2023. Whilst the euro zone and the United Kingdom recorded only marginal growth (despite a palpable easing in energy prices), the United States economy once again performed significantly better, achieving even stronger growth than in the previous year, not least due to private consumption. In many economies, inflation continued to recede from high levels thanks to monetary policy tightening introduced by major central banks. However, price pressures remained high especially in the services sector where salary trends are a strong cost driver. Tension gripped the international financial markets following market turbulence in the US banking sector. The collapse of several US regional banks, together with the troubles at the large Swiss bank Credit Suisse, triggered concerns regarding the stability of the financial system from mid-March onwards. However, these concerns proved to be short-lived. On the other hand, geopolitical tensions and risks – caused by the war in Ukraine, reciprocal sanctions imposed by Western countries and Russia, and October's attack by Hamas on Israel – remained present or were even exacerbated.

Economy

Real gross domestic product in the euro zone climbed by a meagre 0.5 % compared to 2022 – the slight expansion seen in the first half of the year was followed by a significantly softer economic performance between July and December. Various stress factors, including low external demand due to a weak economy in many regions outside of Europe, contributed to persistently weak growth, and the effects of monetary policy tightening increased due to the delayed impact of interest rate hikes. Whilst it was mainly the industrial and construction sectors that were hit by this development, sentiment in the services sector also cooled notably. The result: a highly diverse growth pattern in the euro zone due to different economic structures and associated varying importance of the manufacturing sector and foreign trade. GDP growth in the largest euro zone countries was positive in Spain, France, and Italy (at +2.4 %, +0.8 % and +0.7 %, respectively), whereas Germany's economy contracted 0.3% year-on-year, reflecting structural deficits which have constantly become more evident.

Economic developments in non-euro zone EU member states also varied. For example, real GDP in the Czech Republic and Sweden fell by 0.5 % and 0.3 %, respectively, compared to the previous year, whilst increasing by 0.6 % in Poland.

Economic momentum in the United Kingdom also slowed down, leading to real GDP growth of only 0.3 % compared to 2022. Large-scale industrial action in the public sector and the healthcare industry led to muted economic activity in the first half-year, especially in the services sector. This was followed by stagnating economic output across large parts of the economy in the third and fourth quarter. Manufacturing and construction in particular were weak, impacted by the consistently restrictive financing conditions associated with monetary policy tightening.

US GDP, on the other hand, improved by 2.5 % in 2023 compared to the previous year. Whilst private consumption and increased government-driven demand were two of the growth drivers at the beginning of the year, a solid domestic economy and further significant growth in private consumption drove a surprisingly high GDP increase in the third quarter. Economic momentum slowed down in the final quarter, one of the reasons being that the end of the student loan moratorium affected many households, reducing private consumption levels. The restrictive financing conditions acted as an additional burden. Across the border in Canada, 2023 GDP growth was 1.0 % higher than in the previous year.

Australia recorded a more dynamic growth rate than many other advanced economies in 2023 (real GDP growth of 2.0 % year-on-year), benefiting from stable export demand that offset weaker consumption. The industrial sector was hit by various factors, especially around the half-year mark, whereas the services sector showed a more stable performance.

Many labour markets recorded low unemployment rates and high demand, defying the challenging environment and temporary concerns about a recession. Companies hesitated to lay off employees, due to the persistently tight labour market that led to fierce competition for labour. At 6.4 %, unemployment levels in the euro zone reached a record low at the end of the year; job creation in the United States slowed marginally, leading to a year-end unemployment rate of 3.7 %.

Annual rate of change in real gross domestic product

%	2023[1]	2022[2]
Europe		
Euro zone	0.5	3.4
Belgium	1.4	3.0
Germany	-0.3	1.8
Finland	-0.4	1.6
France	0.8	2.5
Italy	0.7	3.7
Luxembourg	-1.1	1.4
Netherlands	0.0	4.3
Austria	-0.7	4.8
Spain	2.4	5.8
Other European countries		
Denmark	0.7	2.7
UK	0.3	4.3
Poland	0.6	5.3
Sweden	-0.3	2.9
Switzerland	0.7	2.6
Czech Republic	-0.5	2.4
North America		
Canada	1.0	3.4
USA	2.5	1.9
Asia/Pacific		
Australia	2.0	3.8
Maldives	7.6	13.9

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

Financial and capital markets, monetary policy and inflation

The international financial markets were affected by high (albeit decreasing) inflation rates and diverging economic prospects in 2023. Continued monetary policy tightening, temporary tensions in the US regional banking system, and the forced takeover of Credit Suisse were factors dominating the first half of the year. Leading central banks adhered to their path of monetary policy tightening up until the third quarter; however, they were renouncing further interest rate hikes thereafter because inflation rates fell off and the dampening effect of the restrictive financing conditions increasingly took its toll on demand. Following soaring nominal and real interest rate levels in the first nine months of the year, the fourth quarter recorded a palpable decline in yields, especially in the United States, and a depreciation of the US dollar, with market participants pricing in higher economic downside risks and expected key interest rate decreases by the US Federal Reserve (Fed) into their mid-term outlooks.

As inflationary pressures remained elevated, the European Central Bank (ECB) continued its course set in the previous year of raising key interest rates to ensure that inflation will return to the mid-term target of 2 % in due course. Key interest rates were increased in six steps, reaching 4.50 % on main refinancing operations, 4.75 % on the marginal lending facility and 4.00 % on the deposit facility. From October to December 2023, the ECB held off raising interest rates, and the ECB's Governing Council indicated that key interest rates would remain at restrictive levels for as long as necessary, depending on data. Holdings of securities under the asset purchase programme (APP) were reduced from March onwards, and principal payments from maturing securities purchased under the APP were no longer reinvested as of July. In addition, the ECB decided to reduce principal payments for maturing assets bought under the pandemic emergency purchase programme (PEPP) over the course of 2024, and to terminate them by year-end 2024. In order to mitigate risks for the monetary policy transmission mechanism, the Governing Council reserves the right to flexibly adjust reinvestments of redemptions across time, asset classes and jurisdictions at any time. Remuneration of minimum reserves was also lowered to zero per cent in September. Last but not least, the Transmission Protection Instrument allows the ECB to counter market dynamics that it deems to be unwarranted and disorderly.

Addressing a persistently strong labour market and inflation rates that – while abating – were still above 2 %, the Fed revised its federal funds rate upwards four times over the course of 2023, to a corridor between 5.25 % and 5.50 %. Taking account of the progress made in combating inflation and following the review of economic data, the last interest rate hike was made in July; interest rate levels have since remained unchanged. The central bank announced potential prompt adjustments to its monetary policy, depending on economic data and the effects of the interest rates hikes made so far. In particular, it said that interest rates would be increased if provoked by persistently high core inflation or other risks. The Fed also reduced its holdings of bonds and mortgage-backed securities it had taken on during the pandemic.

Meanwhile, on the other side of the Atlantic, the Bank of England (BoE) increased interest rates in five steps by a total of 175 basis points to 5.25 % in the year under review, leaving key interest rates unchanged as of September thanks to progress made in combating inflation, worse than expected economic data, and increasing employment rates. However, the central bank did not rule out further interest rate hikes, should the economy, the state of the labour market or inflation rates require them. The BoE also resolved to reduce its portfolio of sovereign bonds by £ 100 billion until September 2024.

Other major central banks lifted their key rates, too: the Bank of Canada raised its key interest rate to 5.00 % in 2023, Sweden's Riksbank to 4.00 %, and the Reserve Bank of Australia to 4.35 %.

Short-term interest rates[1)] in the euro zone at year-end 2023 were above those for year-end 2022. The same applied to the pound sterling, the US dollar, the Swedish krona, and the Australian dollar. While short-term interest rates also rose for the Canadian dollar, the increase was less pronounced. Long-term interest rates[2)] overall went up during the year, reaching peak levels in October 2023. This was followed by a strong and swift decrease in the fourth quarter due to changed interest rate expectations. Interest rate levels in the euro zone, for the pound sterling, Swedish krona, Canadian dollar, and Australian dollar ended the year below the levels seen at the beginning of the year, and remained nearly unchanged for the US dollar. Ten-year government bonds painted a uniform picture, with yield declines observed for most of them. Only the yields for US bonds remained unchanged compared to the beginning of the

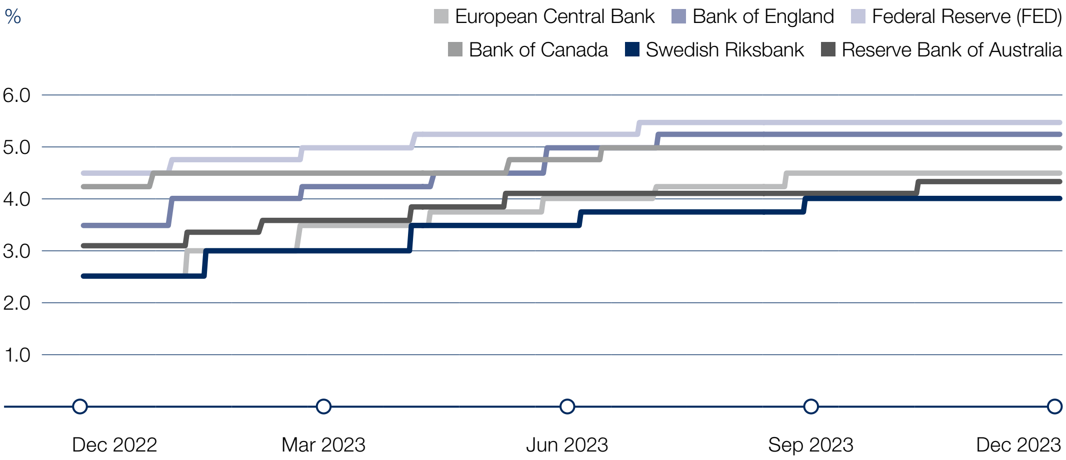
[1)] Calculated on the basis of 3-month Euribor, LIBOR or other comparable rates for other currencies
[2)] Calculated on the basis of swaps in the respective currencies

year, albeit with significant fluctuations over the course of the year. The rapid increase in short-term interest rates caused one of the sharpest yield curve inversions to be witnessed in the euro zone as well as the US. This development was driven by a comparatively stronger increase of short-term than long-term interest rates, and also reflected decreased growth expectations. The inversion levelled off in the fourth quarter due to anticipated interest rate cuts and the higher probability of a soft landing in the US when compared to mid-year expectations.

Monetary policy in the individual currency areas, differing economic outlooks and inflation expectations also shaped the currency markets in 2023. Changing market expectations regarding monetary policy perspectives led to strong EUR/USD exchange rate movements over the course of the year. Especially phases with stronger than expected US economic data were accompanied by a depreciation of the euro, followed by an appreciation in the fourth quarter due to increasing expectations concerning potential earlier interest rate cuts in the US in 2024. At the end of the year, the exchange rate was USD 1.11 per euro, i.e. above the rate prevailing on 30 December 2022 (USD 1.07 per euro). The EUR/CAD exchange rate followed an unspecific trend over the same period, with the euro recovering slightly – from CAD 1.44 per euro at the beginning of the year to a year-end rate of CAD 1.46 per euro. Against pound sterling, the euro fell slightly over the course of the year, from GBP 0.89 to the euro at the beginning of the year to GBP 0.87 at year-end. The depreciation occurred in the first six months, followed by a stable exchange rate during the second half of the year. Similarly, the euro depreciated marginally vis-a-vis the Swedish krona, from SEK 11.12 to the euro at the beginning of the year to SEK 11.10 to the euro at the end of the year, following a volatile intra-year performance. The euro appreciated against the Australian dollar, from AUD 1.57 at the beginning of the year to AUD 1.63 per euro at the end of 2023.

Even though inflation rates in many economies continued their downhill trajectory in 2023, core inflation as at year-end remained clearly above the target levels set by the respective central banks. Lower energy and food prices were a driving force behind the general inflation decrease. Base effects, lower freight costs and raw material prices, along with the removal of supply chain disruptions, resulted in lower costs especially for corporates. However, core inflation decreased more slowly than inflation, which was mainly attributable to consistently tight labour markets and catch-up effects regarding wages in the services sector. In areas that had been particularly hit by the Covid-19 crisis, such as the hospitality industry, high demand from consumers continued to meet limited supply and labour shortage strains. In the euro zone, inflation reached 2.9 % at the end of the year compared with the same month of the previous year: in the US it was 3.4 % and 4.0 % in the UK.

Key rate developments in 2023[1)]



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

Turbulence in the banking sector and the central banks' restrictive monetary policy increased the uncertainty felt by market participants, leading to highly volatile capital markets in 2023. As a result, risk premiums for uncovered bonds were more volatile, and credit spreads for covered bonds rose due to oversupply which in turn was due, amongst other things, to the ECB withdrawing from the market as a large purchaser of covered bonds. The escalating conflict in the Middle East increased market unrest in the fourth quarter.

Regulatory environment

The environment in which banks are operating continues to be defined by highly dynamic regulatory requirements, as well as by changes in banking supervision. This includes, in particular, the EU Banking Package which stipulates implementation of the final draft of the Basel III framework into EU law (known as "Basel IV"), as resolved by the Basel Committee (BCBS). Following lengthy negotiations, the parties involved in the legislative process eventually reached an agreement at the end of 2023, meaning that final regulations and directives are expected to be published in the EU's Official Journal, and thus enter into force, during the first six months of 2024. Meanwhile, the European Banking Authority (EBA), following its roadmap, will work on implementing its mandates to prepare technical standards, which serve to specify the rules and provisions, in 2024. The scheduled first-time application of the new regulations most relevant for the Bank is 1 January 2025 – two years later than initially planned by the BCBS.

New reporting on interest rate risk in the banking book will complement existing CoRep reporting. The first reference date for the application of these reporting requirements is 30 September 2024.

BaFin published the final version of the seventh MaRisk amendment on 29 June 2023. This final version focuses on implementing the EBA guidelines on loan origination and monitoring, new requirements for banks' proprietary property business, and the management of sustainability risks. The transition period for implementing the changes resulting from the new requirements has ended on 1 January 2024.

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, politicians and banking supervisors are deeming it necessary to establish sustainability more strongly within society, and as a regulatory requirement within the economy. To this end, a standard taxonomy was introduced in the EU, which provides 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. Disclosure requirements for the 2024 financial year will also increase due to the first-time application of the Corporate Sustainability Reporting Directive (CSRD). In addition, the number of data points to be published in 2024 will increase due to the requirement for large listed institutions to include qualitative and quantitative information on ESG risks in the regulatory disclosure report on a half-yearly basis, as stipulated by the CRR II.

The ECB's Supervisory Review and Evaluation Process (SREP) ensures a common approach on the supervisory review of banks, within the framework of Pillar 2. The SREP is built around a business model analysis, an assessment of governance, as well as of the capital and liquidity risks. Results from 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.

Sector-specific and business developments

Structured Property Financing segment

High financing costs associated with increased interest rate levels and stricter lending standards influenced the commercial property market in 2023, leading to a significant downturn in transaction activity and lower property valuations, along with a related increase in financing defaults. Uncertainty due to the macro-economic deterioration and strongly diverging pricing expectations between buyers and sellers were an additional burden for the market. It came as no surprise that the swift transition from a low to a high interest rate environment impacted a property market that had become accustomed to easily accessible capital over the past ten years.

Global transaction volumes in 2023 decreased by 44 % year-on-year. Regional differences were less pronounced than in past reporting periods, with North America, Europe and Asia/Pacific recording declines of 47 %, 50 % and 33 %, respectively. Broken down by property type[1)], transaction volumes plunged in all three regions compared to the previous year.

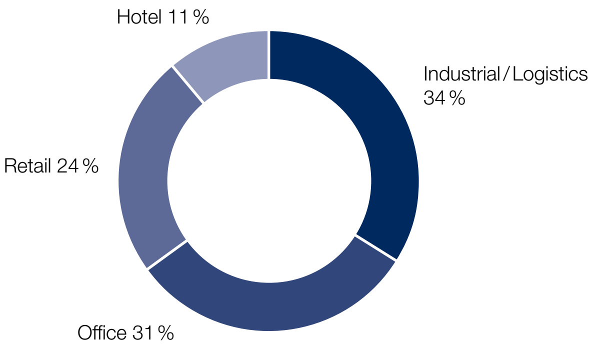
[1)] Property types are office, logistics, retail and hotel properties.

The general picture was one of reticence on the part of investors, more complicated pricing, and predominantly falling property valuations. Office property was especially affected, with the transition towards hybrid working models leading to uncertainty among potential buyers. Lenders focused their interest on residential and logistics properties, food stores, as well as on high-quality office properties in preferred locations. Properties with good re-lettability and sustainable characteristics continued to enjoy demand. Financing costs for newly-financed commercial property have been on the rise for several quarters in a row as a result of higher interest rates and more restrictive lending standards. Construction costs have increased, as has uncertainty surrounding property valuations at the time of disposal. In this context, the number of new project developments has fallen off. Due to lack of relevance for Aareal Bank's portfolio, this report will not go into detail about the related problems arising for project development companies and their financings. Transaction yields increased across all markets and property types in 2023, whilst loan-to-value ratios on the financing markets tended to decrease.

Soaring interest rates not only affected transaction markets and transaction yields demanded by investors, but also the ability to service debt. Financings not hedged via a fixed-rate period or adequate hedging instruments, or financings for which these fixed-date periods or instruments expired, were challenged by higher borrowing costs. The impact on the viability of debt service varied, depending on property type and country, with the strongest effect being observed on the US office market: not only did US interest rate levels rise more than in the euro zone, the US market was also more affected by the working-from-home trend (and the related increase in vacancy rates) which burdened income in addition to the interest rate increases. Logistics properties benefited from higher rents, and hotels from higher occupancy rates and an increase in average room rates, thus offsetting the interest rate pressure on debt service. Even though inflation and the tight labour market challenged hotels with increased operating and personnel costs, and in part with a shortage of skilled labour, this property type generated higher income and thus recorded an overall positive development in 2023. The not-so-new topic of e-commerce had led to lower retail property valuations even before 2023, taking away some of the weight in the year under review.

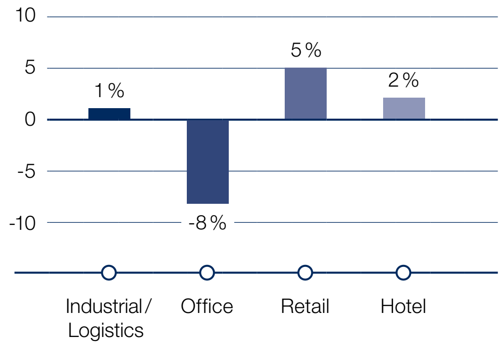
Share of transaction volume observed worldwide in 2023

in %



Change in the relative share of observed global transaction volumes vs. 2022

percentage points



Aareal Bank generated new business[1] of € 10.0 billion (2022: € 8.9 billion) in the full year 2023, reaching the upper limit of the communicated target range of € 9 billion to € 10 billion. The share of newly-originated loans was 62 % (2022: 67 %) or € 6.2 billion (2022: € 6.0 billion). Renewals amounted to € 3.8 billion (2022: € 2.9 billion). Aareal Bank concluded new green financing business of around € 3.0 billion in the full year 2023; the portfolio volume of green financings rose by a total of € 2.6 billion to approximately € 4.8 billion. In this context, it should be noted that changes to the portfolio volume can also result from existing clients issuing the required undertaking and related certificates for the first time, or from other financings losing their status as green instruments.

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

Green loans meet the minimum energy efficiency requirements of the "Aareal Green Finance Framework" and the client undertakes to meet these requirements throughout the term of the loan. Properties are classified as green if they adhere to the EU taxonomy criteria, have an above-average sustainability rating by recognised rating agencies or comply with energy efficiency criteria.

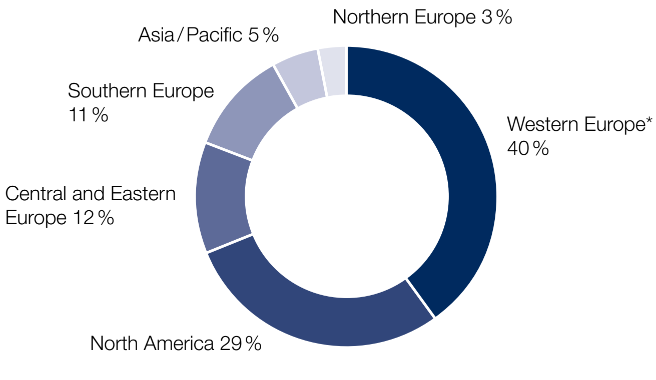
All in all, Aareal Bank Group's property financing portfolio expanded to € 32.9 billion as at the end of 2023.

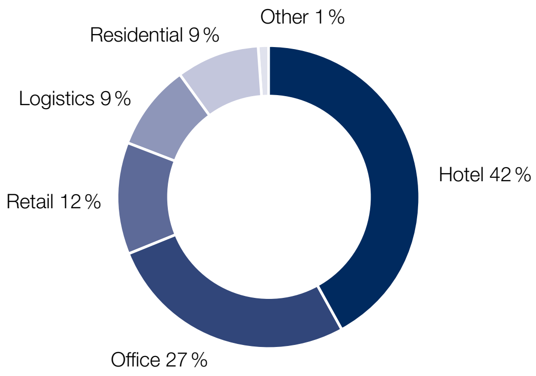
At approximately 66 % (2022: 65 %), Europe accounted for the largest share of new business, followed by North America with 29 % (2022: 28 %) and the Asia/Pacific region with 5 % (2022: 7 %).[1)]

With a share of 42 %, hotel properties accounted for the largest share in new business in terms of property type (2022: 32 %), followed by office property with 27 % (2022: 20 %), ahead of retail property with 12 % (2022: 18 %), logistics property with 9 % (2022: 18 %), and residential property with 9 % (2022: 10 %). Other property and financings accounted for less than 1 % (2022: 2 %) of new business.

New business[2)] 2023

by regions | by type of property (%)





* Incl. Germany

2) New business, excluding private client business and former WestImmo's local authority lending business

Europe

Transaction volumes declined by around 50 % in Europe. The decrease was seen in all European countries. Even so, Poland, the Netherlands, Italy and Germany recorded the strongest downturns. France, Sweden and the UK, on the other hand, registered the smallest declines. Looking at property types, the strongest decline was in office properties, followed by logistics and retail properties. Whilst hotel properties saw the lowest decline, they were nonetheless down by approximately 17 % year-on-year. The majority of cross-border and private investors were on the buy side, whilst REIT structures tended to be sellers. Institutional investors assumed a balanced position overall.

Average rents in the prime office property segment rose slightly during 2023, with more significant increases compared to year-end 2022 seen in some sub-markets (e.g. Copenhagen and selected major UK cities). Whilst vacancy rates increased on average, overall performance showed a mixed picture. For example, vacancy rates rose in London and all relevant major German metropolitan areas, but decreased in Warsaw and Rome. Retail property rents remained stable in most European markets, whereas shopping centre rents in numerous major UK cities rose markedly, as did high-street rents in Rome. Rents for logistics properties benefited from per-

1) 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, allocation is based on the borrower's country of domicile.

sistently strong demand and low, if increasing, vacancy rates in the entire segment, thereby continuing the positive development of the last few years.

In line with the increased interest rate levels seen since 2022, prime yields for office properties climbed further in all major European cities during 2023. Particularly French, German and British cities recorded larger increases, some of them of more than 100 basis points. Yield increases in secondary locations developed similarly. With the trend of falling yields for logistics properties having reversed in 2022, yields continued to rise almost across the board during 2023 – exceptfor several UK sub-markets, where yields remained stable over the course of the year. Stronger increases were observed in Belgium and Poland. Looking at retail properties, prime yields for both shopping centres and high-street properties rose on a European average, which was essentially reflected in secondary locations as well. Some German and French sub-markets saw more pronounced increases.

Despite broad-based economic uncertainty, global travel continued to recover in 2023. This development was no longer driven only by leisure travel, but also by a distinct recovery in business travel. Major travel destinations in Europe continued to benefit from the return of international travel and overnight visits in some countries, e.g. in Spain and the Netherlands, saw robust recoveries, even exceeding the 2019 pre-pandemic levels. Whilst this meant that occupancy rates and revenues per available room in European hotel properties increased versus the previous year, actual growth was weaker than in 2022, something that was to be expected in light of the elevated growth rates that followed pandemic-related lockdowns.

Aareal Bank originated new business of around € 6.6 billion (2022: € 5.8 billion) in Europe during the year under review. As in previous years, at around € 4.0 billion (2022: € 3.7 billion), Western Europe accounted for the largest share, followed by Central and Eastern Europe, where new business of € 1.2 billion (2022: € 0.8 billion) was generated mainly in Poland. Southern Europe contributed € 1.1 billion (2022: € 0.7 billion) and Northern Europe € 0.3 billion (2022: € 0.6 billion). Aareal Bank Group was no longer active in property finance in Russia as at 31 December 2023.

North America

Transaction volumes in North America decreased by around 47 % in 2023 compared to the previous year. A negative year-on-year development was recorded as early as in the first quarter, with this weak performance continuing throughout all the quarters of the year. Total full-year volume was at the lowest level recorded since 2012, even though the number of transferred properties was still well above the lows seen during the pandemic. Cross-border and private investors were on the buy side for the most part, while institutional investors and REIT structures were mostly sellers.

Rents offered for prime and secondary office properties in major US cities remained stable in 2023, which was also true for relevant sub-markets such as New York or Chicago. In San Francisco, rents fell slightly compared to the previous year, whilst the number of incentives for new tenants (e.g. rent-free periods or tenant's improvements) increased. The working-from-home trend was stronger in the US than in Europe, one of the reasons being long commutes. As a result, vacancy rates for US office properties went up during the year, from 12.4 % to 13.5 % on a national average. Hence, the debt servicing ability was not only impacted by the high interest rate environment but also by the increase in vacancies.

Average shopping mall rents in the US were up on a national average. The rise was most pronounced in Dallas and New York, whilst rent levels in Chicago remained stable and fell in San Francisco. Rents for logistics properties again rose significantly, growth averaging more than 7 % nationwide. An increase was reported in all the important individual markets.

Yields for office properties in prime and secondary markets were up since the beginning of the year under review, both on a national average and in relevant sub-markets. Increases were similar in prime and secondary markets, but different across sub-markets, with Washington D.C. and – once again – San Francisco registering the strongest growth rates. To a major extent, the general rise in yields was driven by the fast, very abrupt US interest rate hikes, which commenced in 2022 and have been more pronounced than in the euro zone. This exerted increasing pressure on office property valuations in the year under review. Yields for retail properties remained largely stable, with only minor changes vis-a-vis the previous year. With interest rates generally increasing, the long-standing trend of falling yields for logistics properties has also reversed in the United States. Yields for this property type increased both on a national average and in all relevant sub-markets compared to the previous year.

Hotels in North America saw an increase in occupancy and revenues over the course of the year. In the US, occupancy rates and revenues per available room increased compared to 2022, both in the luxury and upper upscale category, and on the overall market. This positive development was driven not only by strong national tourism, but also by international visitors. In Canada, key hotel indicators developed even better in 2023.

New business of € 2.9 billion (2022: € 2.5 billion) was originated across North America in 2023, most of which was attributable to the US.

Asia / Pacific region

2023 transaction volumes for commercial properties in the Asia/Pacific region decreased by approximately 33 % year-on-year. The slump in Australia was particularly marked, with a decline of 57 %. Within the Australian market, the office market was particularly affected, while hotels showed some resilience. Across the region, cross-border and institutional investors were on the buy side for the most part, whilst REIT structures were predominantly sellers. Private investors assumed a balanced position overall.

Prime rents for Australian logistics properties continued their year-on-year upward trajectory in 2023; Melbourne and Sydney recorded a particularly marked increase. Yields for logistics properties also went up once again, with yields for properties in the relevant major cities increasing by up to 125 basis points during 2023.

Hotels in the Asia/Pacific region registered a positive performance vis-à-vis 2022: both occupancy rates and revenues improved in most markets, reflecting the ongoing recovery in international tourism. The main driver for success, however, remained short-haul visits and domestic travellers. Even though international travel remains below the levels of 2019, hotel revenues are reaching, or approaching, new highs in some locations. In this context, the Maldives again recorded a significant increase in visitors. A total of 1.9 million tourists visited the island nation in 2023 compared with 1.7 million in the previous year. All in all, 2023 occupancy rates and revenues per available room in Maldivian hotel properties were slightly below the previous year's figure. Hotels in key Australian markets on the other hand were able to improve their indicators significantly compared to the previous year; this was due, amongst other things, to business travel increasingly returning to normal levels.

The Bank originated new business of € 0.5 billion in the Asia/Pacific region in 2023 (2022: € 0.6 billion), most of which was attributable to Australia. Aareal Bank Group no longer held property financing exposures to China as at 31 December 2023.

Banking & Digital Solutions segment

The housing and property management sector once again proved its overall resilience in 2023, defying the changes and challenges in the sector. For example, the housing price index showed a 10.2 % decline in the third quarter of 2023 compared to the third quarter of 2022, whereas the consumer price index for net rent (excluding VAT and operating costs) reached a record high of 105.7 points in November 2023 (November 2022: 103.6). Whilst the recent supply chain issues and high energy costs have normalised and the year-on-year consumer price index change rate sank to 3.2 % in November 2023 (November 2022: 8.8 %), the third-quarter construction price index increased by 6.4 % compared to the previous year's figure, albeit trending downwards. Combined with the interest rate increases during the year under review, this led to fewer new construction projects. A total of 179,800 apartments were approved between January and October 2023 – a decrease of 29.8 %, or 76,300 apartments, vis-à-vis the same period of 2022.

At present, more than 4,000 corporate clients throughout Germany are using Aareal Bank Group's process-optimising products and banking services, most of them via the ERP-integrated BK01 functionality. The segment's volume of deposits from the housing industry averaged € 13.6 billion in the financial year 2023 (2022: € 13.4 billion), exceeding original expectations. All in all, this reflects the strong trust our clients continue to place in Aareal Bank. Net commission income increased as planned, from € 31 million in 2022 to € 33 million in 2023. Higher interest rate levels, combined with the persistently high volume of deposits, made a notable contribution to stronger operating profit in the BDS segment.

The scope of BK01 functionality was extended during the year under review, to account for our clients' special needs in terms of receivables management – also incorporating functionality from our platform offers as well as the expertise of collect.AI, the payment solutions provider acquired in 2022 whose product range also includes AI-supported end-customer communications. Furthermore, favourable interest rate developments meant that the Bank was still able to offer clients attractive interest rates, and attract new deposit volumes (including from new clients) for various deposit categories. To strengthen client growth and cross-selling, Aareal Bank, First Financial and Aareon have entered into a long-term strategic partnership which is geared towards securing the three partners' strategic and operative interests on a long-term basis. Within the scope of this strategic partnership, Aareon acquired a majority stake in First Financial, which focuses on software solutions for the technical integration of financial services into ERP systems. Aareal Bank will thus remain a reliable partner to the housing industry for payments and deposits. Together with Aareon, it will continue to ascertain and develop integrated financial services for its clients in the future.

Aareon segment

Aareon's strategic focus in the 2023 financial year was on accelerating organic growth of recurring revenues (from maintenance contracts, SaaS solutions, and fees), on optimising its operating business, and on executing M&A transactions.

In addition, Aareon launched its open "Aareon Connect" ecosystem in the first quarter of 2023, to facilitate the integration of third-party solutions: "Aareon Connect" was developed using the low-code technology by Locoia GmbH, which was fully acquired by Aareon in December 2022. This approach enables a far simpler and faster technical integration of third-party solutions into the open digital ecosystem. At the end of the year, "Aareon Connect" was also rolled out in the UK and Dutch markets and already has its first domestic partners on board.

Up- and cross-selling to existing clients, additional new clients, and SaaS migrations drove strong organic recurring revenue growth in the year under review. The transformation process towards SaaS and subscription solutions continued to be on track, thus increasing the share of recurring revenue compared to total sales to 81 % (2022: 74 %). We have also further limited our dependence on license models, focusing on generating recurring revenue instead. The implementation of standardised SaaS platforms has allowed Aareon to optimise its clients' advisory needs, which has led to lower consulting revenues. The focus on the SaaS core business, and the related disposal of phi-Consulting GmbH, also impacted consulting revenues.

Aareon has optimised its operating processes and their management by introducing a new internal customer relationship management software and an HR management software. Further measures to future-proof Aareon included the acquisition of new talent, including employees for product portfolio optimisation, in particular in the UK. These activities have also improved the cost structure.

Aareon acquired German UTS innovative Softwaresysteme GmbH in February 2023, a provider of software solutions specialising in the administrative needs of residential owners' associations and external property management companies. In March 2023, Aareon added Embrace – The Human Cloud, the Dutch market leader for SaaS solutions in the areas of digital workspace and customer engagement, to its portfolio. Last but not least, Aareon entered the Spanish market in December 2023, acquiring the software provider Informatización de Empresas SLU (IESA). IESA develops software for the digital property management of residential owners' associations in Spain.

As expected, Aareon Group's sales revenues increased to € 344 million (2022: € 308 million). Adjusted EBITDA[1)] amounted to € 100 million (2022: € 75 million) and was therefore at the upper end of the target corridor.

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

Financial Position and Financial Performance

Financial performance

Group

Consolidated net income of Aareal Bank Group

€ mn	1 Jan-31 Dec 2023	1 Jan-31 Dec 2022
Net interest income	978	702
Loss allowance	441	192
Net commission income	307	277
Net derecognition gain or loss	23	1
Net gain or loss from financial instruments (fvpl)	-71	26
Net gain or loss from hedge accounting	1	-2
Net gain or loss from investments accounted for using the equity method	3	-2
Administrative expenses	645	571
Net other operating income/expenses	-6	0
Operating profit	**149**	**239**
Income taxes	101	86
Consolidated net income	**48**	**153**
Consolidated net income attributable to non-controlling interests	-23	0
Consolidated net income attributable to shareholders of Aareal Bank AG	71	153

At € 149 million, consolidated operating profit for the 2023 financial year was lower than in the previous year (€ 239 million) and below the original target, reflecting the additional, substantial efficiency-enhancing measures at Aareon and the exploitation of additional opportunities in the swift NPL reduction. The Bank's operating profit amounted to € 221 million. The dynamic income growth compensated for the significantly increased loss allowance for US office properties. Aareon's operating profit amounted to € -72 million, reflecting the extensive measures to enhance efficiency.

Mainly due to a year-on-year increase in the credit portfolio, solid margins, and the impact of rising interest rates on the continued high volume of deposits, net interest income of € 978 million was significantly higher than in the previous year (€ 702 million), and above expectations.

Loss allowance totalled € 441 million (2022: € 192 million), exceeding expectations. It was largely attributable to new loan defaults of US office properties. The figure also includes additions to loss allowance for a swift NPL reduction, as well as approximately € 35 million for our run-down Russian exposure. In addition, model-based Stage 1 and Stage 2 loss allowance was recognised in an aggregate amount of € 25 million, as a result of a post-model adjustment which reflects necessary adjustments to loss allowance due to effects at the reporting date.

Net commission income also increased to € 307 million (2022: € 277 million) on the back of sales growth at Aareon and in the Banking & Digital Solutions segment, only slightly missing the Bank's ambitious expectations.

Net derecognition gain of € 23 million (2022: € 1 million) reflected income from the Treasury portfolio as well as positive market-driven effects from early loan repayments.

Net gain or loss from financial instruments (fvpl) and from hedge accounting in the aggregate amount of € -70 million (2022: € 24 million) was largely due to credit risk-induced valuation losses on defaulted US office property loans – in contrast to positive valuation effects resulting from market developments for currency and interest rate hedging derivatives due to strong market dynamics in the previous year.

Administrative expenses increased to € 645 million (2022: € 571 million), reflecting Aareon's strong growth and efficiency-enhancing measures of around € 90 million, exceeding original expectations. Costs at the Bank remained largely stable: at 32 % (excluding the bank levy and contributions to the deposit guarantee scheme, as is customary in the banking sector), the cost/income ratio in the banking business was at a very low – i. e. very good – level during the period under review, even in an international comparison.

Net other operating income/expenses amounted to € -6 million (2022: € 0 million); the figure was burdened by a property transaction tax effect.

All in all, consolidated operating profit for the 2023 financial year totalled € 149 million, after € 239 million in 2022. Taking into consideration income taxes of € 101 million (2022: € 86 million) and non-controlling interest income of € -23 million, consolidated net income attributable to shareholders of Aareal Bank AG amounted to € 71 million (2022: € 153 million). The income taxes item was burdened by the write-off of Aareon's loss carryforwards in the context of Aareal Bank AG's takeover by Atlantic BidCo GmbH. Assuming the pro rata temporis accrual of interest payments on the AT 1 bond, consolidated net income allocated to ordinary shareholders stood at € 42 million (2022: € 138 million). Earnings per ordinary share (EpS) of € 0.69 (2022: € 2.32) and RoE after taxes of 1.4 % (2022: 5.0 %) were below the forecast.

Structured Property Financing segment

Segment result

€ mn	1 Jan - 31 Dec 2023	1 Jan - 31 Dec 2022
Net interest income	776	627
Loss allowance	441	192
Net commission income	6	6
Net derecognition gain or loss	23	1
Net gain or loss from financial instruments (fvpl)	-71	26
Net gain or loss from hedge accounting	1	-2
Net gain or loss from investments accounted for using the equity method	1	0
Administrative expenses	231	260
Net other operating income/expenses	-4	-6
Operating profit	**60**	**200**
Income taxes	44	70
Segment result	**16**	**130**

Net interest income of € 776 million in the segment was significantly higher than in the previous year (€ 627 million), mainly due to a year-on-year increase in the credit portfolio and good margins.

Loss allowance totalled € 441 million (2022: € 192 million), and was largely attributable to new loan defaults of US office properties. The figure also includes additions to loss allowance for a swift NPL reduction, as well as approximately € 35 million for our rundown Russian exposure. An additional € 25 million was recognised for Stages 1 and 2 through a post-model adjustment.

Net derecognition gain amounted to € 23 million (2022: € 1 million), reflecting income from the Treasury portfolio as well as positive market-driven effects from early loan repayments.

Net gain or loss from financial instruments (fvpl) and from hedge accounting in the aggregate amount of € -70 million (2022: € 24 million) was largely due to credit risk-induced valuation losses on defaulted US office property loans – in contrast to positive valuation effects resulting from market developments for currency and interest rate hedging derivatives due to strong market dynamics in the previous year.

Administrative expenses in the segment remained largely stable; the decrease to € 231 million (2022: € 260 million) resulted from the regular review and revision of intra-Group cost allocation between the SPF and BDS segments in 2023.

Net other operating income/expenses amounted to € -4 million (2022: € -6 million); the figure was burdened by other taxes.

Overall, operating profit for the Structured Property Financing segment was € 60 million (2022: € 200 million). After income taxes of € 44 million (2022: € 70 million), the segment result amounted to € 16 million (2022: € 130 million). Income taxes are comparatively high, in particular due to the non-deductibility of the bank levy.

Banking & Digital Solutions segment

Segment result

€ mn	1 Jan-31 Dec 2023	1 Jan-31 Dec 2022
Net interest income	238	92
Loss allowance	0	0
Net commission income	33	31
Administrative expenses	110	79
Net other operating income/expenses	-2	-1
Operating profit	**161**	**42**
Income taxes	50	14
Segment result	**111**	**28**

Net interest income in the Banking & Digital Solutions segment of € 238 million was significantly higher than in the previous year (€ 92 million), because of positive effects from increased market interest rates on the deposit-taking business.

On the back of sales growth, net commission income of € 33 million increased as planned (2022: € 31 million).

Administrative expenses in the segment remained largely stable; the increase to € 110 million (2022: € 79 million) resulted from the regular review and revision of intra-Group cost allocation between the SPF and BDS segments in 2023.

Overall, segment operating profit was € 161 million (2022: € 42 million). After income taxes, the segment result amounted to € 111 million (2022: € 28 million).

Aareon segment

Segment result

€ mn	1 Jan-31 Dec 2023	1 Jan-31 Dec 2022
Net interest income	-36	-17
Loss allowance	0	0
Net commission income	284	252
Net gain or loss from financial instruments (fvpl)	0	0
Net gain or loss from investments accounted for using the equity method	-	-1
Administrative expenses	320	244
Net other operating income/expenses	0	7
Operating profit	**-72**	**-3**
Income taxes	7	2
Segment result	**-79**	**-5**

Net interest income in the Aareon segment amounted to € -36 million, reflecting partially debt-financed M&A activities and funding raised outside the Group (2022: € -17 million).

Thanks to strong organic and inorganic growth, net commission income increased to € 284 million (2022: € 252 million).

Administrative expenses increased to € 320 million (2022: € 244 million), reflecting strong growth and realised significant efficiency-enhancing measures of around € 90 million which will lead to lower running costs in the future.

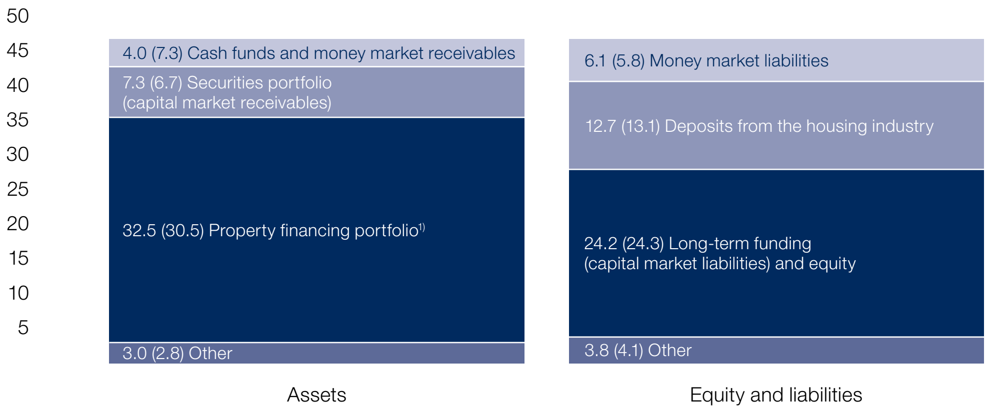
Overall, segment operating profit was € -72 million (2022: € -3 million). After income taxes, the segment result amounted to € -79 million (2022: € -5 million). The income taxes item was burdened by the write-off of Aareon's loss carryforwards in the context of Aareal Bank AG's takeover by Atlantic BidCo GmbH.

Financial position – assets and liabilities

Consolidated total assets as at 31 December 2023 amounted to € 46.8 billion, thus remaining largely stable compared to the amount of € 47.3 billion as at 31 December 2022.

Statement of financial position – structure as at 31 December 2023 (31 December 2022)

€ bn



[1] Excluding € 0.2 billion in private client business (31 December 2022: € 0.2 billion) and € 0.2 billion in local authority lending business by the former Westdeutsche ImmobilienBank AG (WestImmo) (31 December 2022: € 0.2 billion), and excluding loss allowance

Cash funds and money market receivables

The cash funds and money market receivables item contains excess liquidity invested at short maturities. As at 31 December 2023, this comprised predominantly cash funds and deposits with central banks and money-market receivables from banks.

Property financing portfolio

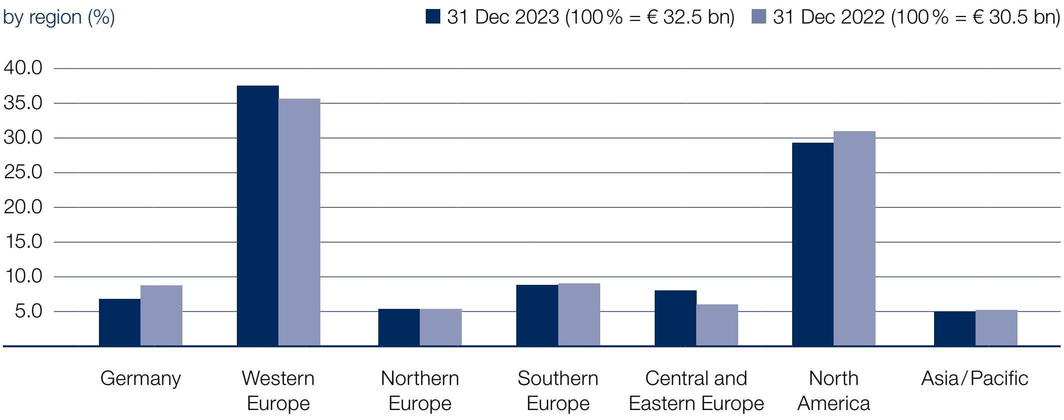
As at 31 December 2023, the volume of Aareal Bank Group's property financing portfolio[1] stood at € 32.5 billion (2022: € 30.5 billion). Including the former WestImmo's private client business and local authority lending, it amounted to € 32.9 billion (2022: € 30.9 billion) and is thus within the target range for portfolio size.

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

At the reporting date (31 December 2023), Aareal Bank Group's property financing portfolio was composed as shown in the charts below, compared with year-end 2022.

Property financing volume[1] (amounts drawn)

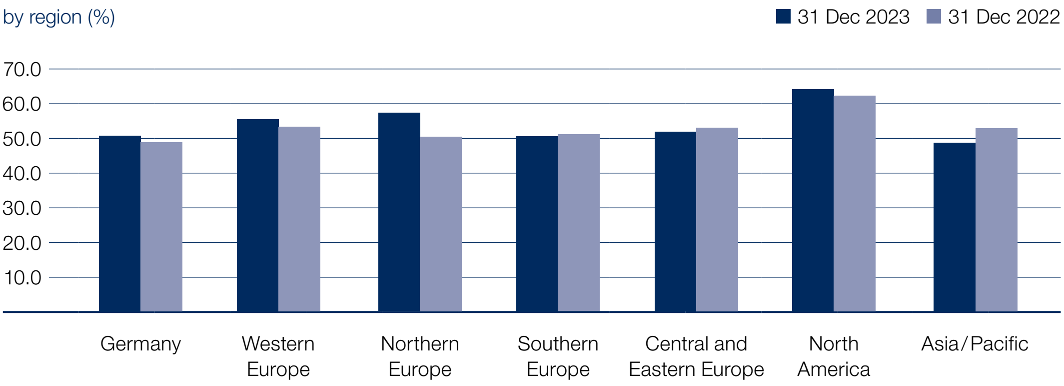
by region (%)



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

Average LTV of property financing[1]

by region (%)

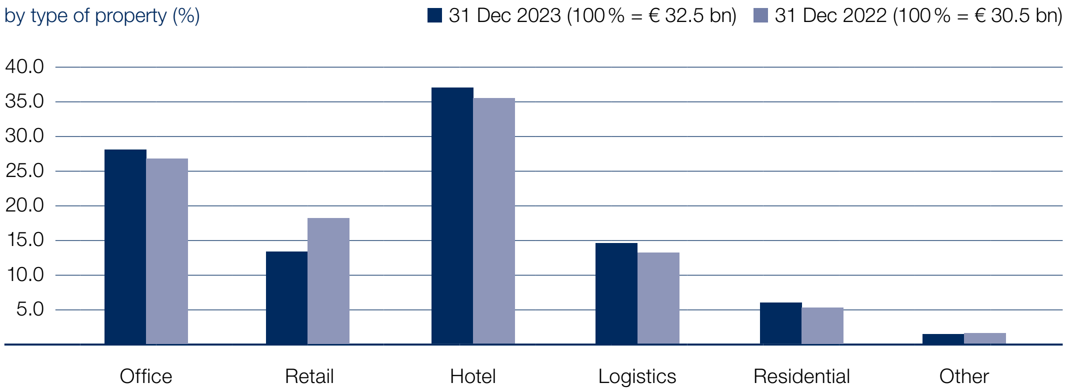


[1] Excluding former WestImmo's private client business and local authority lending business

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)

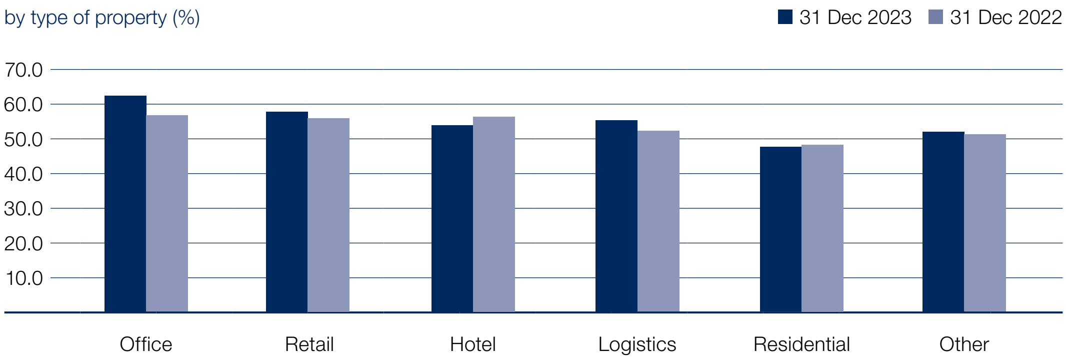
by type of property (%)



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

Average LTV of property financing[1]

by type of property (%)



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

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.

Portfolio allocation by region and continent did not change significantly during the period under review. Whilst the portfolio share of exposures rose by around 2.0 percentage points in Central and Eastern Europe and by around 1.9 percentage point in Western Europe, it was down by around 1.6 percentage points for Northern America and by around 1.9 percentage points for Germany whilst remaining relatively stable for all other regions.

The share of hotel properties increased by 1.5 percentage points and the share of logistics properties by 1.4 percentage points compared to year-end. The share of retail properties decreased by 4.8 percentage points, whereas the share of other property types in the overall portfolio remained relatively stable compared to the year-end 2022.

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 2023, the total nominal volume of the Treasury portfolio[1] was € 7.1 billion (31 December 2022: € 6.7 billion), with the year-on-year increase being due to securities purchases.

The portfolio comprises the asset classes public-sector borrowers, covered bonds and bank bonds (financials), with the public-sector asset class accounting for the largest share of the portfolio (currently at around 74 %). The share of covered bonds was 25 %, while bank bonds account for a small share of 1 %.

The high credit quality requirements are also reflected in the portfolio's rating breakdown. 99.8 % of the portfolio has an investment grade rating[2], and 89.3 % of the positions have an AAA to AA- rating (2022: 84.2 %).

The portfolio currently comprises almost exclusively (96 %) securities denominated in euros, and its average remaining term as at the reporting date was 5.9 years.

Given the high requirements as regards liquidity of the positions as part of their use for the liquidity portfolio, 91 % of the portfolio can be pledged as collateral with the ECB and 84 % fulfils the requirements for "High Quality Liquid Assets" (as defined in the Liquidity Coverage Ratio (LCR)).

Treasury portfolio as at 31 December 2023

%

Total volume (nominal): € 7.1 bn

[1] As at 31 December 2023, the securities portfolio was carried at € 7.3 billion (31 December 2022: € 6.7 billion).
[2] The rating details are based on the composite ratings.

Financial position – liquidity

Money-market liabilities and deposits from the housing industry

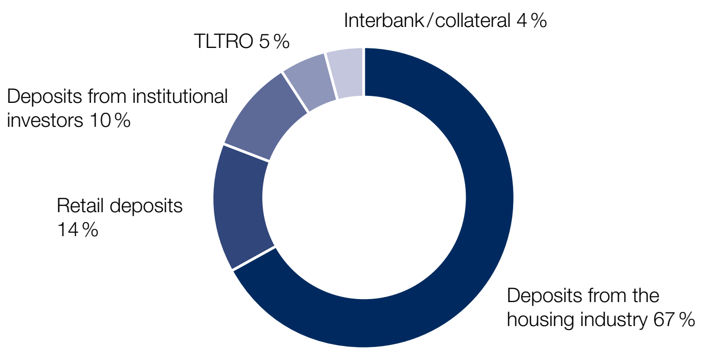
Generally, in addition to deposits from housing industry clients, Aareal Bank also uses deposits from institutional investors including retail deposits for short-term refinancing. To raise funds from retail deposits, it launched several cooperations in 2022 by way of a trust model – via Raisin and Deutsche Bank, for example. It also uses interbank and repo transactions to manage liquidity and cash positions.

As at 31 December 2023, Aareal Bank had € 12.7 billion at its disposal in deposits generated from the business with the housing industry (31 December 2022: € 13.1 billion). Money market liabilities, including targeted longer-term refinancing operations (TLTROs) of Deutsche Bundesbank, amounted to € 6.1 billion (31 December 2022: € 5.8 billion), including € 1.9 billion in deposits from institutional investors and € 2.6 billion in retail deposits.

Money market funding mix as at 31 December 2023

%

Total volume: € 18.8 bn



Long-term funding and equity

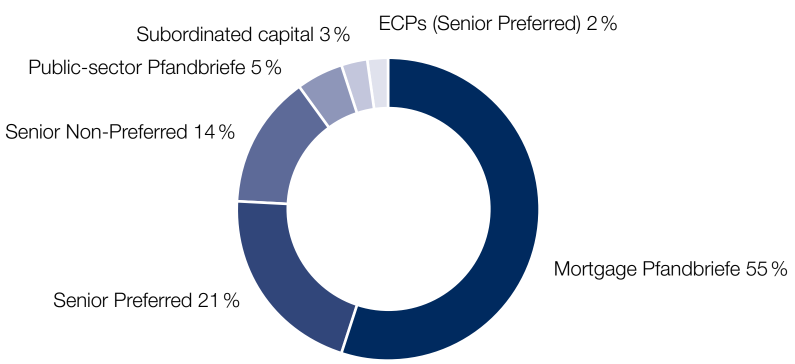
Funding structure

Aareal Bank Group continues to be solidly funded, a development visible by its major share of long-term funding. This encompasses registered and bearer Pfandbriefe, promissory note loans, medium-term notes, other bonds and subordinated issues. According to its legal characteristics, we recognise European Commercial Paper (ECP) as debt even though its maturity is usually less than one year. Subordinated capital includes subordinated liabilities and the Additional Tier 1 (AT1) bond.

As at 31 December 2023, the notional volume of the long-term funding portfolio was € 22.0 billion. The long-term funding portfolio was carried at an aggregate € 20.5 billion.

Capital market funding mix as at 31 December 2023

% Total volume (nominal): € 22.0 bn



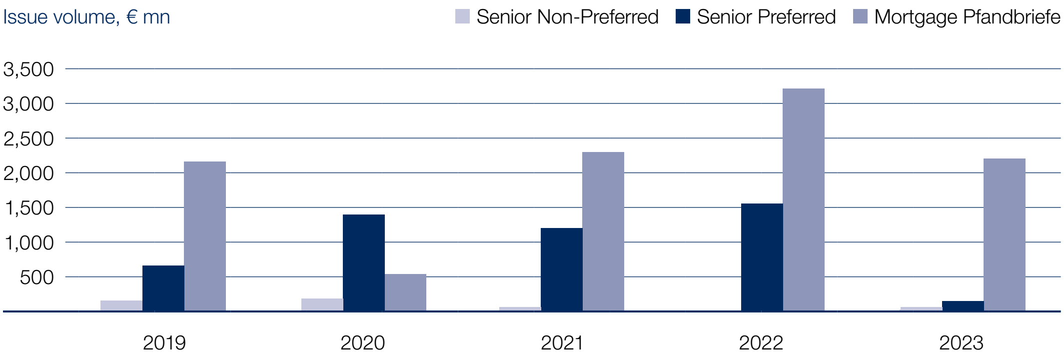
Funding activities

During the 2023 financial year, Aareal Bank Group was able to place € 2.4 billion on the capital markets. This included two benchmark Pfandbrief transactions of € 750 million each, plus another € 500 million issue. Fitch Rating's downgrade on 14 February 2024 (from "BBB+", outlook negative to "BBB", outlook stable) hardly had any impact on our funding situation. Thanks to our broadly diversified funding activities, the downgrade did not lead to any structural changes in our funding strategy.

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

Issuing activities – 2019 to 2023

Issue volume, € mn



Equity

Aareal Bank Group's total equity as disclosed in the statement of financial position amounted to € 3,300 million as at 31 December 2023 (31 December 2022: € 3,258 million). The increase was due, in particular, to the consolidated net income for 2023. € 300 million was attributable to the Additional Tier 1 (AT 1) bond. Please also refer to the statement of changes in equity, and to our explanations in Note 60 of the consolidated financial statements.

At 19.4 %, the Common Equity Tier 1 ratio (CET 1 ratio) – Basel IV (phase-in) – was markedly above the standardised capital requirement of 15 % in the year under review, as expected.

Regulatory indicators[1)]

€ mn	31 Dec 2023	31 Dec 2022
Basel IV (phase-in)		
Common Equity Tier 1 (CET1) capital	2,661	2,468
Tier 1 (T1) capital	2,961	2,768
Total capital (TC)	3,218	3,065
%		
Common Equity Tier 1 ratio (CET1 ratio)	19.4	19.3
Tier 1 ratio (T1 ratio)	21.6	21.7
Total capital ratio (TC ratio)	23.5	24.0
Basel III		
Common Equity Tier 1 ratio (CET1 ratio)	19.4	19.3

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 2022: including the originally proposed dividend of € 1.60 per share in 2022 and pro rata temporis accrual of the interest on the AT1 bond, excluding profits for 2022 under commercial law.
31 December 2023: including profits for 2023 and pro rata temporis accrual of interest on the AT1 bond, given that there are no plans to pay out profits for 2023 in 2024. 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.
Adjusted total risk exposure amount (in accordance with Article 3 CRR – RWAs), in accordance with currently applicable law (CRR II) and applying the partial regulation for the "output floor" in connection with commercial property lending and equity exposures, based on the European Commission's proposal dated 27 October 2021 for implementation of Basel IV (CRR III). The adjusted risk-weighted exposure amount for commercial property lending and equity exposures is determined using the higher of (i) total RWAs calculated in accordance with CRR II currently in force, and (ii) the figure calculated in accordance with the revised CRSA (pursuant to CRR III), applying the transitional provisions for 2025 (50 % output floor).

Regulatory capital[2)]

€ mn	31 Dec 2023	31 Dec 2022
Common Equity Tier 1 (CET1) capital		
Subscribed capital and capital reserves	900	900
Eligible retained earnings	2,088	1,985
Accumulated other comprehensive income	-118	-71
Amounts to be deducted from CET1 capital	-209	-346
Total Common Equity Tier 1 (CET1) capital	**2,661**	**2,468**
AT1 bond	300	300
Sum total of Additional Tier 1 (AT1) capital	**300**	**300**
Sum total of Tier 1 capital (T1)	**2,961**	**2,768**
Tier 2 (T2) capital		
Subordinated liabilities	193	248
Other	64	49
Sum total of Tier 2 capital (T2)	**257**	**297**
Total capital (TC)	**3,218**	**3,065**

2) 31 December 2022: including originally proposed dividend of € 1.60 per share in 2022 and pro rata temporis accrual of interest on the AT1 bond, excluding profits for 2022 under commercial law.
31 December 2023: including profits for 2023 and pro rata temporis accrual of interest on the AT1 bond, given that there are no plans to pay out profits for 2023 in 2024. 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.

Analysis of risk-weighted assets (RWA)[1)]

€ mn	Risk-weighted assets (RWA) 31 Dec 2023	Minimum capital requirements Total 31 Dec 2023	Risk-weighted assets (RWA) 31 Dec 2022	Minimum capital requirements Total 31 Dec 2022
Credit risk (excluding counterparty credit risk)	11,454	916	10,063	805
Counterparty credit risk	520	42	384	31
Market risk[2)]	–	–	136	11
Operational risk	1,283	103	1,142	91
Additional RWA pursuant to Article 3 of the CRR	463	37	1,057	85
Total	**13,720**	**1,098**	**12,782**	**1,023**

[1)] Adjusted total risk exposure amount (as defined in Article 3 CRR – RWAs), in accordance with currently applicable law (CRR II) and applying the partial regulation for the “output floor” in connection with commercial property lending and equity exposures, based on the European Commission’s proposal dated 27 October 2021 for implementation of Basel IV (CRR III). The adjusted risk-weighted exposure amount for commercial property lending and equity exposures is determined using the higher of (i) total RWAs calculated in accordance with CRR II currently in force, and (ii) the figure calculated in accordance with the revised CRSA (pursuant to CRR III), applying the transitional provisions for 2025 (50 % output floor).
[2)] 31 December 2023: there was no requirement to cover market risk with regulatory capital since, under Article 351 of the CRR, the sum total of the net foreign currency position in aggregate did not exceed 2 % of regulatory capital.

Our Employees

Our employees play a key role in the future development of Aareal Bank Group: their motivation, entrepreneurial thinking and action, sense of responsibility and the development of forward-looking solutions are decisive for the Group’s performance and competitiveness. This is all the more relevant in our complex business, which in many cases is based on long-standing client relationships built on trust. It is therefore of the utmost importance for us to broaden our employees’ general knowledge base through our junior staff programme and the targeted promotion of internal transfers and further development, and to allow this to have an impact on our client relationships.

Employee data as at 31 December 2023[1)]

	31 Dec 2023	31 Dec 2022	Change
Number of employees at Aareal Bank Group	3,463	3,316	4.4 %
Years of service	11.2 years	11.1 years	0.1 years
Staff turnover rate	7.5 %	10.0 %	-2.5 percentage points

[1)] 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.

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 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.

With the new training and continuing professional development approach Learning@Aareal, introduced in 2020, Aareal Bank supports employees through targeted offers that are focused on the Company and HR strategy, and Aareal Bank’s Unique Selling Point (USP).

Learning@Aareal is integrated in Aareal Bank's strategic development approach, which uses a skills matrix as the basis for talent development at an organisational level. By linking the skills matrix, Learning@Aareal, clear selection procedures and management and expert career paths, we are facilitating the sustainable development of our employees, which is supplemented by the mandatory staff 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 the years ahead so that employees will develop competencies and invest their talent in a forward-looking way.

The staff development dialogue builds on the employee's current tasks and, in the Company's and the employee's interests, promotes and enhances both soft skills and hard (professional, methodological and digital) skills. 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 improve the balance between work and family life, which is one of Aareal Bank's core concerns. As a matter of consequence, 50 % of the training content is available in digital format, therefore facilitating permanent learning regardless of time or location.

In addition, a digital language learning portal helps to further build language and communications skills, 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 continue the cross-mentoring programme, whereby mentees and mentors from different companies exchange ideas in a professional tandem relationship. This is another way in which we promote targeted, cross-divisional exchange and knowledge transfer.

Promoting the next generation

Attracting and growing talented young employees is a core element of Human Resources work at Aareal Bank Group. The specialist knowledge required in our business segments means that we have 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. We continued to expedite talent recruitment and training during the year under review.

Aareal Bank's talent development programme comprises not only trainee programmes, but also two twin-track degree courses – business information systems and business administration – in cooperation with DHBW Mannheim and RheinMain University. It collaborates closely with universities in the region using a variety of initiatives that are constantly being expanded. 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.

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 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 (facilitated by the City of Wiesbaden), the availability of a parent-child workroom, flexible working policies, part-time positions and the option of mobile working 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.

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. 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, and business yoga in a digital format.

Risk Report

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 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 are a component of the regular risk inventory process. Physical climate-related 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 material mid- to long-term risk factors of climate transition risk related to technology, the risk of regulatory breaches as well as governance factors such as fraud, sustainability management and data protection. In addition, there is client behaviour as an overarching factor. Management and monitoring of ESG risks are further refined on an ongoing basis, suitable risk indicators and limits for climate and environmental risks are being developed for this purpose.

Risk management – scope of application and areas of responsibility

Aareal Bank AG 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 individual entities. In addition, risk monitoring for these entities is carried out at Group level via the relevant control bodies of the respective entity, and equity investment risk controlling.

Overall responsibility for Aareal Bank Group's 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.

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 Management Credit Portfolio Management Capital Markets Management Workout	Risk Controlling Second Line of Defence (NPL)
Treasury business	Treasury	Risk Controlling
Country risks	Treasury Credit Management Capital Markets 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		

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 Risks division exercises this function for non-financial risks. Both divisions report directly to the Chief Risk Officer (CRO).

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 the respective control activities being outlined in the Written Set of Procedural Rules for the 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 by the respective divisions or subsidiaries on an event-driven basis; in any case, at least every six months. The results are discussed with the corresponding units within the Second and Third Lines of Defence (Risk Controlling, Compliance and Internal Audit). Following a plausibility check carried out by a centralised ICS Coordination Unit, results are 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 Common Equity Tier I (CET1) capital forms the basis for determining economic aggregate risk cover. Additional Tier I (AT1) capital is not added to internal 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. The management buffer also includes adjustments for potential climate-related risks.

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 interval of 99.9 %.

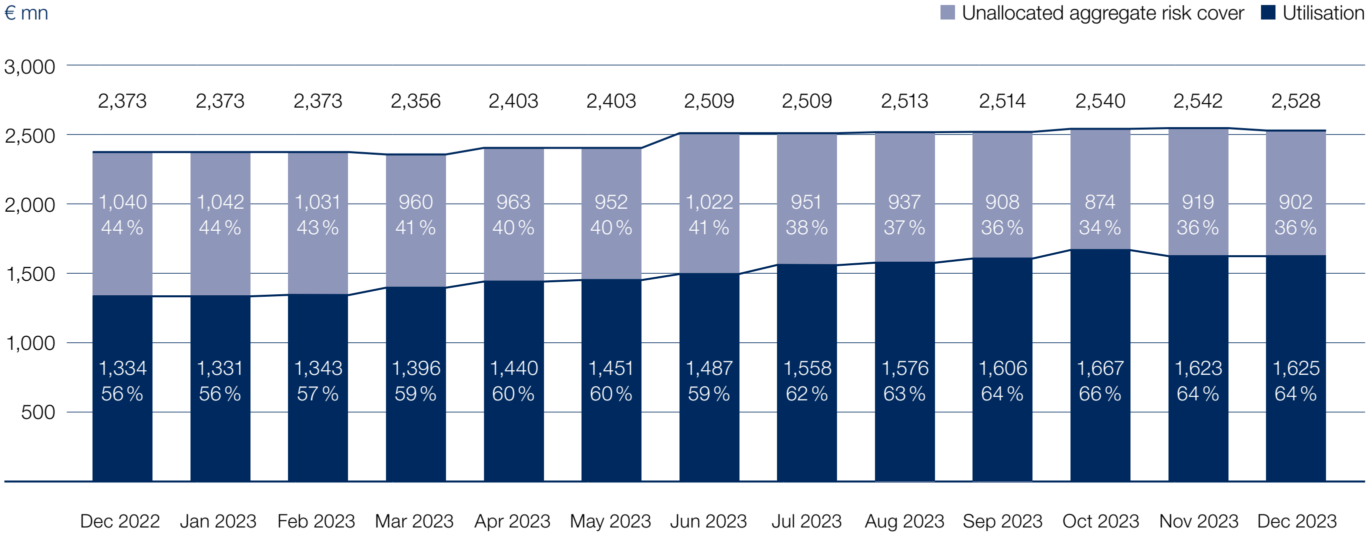
Limits for specific risk types are determined in such a manner that aggregate limits do not exceed economic aggregate risk cover, less a risk buffer designed to cover risks not explicitly covered by limits, and to also absorb other fluctuations of internal capital over time. Individual limits are set 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 at the aggregate risk level were detected during the period under review.

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

€ mn	31 Dec 2023	31 Dec 2022
Common Equity Tier 1 capital (CET1 in accordance with Basel III)	2,661	2,468
Economic adjustments	-133	-95
Aggregate risk cover	**2,528**	**2,373**
Utilisation of aggregate risk cover		
Loan loss risks	680	467
Interest rate risk in the banking book (IRRBB)	99	86
Pension risks	118	72
Market risks	385	406
Operational risks	103	91
Investment risks	43	75
Property risks	100	71
Business and strategic risks	97	66
Total utilisation	**1,625**	**1,334**
Utilisation (% of aggregate risk cover)	**64 %**	**56 %**

Utilisation of aggregate risk cover during the course of 2023



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.

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. ESG risks are integrated into the stress testing methodology; ESG-related stress test calculations comprise scenarios depicting climate change, supplemented by a scenario on change in society.

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 clearly 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, Capital Markets Management and Credit Portfolio Management (organisational units which are independent of Sales units), is responsible for the approval of counterparty, issuer, or country limits.

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

Process requirements

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

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

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

Early risk detection procedures

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

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

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 uncertainty of future developments and supplements our baseline scenario through 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 Capital Markets 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 CFO and CRO, and other members appointed by the Management Board, meets every two weeks.

Capital Markets 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. Legal performs 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. 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.

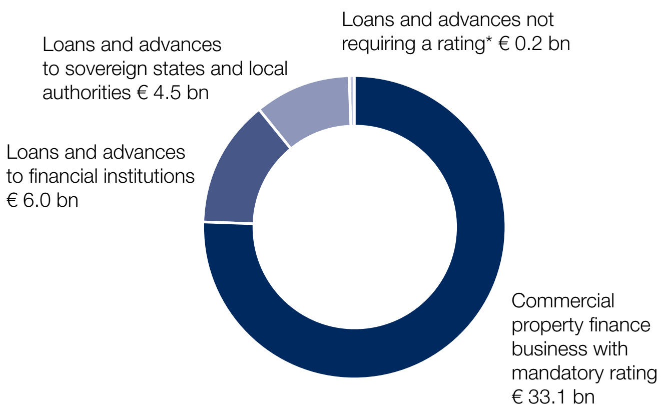
In light of geopolitical and macro-economic uncertainty, special attention is currently paid to economic forecasts. In the context of this ongoing review, we also rely on projections published by the ECB, apart from those issued by our usual data providers. Yet estimation uncertainties are currently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

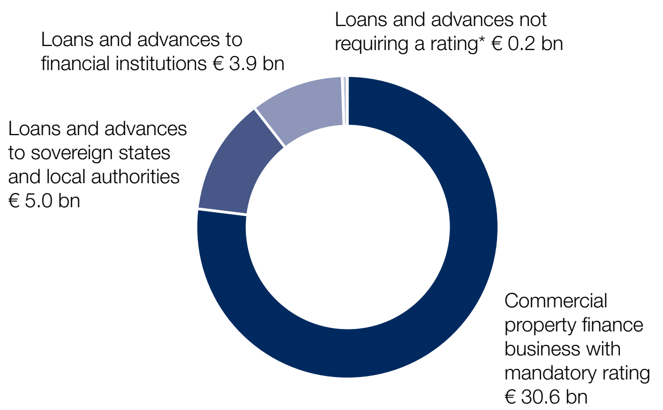
We use a credit portfolio risk model to measure, control and monitor concentration and diversification effects on a portfolio level. This is supplemented by limits on individual and sub-portfolio level to facilitate operating management. Based on these instruments, the Bank's decision-makers are regularly 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.

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

by rating procedure, € bn

31 Dec 2023 | 31 Dec 2022





* Including the private client business of former WestImmo

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.

The following tables provide a breakdown of gross carrying amounts of on-balance sheet as well as off-balance sheet credit business, money-market business, and capital markets business, by rating classes and loss allowance stages, in line with credit risk management at Group level. The ongoing interest rate increases on the international markets burdened debt service requirements, resulting in continued high levels of Stage 2 loss allowance compared to historical levels. 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 2023					31 Dec 2022				
	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
€ mn										
Class 1	–	–	–	–	**–**	–	–	–	–	**–**
Class 2	50	–	–	–	**50**	158	–	–	–	**158**
Class 3	48	–	–	–	**48**	258	–	–	–	**258**
Class 4	734	–	–	–	**734**	775	24	–	–	**799**
Class 5	3,359	19	–	18	**3,396**	4,367	19	–	18	**4,404**
Class 6	4,249	–	–	68	**4,317**	4,296	52	–	112	**4,460**
Class 7	6,268	79	–	5	**6,352**	4,534	772	–	37	**5,343**
Class 8	4,393	912	–	32	**5,337**	2,610	1,352	–	52	**4,014**
Class 9	4,254	2,551	–	0	**6,805**	3,649	2,623	–	33	**6,305**
Class 10	1,378	794	–	23	**2,195**	962	1,519	–	42	**2,523**
Class 11	234	372	–	–	**606**	157	116	–	–	**273**
Class 12	–	188	–	–	**188**	–	97	–	–	**97**
Classes 13-15	–	426	–	–	**426**	–	–	–	–	**–**
Defaulted	–	–	1,468	109	**1,577**	–	–	983	133	**1,116**
Total	**24,967**	**5,341**	**1,468**	**255**	**32,031**	**21,766**	**6,574**	**983**	**427**	**29,750**

[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 2023					31 Dec 2022				
	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
€ mn										
Classes 1-3	1	–	–	–	**1**	–	–	–	–	**–**
Class 4	7	–	–	–	**7**	5	–	–	–	**5**
Class 5	13	–	–	–	**13**	52	–	–	–	**52**
Class 6	134	–	–	–	**134**	72	–	–	0	**72**
Class 7	151	–	–	–	**151**	62	19	–	–	**81**
Class 8	167	21	–	–	**188**	211	33	–	–	**244**
Class 9	205	102	–	–	**307**	84	18	–	–	**102**
Class 10	122	–	–	3	**125**	211	20	–	–	**231**
Class 11	100	49	–	–	**149**	19	–	–	–	**19**
Classes 12-15	–	3	–	–	**3**	–	–	–	–	**–**
Defaulted	–	–	10	–	**10**	–	–	2	–	**2**
Total	**900**	**175**	**10**	**3**	**1,088**	**716**	**90**	**2**	**0**	**808**

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

On-balance sheet loans and advances to financial institutions

€ mn	31 Dec 2023 Stage 1	Stage 2	Stage 3	fvpl[1]	Total	31 Dec 2022 Stage 1	Stage 2	Stage 3	fvpl[1]	Total
Class 1	478	–	–	–	**478**	322	–	–	–	**322**
Class 2	418	–	–	–	**418**	157	–	–	–	**157**
Class 3	281	–	–	–	**281**	476	–	–	–	**476**
Class 4	2,579	–	–	–	**2,579**	1,102	–	–	–	**1,102**
Class 5	55	–	–	–	**55**	302	–	–	–	**302**
Class 6	281	–	–	–	**281**	7	–	–	–	**7**
Class 7	1,141	–	–	–	**1,141**	655	–	–	–	**655**
Class 8	593	–	–	–	**593**	422	–	–	–	**422**
Class 9	87	–	–	–	**87**	396	–	–	–	**396**
Class 10	30	8	–	–	**38**	18	–	–	–	**18**
Classes 11-18	–	–	–	–	**–**	–	–	–	–	**–**
Defaulted	–	–	–	–	**–**	–	–	–	–	**–**
Total	**5,943**	**8**	**–**	**–**	**5,951**	**3,857**	**–**	**–**	**–**	**3,857**

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

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

€ mn	31 Dec 2023 Stage 1	Stage 2	Stage 3	fvpl[1]	Total	31 Dec 2022 Stage 1	Stage 2	Stage 3	fvpl[1]	Total
Class 1	1,887	–	–	–	**1,887**	1,687	–	–	–	**1,687**
Class 2	1,317	–	–	–	**1,317**	1,802	–	–	–	**1,802**
Class 3	451	146	–	–	**597**	495	–	–	–	**495**
Class 4	40	–	–	–	**40**	30	–	–	–	**30**
Class 5	12	–	–	–	**12**	21	–	–	–	**21**
Class 6	112	–	–	–	**112**	273	–	–	–	**273**
Class 7	24	–	–	–	**24**	120	–	–	–	**120**
Class 8	550	–	–	–	**550**	526	–	–	–	**526**
Class 9	–	–	–	–	**–**	–	–	–	–	**–**
Classes 10-20	–	–	–	–	**–**	–	–	–	–	**–**
Defaulted	–	–	–	–	**–**	–	–	–	–	**–**
Total	**4,393**	**146**	**–**	**–**	**4,539**	**4,954**	**–**	**–**	**–**	**4,954**

[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 credit risk in Aareal Bank’s trading business, the master agreements for financial derivatives[1] and master agreements for securities repurchase transactions (repos)[2] used by the Bank provide for credit risk mitigation techniques, via mutual netting framework agreements (“contractual netting agreements”).

The master agreements for financial derivatives used by the Bank contain netting 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”).

[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”).

[2] Any comments below referring to master agreements for securities repurchase agreements (repos) also pertain to the master agreement issued by the International Capital Markets Association Inc. (ICMA) (the “Global Repurchase Agreement”). Both agreements are standardised agreements recommended by leading associations – among others, by the Association of German Banks (Bundesverband deutscher Banken – “BdB”).

In general, all master agreements for financial derivatives are based on the principle of a common agreement. This means that, in the case of a termination or counterparty default, 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 contractual netting 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. Hence, the Bank decides for each individual transaction whether close-out netting is viable, thus allowing set-off against other individual transactions covered by the relevant framework agreement. The Bank uses eligible contractual netting agreements within the meaning of Article 296 of the CRR for all transactions with financial institutions; in many cases there are additional collateral agreements which further reduce the relevant credit risk.

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

The Bank also 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 on a single transaction level. For this purpose, the Bank applies the Financial Collateral Comprehensive Method in accordance with chapter 4 (Articles 223 et seqq.) of the CRR.

In principle, framework agreements for securities repurchase transactions (repos) provide for close-out netting of all individual transactions covered by a contractual netting agreement. However, as far as repos are concerned, the Bank has not yet made use of the regulatory option to reduce the capital backing for all individual transactions covered by a contractual netting agreement.

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

Collateral for financial derivatives is usually provided in cash. Securities repurchase agreements (repos) are usually collateralised through the exchange of securities.

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

Country risks

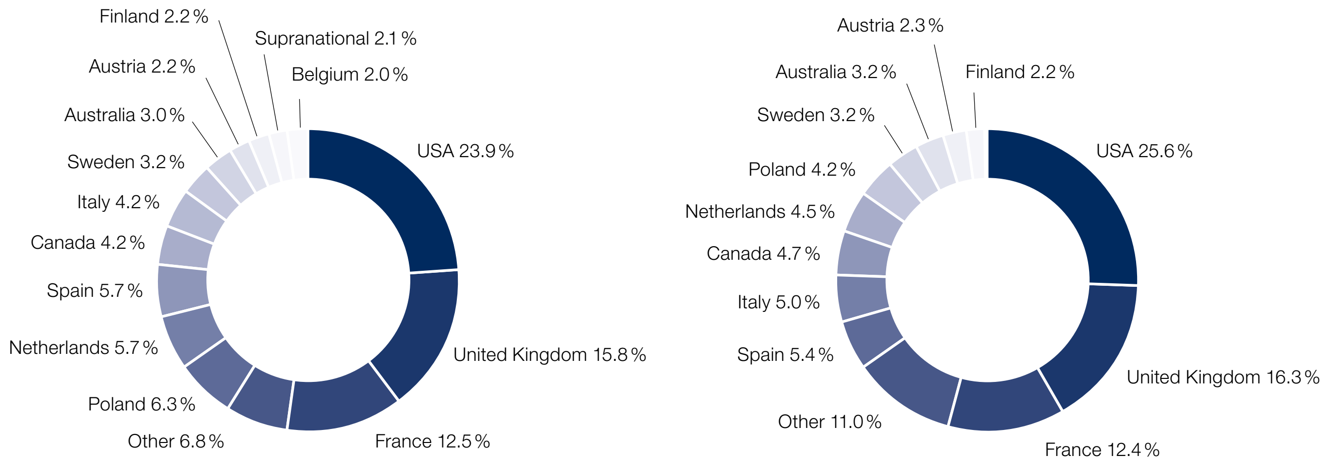
Our comprehensive approach to risk management also includes measuring and monitoring country risk exposure. When defining country risk, in addition to the risk of sovereign default or default of state entities, Aareal Bank also considers the risk that a counterparty could become unable to meet its payment 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 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.

Breakdown of country exposure in the international business

%

31 Dec 2023 | 31 Dec 2022



Interest rate risk in the banking book

Definition

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

Risks arising from fluctuations in the value of fund assets (funds risk) have been reclassified to other market risk. Work in the context of the benchmark reform has been completed: for all currencies affected, the so-called risk-free rate of the respective currency is the reference for measuring interest rate 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 a presentation of potential plan deviations of income in case adverse interest rate scenarios occur (earnings perspective). The interest rate scenarios used for the measurement of potential plan deviations comprise interest rate shocks (both increases and reductions) as well as time-based increases or reductions of the interest rate projection used to determine planned interest income.

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 (1.88 years on average), using the average residual amount of deposits observed in the past. Modelling does not include deposits by large clients from the financial sector, in line with EBA Guidelines on the management of interest rate risk arising from non-trading book activities (EBA/GL/2022/14).

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, which tends to overstate VaR. The new EBA guidelines on the management of interest rate risk arising from non-trading book activities (EBA/GL/2022/14), which were applicable as at 30 June 2023 for the first time, did not lead to any further material adjustment of present values.

In addition to this and in line with EBA/GL/2022/14 (Guidelines on the management of interest rate risk arising from non-trading book activities), the change in net interest income is determined in the relevant interest rate shock scenarios. 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 the present value approach, net interest income includes not only the earnings contributions of the modelled existing business as at the planning or forecast date, but also the income and expenses from planned new business and prolongations. 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; to this end, EBA guidelines EBA/GL/2018/02 on the management of interest rate risk arising from non-trading book activities are still applied.

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 %.

	31 Dec 2023		31 Dec 2022	
	-200 bp	+200 bp	-200 bp	+200 bp
€ mn				
EUR	-43	40	-40	23
GBP	12	-18	15	-25
USD	36	-45	18	-14
Other	8	-8	6	-6
Total	**13**	**-31**	**-1**	**-22**
Ratio to regulatory capital requirements in accordance with Basel III (%)	**0.4**	**1.0**	**0.0**	**0.7**

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

€ mn	31 Dec 2023	31 Dec 2022
Parallel shock up	-35	-28
Interest rate coefficient for parallel shock up (%)	1.2	1.0
Parallel shock down	18	4
Interest rate coefficient for parallel shock down (%)	0.6	0.1
Steepener shock	-2	7
Interest rate coefficient for steepener shock (%)	0.1	0.3
Flattener shock	-13	-24
Interest rate coefficient for flattener shock (%)	0.4	0.9
Short-term rates shock – up	-32	-29
Interest rate coefficient for short rates shock up (%)	1.1	1.0
Short-term rates shock – down	1	22
Interest rate coefficient for short rates shock down (%)	0.0	0.8
Tier 1 capital in accordance with Basel III	**2,961**	**2,768**

Net interest income is a metric derived from the income statement. The earnings risk is measured based on the changes in net interest income of the next twelve months as a result of a parallel shift of the yield curve by 200 basis points. In this context, assumptions regarding client behaviour and the competitive environment in such a scenario are especially subject to idealised model parameters.

Pension risks

Pension risks arise from the measurement of pension obligations entered into, and of plan assets held under pension plans. Risk is mitigated by structuring plan assets – largely a special investment fund held in trust – accordingly.

VaR, which requires sensitivity data for risk factors (representing exposure) as well as a covariance matrix of such risk factors (volatility and correlation) to map market dynamics, is calculated as the simplest stochastical model in the delta-normal approach.

Pension risks are managed directly by the Asset-Liability Committee (ALCO); for this purpose, the ALCO has also assumed the function of Investment Committee for the plan assets. Pension obligations and plan assets are subject to regular risk reviews and assessments.

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 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).

Since Aareal Bank did not pursue any trading book activities (as defined by the CRR) during the period under review, trading book risks had no relevance.

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);
- risks from fluctuations in the value of fund assets (fund risk); and
- risks from adjustments to the credit valuation of OTC – derivatives (CVA risk).

This means that credit spread risk in the banking book (CSRBB) is assigned to market risk. The requirements of new EBA Guidelines on the management of interest rate risk and credit spread risk arising from non-trading book activities (EBA/GL/2022/14) have been applicable for the first time as at 31 December 2023. The calculation of credit spread risks was reviewed and adjusted during the course of implementation of these new guidelines. A material adjustment in this context involved incorporating sensitivities associated with the Bank's own benchmark issues to suitable Pfandbrief and senior unsecured spreads in the risk indicators.

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 to determine the aggregated VaR indicator for market risk. 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

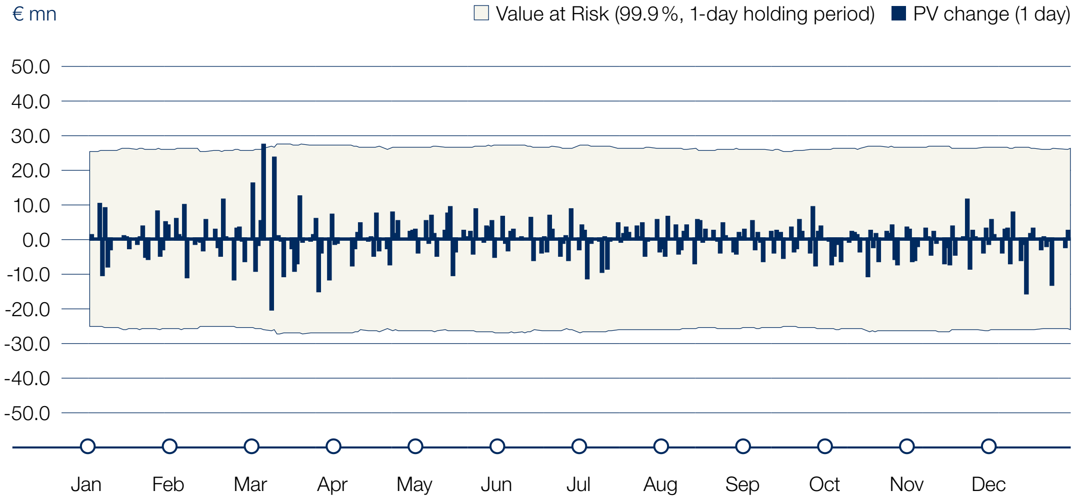
The quality of forecasts made using statistical models is checked through a monthly backtesting process. The quality of the statistical procedure used to measure risk is checked using a method referred to as binomial test, whereby daily profits and losses from market fluctuations are compared with the upper projected loss limit (VaR) forecast on the previous day (known as 'clean backtesting'). In line with the selected confidence interval 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.

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

Present values and 1-day VaR during the course of 2023



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, ESG risk factors as well as model and reputational risks are also taken into consideration within this type of risk.

Risk strategy

The primary purpose of the risk strategy is to provide strategic guidance on the conscious and professional handling of operational risk. The strategy covers the organisational framework as well as the fundamentals of reporting related to this topic, supplementing and specifying the existing central rules set out in the Risk Appetite Framework.

To facilitate a holistic risk management of operational risk, Aareal Bank has implemented a governance structure which puts the "three lines of defence" concept into operational practice. Given that, in principle, the management approach is organised in a decentralised manner, located in the various divisions or subsidiaries, there is a distinct emphasis on a strong first line of defence which is responsible for risks on a single-risk basis. The centralised OpRisk Controlling department, which is part of the Non-Financial Risks division, monitors the first-line activities as an independent second line of defence. In this context, the general second line of defence is supplemented by specialised monitoring functions known as 'specialist second lines'.

Process risks are addressed through the internal control system (ICS). The design of the Group-wide ICS emphasises mitigating material process-inherent risks through appropriate and effective key controls which are compiled for Aareal Bank in a dedicated inventory.

The Non-Financial Risks division is responsible for monitoring compliance risks, as well as risks related to financial crime. The Group-wide objective of the compliance management system is to mitigate liability risks in the form of potential fines and penalties for the Bank or its subsidiaries and their board members. In addition, Aareal Bank's positive reputation as a group of companies with integrity vis-à-vis external stakeholders such as business partners, counterparties and investors is to be maintained and further strengthened. The Anti Financial Crime strategy serves to manage risks related to money laundering, terrorist financing, sanction breaches and fraud in a professional and conscious manner. It encompasses applicable qualitative standards (for example, listing business areas and sectors not served) and quantitative key risk indicators (such as thresholds for high-risk clients and politically exposed persons) for the purpose of risk monitoring.

In order to mitigate legal risks, Aareal Bank's central Legal department and decentralised legal units monitor any litigation the Bank is involved in (whether in court or out-of-court), and deal with any legal issues of fundamental importance, and provide legal advice on day-to-day business. Legal compiles all information concerning any legal disputes at Group level, whether in or out of court. The Bank's decentralised operating legal entities, as well as the legal departments of individual Group entities 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. Tax risks including related legal risks are monitored and managed separately by Aareal Bank's tax department. The tax compliance management system actively reduces the risk related to tax law compliance and fraud cases, for example by setting standardised work instructions and controls, both within the tax department and in interfaces with other divisions.

Information Security & Data Protection has central responsibility for monitoring risks affecting operational resilience. The division defines Bank-wide requirements and initiates different measures to mitigate information security risk and to achieve the level of security targeted in the Information Security Framework Directive. This includes raising awareness amongst internal and external employees through corresponding training courses and the exchange of information on cyber threats via the communication channels with ECB, BaFin and BSI. To mitigate outsourcing risk, the responsible outsourcing organisational units regularly assess the performance of external service providers, using defined criteria. The results of this process, and control measures taken, are consolidated and communicated to the Bank's Management. Business Continuity Management (BCM) mitigates business continuity risks by defining the emergency organisation, setting out and testing emergency and crisis plans for the Bank's business processes identified as time-critical. Business will be managed in accordance with these plans in the event of an emergency or crisis.

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.

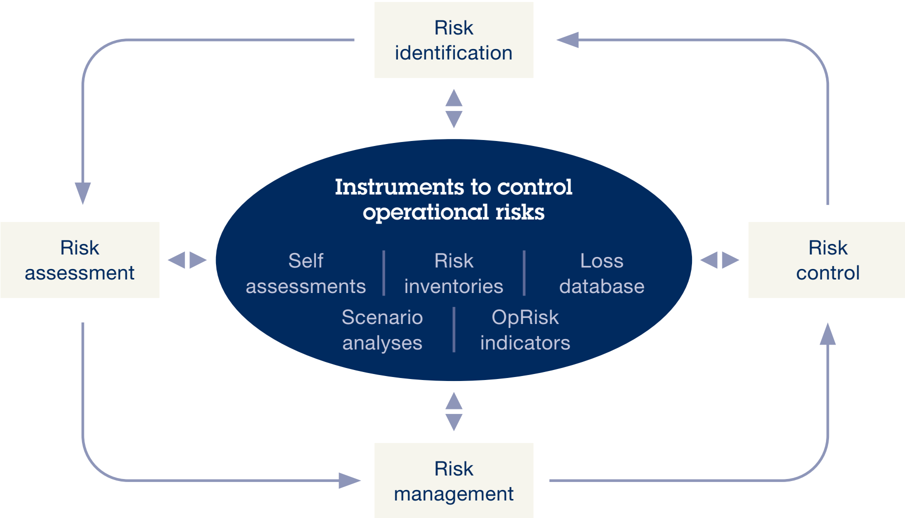
The Bank currently uses the following risk control tools to manage operational risks:

- Self-assessments: analysis thereof can provide management with an indication of any potential risks within the organisational structure;
- risk inventories and subsequent risk assessments that include a periodic systematic identification and compilation of all relevant risks and their qualitative and quantitative assessment;
- a loss database, in which relevant risk events incurred are reported, and in which they can be monitored until they are officially closed;
- operational risk indicators for all risk levels that show current threat potential using a defined 'traffic light' system;
- stress tests based on hypothetical as well as historical scenarios and sensitivity analyses of risk inventory data, carried out in order to gain indicators for developments which may potentially threaten the Bank's continued existence.

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

The tools described above are used to prepare the regular risk reporting to the Bank's senior management. 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. 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 – is determined using the regulatory standardised approach under Pillar I.

Management of operational risks



No material risk concentrations were evident in the 2023 financial year. Risk events are recorded in a database on an ongoing basis. The aggregate impact of such risk events during the year under review amounted to less than 10% of the regulatory capital to be maintained for operational risks. Supplementary operational risk management tools – in particular, the monitoring of indicators, scenario analyses and the self-assessment – do not indicate potential elevated risk either.

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

The investment risk model breaks down investments outside the regulatory scope of consolidation into two groups, whereby risk-equivalent exposures are determined for material investments using the regulatory IRB formula. This was supplemented by a concentration risk component, to account for cases where individual investments constitute a significant concentration risk for the Bank as a whole. For non-material investments, equity coverage is determined using the simple risk weight function for investments in accordance with the CRR. Risk exposure for investments within the regulatory scope of consolidation is measured using the look-through principle, based on the assets of the respective investment.

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

Group Strategy, 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 property types, and over the time horizons available: on this basis, potential yield increases for different regions and property types 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. Over and above this, the model takes into account idiosyncratic shock events for individual properties which may occur independently of general market developments.

Property holdings as at the reporting date increased as a result of the acquisition of two property SPVs from US lending exposures.

Business and strategic risks

Definition

Business and strategic risks are defined as risks that may potentially threaten achievement of corporate objectives, and which may result (for example) from changes in the competitive environment, or from an unsuitable strategic positioning in the macro-economic environment. We distinguish between allocation risk and investment risk, whereby allocation risk is defined as a divergence of operating results due to lower-than-expected income from allocated capital that cannot be offset through reductions in costs or administrative expenses. Investment risk is defined as the risk that the Bank is unable to compensate for any divergence in operating results through activities or investments in alternative business segments that generate results to the same or similar extent.

Risk measurement and monitoring

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, the Bank considers not only ICAAP risk parameters, but also ILAAP risk parameters for a three-year horizon.

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

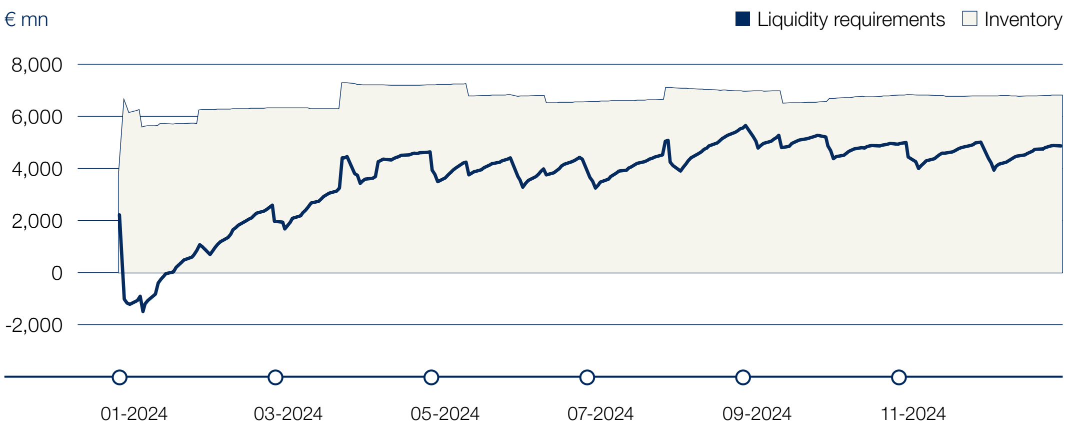
Moreover, we employ stress tests and scenario analyses to assess the impact of sudden stress events onto the Bank's liquidity situation. The various standardised scenarios used, which include historic, idiosyncratic, market-wide and combined scenarios, are evaluated on the basis of the liquidity run-off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

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

Time to illiquidity

To safeguard adequate liquidity beyond the three-month horizon covered by the liquidity run-off profile, we use the concept of time to illiquidity as a parameter. For this purpose, a liquidity run-off profile was developed which compares liquidity requirements occurring with the liquidity stock, for a one-year period. Time to illiquidity ("TtI") denotes the remaining period (expressed in days) during which the Company 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 2024. The chart demonstrates that the liquidity stock will always exceed liquidity requirements, even under adverse conditions.



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 ICS and RMS

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 effec-tiveness 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 Internal Control System, in particular with regard to the accounting process. 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 quarterly reports 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.

The Management Board regularly assesses the appropriateness and effectiveness of the ICS and RMS. This assessment is primarily based on the result of the semi-annual ICS report and the monthly risk reporting and provides the Management Board with an overview of the key elements of Aareal Bank Group's ICS and RMS. As part of the reporting, the Management Board thus receives a summary of the assessment activities regarding the appropriateness and effectiveness of the ICS and RMS, as well as of any anomalies that were identified during these activities. The information contained in the ICS report and risk reporting are also presented to Aareal Bank AG's Supervisory Board as a report on the effectiveness of the ICS and RMS. The assessment of the ICS is based on the evaluation of the decentralised ICS officers, which includes internal and external audit results in particular. On this basis, the Management Board has no evidence that the ICS or RMS in their entirety are not appropriate or effective as at 31 December 2023.

Irrespective of this, the effectiveness of any risk management and control system is subject to an inherent restriction. Therefore, no system – even if it was evaluated as appropriate and effective – can guarantee a 100% prevention of risks or process violations under any circumstances. In addition to the ICS and RMS, and especially for those processes and procedures that, due to high momentum and a large number of new regulations, are not yet at the same stage of maturity as established processes, Aareal Bank has established a Code of Conduct for its employees. This Code of Conduct makes ethical conduct a guideline and minimum requirement of corporate action in dealing with new or unregulated matters, thus largely minimising violations of internal and external regulations.

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 are available for inspection for all affected 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 communicated to the relevant divisions. 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

Economic activity, the financial and the commercial property markets are all exposed to numerous risks. Some downside risks weakened during 2023, for example through declining inflation rates and the elimination of supply chain disruptions. Some risks also proved to be temporary. Nonetheless, the subject of risks still dominates the overall view. The Russian invasion of Ukraine, which has caused enormous humanitarian and economic distress, remains an extraordinary concern. Other risks that could have a negative impact are geopolitical risks, the repercussions of declining (but persistently high) inflation, an excessive monetary tightening by central banks, increased public and private debt, doubts about the cohesion of the European project as well as the consequences of the transformation of the economy towards more climate neutrality.

The consequences of the Russian invasion of Ukraine and mutual sanctions between the West and Russia continue to have a serious negative impact on many economies, which may persist or be exacerbated if the conflict continues. Since Russia is a major exporter of oil, gas, nickel and palladium, while Ukraine is a major exporter of grain, this war continues to create the potential for considerable volatility on the commodity markets. This, together with an increased risk of cyberattacks, heightened investor reluctance, and the risk of critical infrastructure sabotage, puts economic growth at serious risk. In this context, it is fair to expect that the economic relationship between Russia and the West will not normalise completely in the near term, even if the war should end.

In addition, Russia and China are apparently forming an alliance against the Western world. Since China has a major role in global supply chains, escalating trade conflicts could significantly damage the global economy and would certainly be exacerbated if China attacked Taiwan. Meanwhile, after the Covid-19 pandemic had demonstrated the vulnerability of global supply chains, decoupling processes and general efforts towards de-globalisation can already be observed. Other geopolitical risks, such as terrorism and military conflicts, could also have enormous effects on the markets and their participants: following Hamas's attack on Israel and Israel's invasion of the Gaza Strip, the threat of terrorism has increased not only in the Middle East, but also in Western countries. This conflict also harbours the risk of increased volatility in energy prices. In particular, there is a risk of the conflict spreading to the Middle East, which in turn might disrupt global oil supplies.

While energy and commodity prices were the main drivers of inflation in the first half of 2022, price pressures subsequently became increasingly broad-based, pushing inflation in many economies to its highest level in several decades. Although energy-related price pressures subsided in 2023, persistently high core inflation suggests that companies are passing higher input costs (including catch-up effects on the wage front) directly through to consumers in the form of higher prices for goods and services – with the express intention of protecting their profit margins. To the extent that demand could meet supply shortages in the future, prices of some goods and services may continue to rise, contributing to high inflation rates and (potentially) to persistently higher inflation expectations. Another possibility is that structurally higher energy prices, for example due to supply shortages, may become a permanent concern, especially for major developed countries – and particularly for Germany, which is also phasing out nuclear energy.

Central banks continue to face the difficult task of bringing inflation rates back in line with target values without jeopardising financial stability. Persistently high inflation along with a sustained elevated level of interest rates present a major risk to the financial and property markets, making it imperative to the central banks to strike the right balance when it comes to tightening their monetary policy. Such monetary tightening could have serious consequences and may trigger a substantial rise in bond yields and negative corrections on the equity and property markets. In addition, limited liquidity on the funding markets may place financial institutions under enormous pressure and, combined with uncertainties about economic momentum, could inhibit lending activity. Another source of stress for banks' profitability is the ECB's decision to cut the interest rate on minimum reserves to 0%, and the further tightening of regulatory requirements. Lifting the level of required minimum reserves – an option that is currently being discussed by some Eurosystem central banks – would make life for banks even more difficult.

Another risk is rising government indebtedness as a consequence of massive fiscal stimulus alongside the slowdown in economic growth and a lack of willingness to reform. With bond purchase programmes expiring and ongoing monetary tightening by central banks, risk premiums for highly indebted countries – and also developing and emerging countries – have already risen. Non-financial corporate debt has also climbed to a high level in many advanced economies, mainly reflecting bond issuance. Reduced macro-economic activity or other risks could be a reason for downgrading the rating of these bonds.

Political anti-EU sentiment is a major long-term threat – not only to the member states but European cohesion as a whole, although Poland has recently been sending encouraging signals. Insufficient coordination and cooperation in the refugee crisis, slowing economic growth, and recessionary fears have all fuelled the risk of rising populism and resulting electoral success for populist parties in several countries. The reform backlog and structural economic problems in some euro zone countries present further uncertainty, risk and stress factors. Whilst the EU's investment package is aimed at supporting these countries in particular, there is still a risk that the measures will not be quite enough to address structural problems. Finally, for the US, political confrontation between the two main parties – particularly in light of the upcoming presidential election on 5 November 2024 – bears the risk that profound uncertainty amongst consumers and investors alike will weigh upon economic activity.

The efforts of many countries and companies to limit global warming require a radical transformation of the entire economy. The macro-economic impact of this transition is uncertain, and the actual effects depend on a number of factors. At the same time, this change entails costs which 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. However, this also offers opportunities for investment in related technologies or the decarbonisation of properties. In addition to the transition costs incurred in decarbonising the global economy, the costs directly attributable to climate change will also increase over the medium term. Extreme weather events, temperature fluctuations and more frequent extreme heat events are causing physical damage that will increase over time. The extent of this increase will depend on how well the global community succeeds in reducing greenhouse gas emissions.

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 any considerable extent.

Opportunities lie in a faster decline in inflation combined with faster than expected monetary easing and a further reduction in the excess savings accumulated during the Covid-19 pandemic, which could boost private consumption. Productivity increases, for example through the adoption of digital technology or progress with AI, should also be mentioned here.

Economy

A variety of stress factors support the assumption that global economic activity will continue to be hampered in 2024. Specifically, we expect that monetary tightening will only take its full effect in 2024 and that insufficient fiscal support will be a drag on growth in many countries. A recession, however, will likely be avoided in most countries. Both overall and core inflation will continue to subside, allowing the major central banks to start cutting interest rates during the course of 2024, which will favour growth in the second half of the year. While lower inflation should support consumer spending, this may be countered by a slight increase in unemployment which could slow down the growth of real disposable household incomes and thus have a dampening effect on consumer spending.

The euro zone's real gross domestic product should see slightly stronger growth in 2024 than in the previous year, albeit at a low level given the multiple burdening factors. The economy should gain momentum throughout the year, as the purchasing power of private households will grow, whilst financial conditions will ease. Diverging economic trends between European regions should persist for the time being: in particular those economies with a large industrial sector (such as Germany) should see slower growth than the euro zone as a whole.

Positive real economic growth is also expected for the UK in the full year 2024, reaching a similarly low level as in the euro zone. Despite the ongoing decline in inflation, the full impact of monetary tightening should become palpable and prevent the upturn from gaining momentum. This will be aggravated by the expiry of economic and energy-related aids introduced during the pandemic and the implementation of announced tax increases, which would mean fiscal tightening and a reduction in government spending.

The US should see growth levels significantly ahead of the euro zone and the UK in 2024 due to labour market strength, a continued decline in inflation and the expected easing of financing conditions.

We expect positive real growth for Australia in 2024, albeit at a lower rate than in the previous year. Growth should be driven by strong private consumption and positive momentum for imports and exports. A decline in corporate investments and a rise in unemployment, on the other hand, should act as a drag on economic activity.

Financial and capital markets, monetary policy and inflation

The risks and uncertainty factors referred to above are also significant for the financial and capital markets and could once again cause disruption. Steeper funding costs in 2023 were a reflection of monetary policy tightening induced by rising inflation, along with higher levels of uncertainty. They should decline slightly in the course of 2024, whilst remaining at a high level. Major central banks recently confirmed their intention to keep key interest rates at restrictive levels for as long as necessary, depending on available data.

We expect the funding markets relevant for Aareal Bank to remain accessible during 2024. Nevertheless, the developments seen in 2023 and the apparent reservations about commercial property financing suggest that higher liquidity premiums for all products and property finance providers can be expected compared to medium-term history.

We expect an ongoing decline in inflation throughout 2024, albeit at a slower pace than in the previous year. However, the speed and exact development of the decline will vary from country to country, depending on how relevant individual supply and demand factors were for the rise in inflation and when monetary tightening measures were initiated. Specifically, we are expecting a quicker return to the inflation target in the euro zone and deeper interest rate cuts than in the US and the UK.

The key priority for central banks during 2024 will be once more to steer inflation rates back towards the target level. Once inflation approaches its target value, central banks should shift their attention to future economic conditions and adjust their monetary policy accordingly. But having lived through a period of overshooting inflation, central banks will presumably act with caution and focus on slowly lowering interest rates to less restrictive levels. On top of the ongoing reduction of the securities holdings created under the APP since 2023, the ECB will also begin to reduce assets acquired under the PEPP in 2024. In addition, it will also stop reinvesting principal payments from the second half of the year onwards. The BoE and the Fed will further reduce their securities holdings, too.

We expect interest rates in advanced economies to decline in 2024 compared to the previous year and anticipate that interest rates will go down more quickly and more sharply in the eurozone than in the US and the UK. In addition, we expect that the inversion of the yield curves will be reversed earlier in the eurozone than in the US and the UK.

Regulatory environment

It is fair to expect the trend towards a tighter regulatory framework to persist in the years ahead.

This includes, in particular, the final steps to fully implement the EU Banking Package which stipulates implementation of the final draft of the Basel III framework into EU law (known as "Basel IV"), as resolved by the Basel Committee (BCBS). Following lengthy negotiations, the parties involved in the legislative process eventually reached an agreement at the end of 2023, meaning that final regulations and directives are expected to be published in the EU's Official Journal, and thus enter into force, during the first six months of 2024. Meanwhile, the European Banking Authority (EBA), following its roadmap, will work on implementing its mandates to prepare technical standards, which serve to specify the rules and provisions, in 2024. The scheduled first-time application of the new regulations most relevant for the Bank is 1 January 2025 – two years later than initially planned by the BCBS.

Quarterly reporting requirements regarding interest rate risk in the banking book will have to be met regularly from the reporting date of 30 September 2024 onwards. The supervisory authorities accelerated these requirements through ad-hoc reports for the reporting dates of 31 December 2023, 31 March 2024 and 30 June 2024.

In addition, the EU intends to adopt 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, which is to be fully established by 2025. Final resolutions about the foundation of this authority and its general responsibilities were already passed in December 2023; a trilogue on the remaining elements of the package is still under way.

To improve the sector's resilience vis-à-vis information and communication technology risks, the EU Commission and the European Council adopted the Regulation on digital operational resilience for the financial sector (known as the Digital Operational Resilience Act – "DORA") at the end of 2022; implementation is scheduled at the latest by 17 January 2025.

In addition, requirements for sustainable business and ESG risk management will increasingly define the regulatory landscape in the years to come. One of the main foundations in this context is the introduction and further expansion of the EU taxonomy for the classification of economic activities. Disclosure requirements for the 2024 financial year will also increase due to the first-time application of the Corporate Sustainability Reporting Directive (CSRD). In addition, the number of data points to be published in 2024 will increase due to the requirement for large listed institutions to include qualitative and quantitative information on ESG risks in the regulatory disclosure report on a half-yearly basis, as stipulated by the CRR II.

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.

Moreover, 2023 saw a trend towards the (re)introduction of capital buffer requirements, with regulatory authorities in many countries defining or increasing countercyclical buffers and/or capital buffers for systemic risks. Should it continue, this trend will lead to further increases in capital buffer requirements.

Sector-specific and business developments

Structured Property Financing segment

The macro-economic risks and burdens described above are also of great relevance for the development of property markets.

Demand for commercial properties will vary in 2024, depending on the region and property type. Given the high financing costs, we believe that the general conditions for the property markets will remain challenging. Other uncertainty factors and risks in the macro-economic environment also remain relevant; increasing political and geopolitical uncertainty, a dragging economic recovery or investor reticence all might negatively affect property values. In fact, restrictive lending standards, persistently low investor confidence, high borrowing costs, and the gradual transmission of interest rate increases to the market are making a timely recovery difficult. The fact that the major central banks are likely to cut interest rates is positive for the commercial property industry; however, the gradual refinancing of fixed-rate loans means that the average effective interest rate paid by the market will continue to rise in the near term. Especially when fixed-rate periods or hedging instruments expire, this may have a negative impact on the viability of debt service or on the investors' free cash flow after having serviced their debt. A loss of tenants due to negative economic developments and the resulting lower demand may even exacerbate the situation.

For the financing markets, the Bank anticipates that strong competitive pressure will persist, especially in regions and for property types that have already experienced high demand in recent years, even though lending conditions have generally become more restrictive. Higher financing costs and more restrictive lending policies should counteract an increase in loan-to-value ratios (LTVs); we thus assume stable LTV ratios for new business. However, improvements in the market environment could put direct pressure on margins or result in higher LTV ratios. While we assume that transaction activity will remain reduced, especially in the first half of 2024, the substantial accumulation of uninvested capital from investors around the world and an increasingly attractive yield level should mitigate another significant downward pressure on demand as the one seen in 2023. Low transaction volumes as such limit the opportunities for new business. But since the sale of a property may indicate the repayment of a loan that is due or even early repayment, a decrease in sales suggests that renewal rates remain elevated and early repayments occur less frequently.

Despite the expected interest rate cuts in 2024, the monetary policy environment will remain tight, causing considerable uncertainty for commercial properties. The elevated cost of capital associated with higher interest rates, for example, will result in a lower valuation of commercial properties if these costs are not offset by rent increases. This risk will grow if higher interest rates go along with more restrictive lending standards, which can limit the financing options for potential property buyers.

Should the trend towards increased remote working continue or even intensify, more and more companies may decide to rent less office space. The transition to such a new way of working could exert pressure on rental prices for office properties and on the demand for office space. It can be assumed that the impact varies depending on the market, the country, and a property's quality. On the other hand, communal and flexible working space will be increasingly sought after in a changing world of work, halting or even reversing the pre-pandemic trend of decreasing office space per employee. There is also the possibility that office properties that do not meet the changed tenant requirements may permanently leave the market, which could lead to a shortage of office supply and could counteract a decline in rent levels.

All in all, Aareal Bank expects that the rise in interest rates and financing costs compared with recent years will continue to weigh on the market values of commercial properties in 2024 and may lead to further downward pressure depending on property type and location. This pressure on property values is expected to last until 2025, followed by a period of stabilisation or growth. However, market value developments will be influenced not only by the quality and location of properties, but also increasingly by compliance with sustainability criteria (ESG).

With a view to retail properties, we expect that the structural change in shopping habits will have a weakening effect on the outlook for value-driving rental revenues, depending on location and segment. The current year is exposed to cyclical risks, i. e. higher interest rate levels and slightly weaker labour markets could mean that private consumption might not recover as expected, which, in turn, could have a negative impact on rental growth. Sustained low unemployment rates on the other hand should continue to mitigate negative effects on the retail segment. Apart from that, it should be noted that the retail market had already seen valuations decline in recent years.

Hotels saw a significant recovery in both occupancy and income over the last two years, depending on location and segment. However, the recovery seems now largely achieved even if international tourism has not yet returned to pre-pandemic levels. The sector's fundamental data and income should remain sound in the near term, despite the pressure on real income and the uncertain economic outlook. Unemployment continues to be low; however, hotel income should not grow very much given that room rates have already seen substantial raises and that households are feeling inflation-related real effects upon incomes. While higher operating and personnel costs are having a negative impact on free cash flows, this should not be a fundamental threat to the hotel segment. The high interest rate levels should continue to weigh on average market values in the short term.

We have a positive outlook for co-living, i. e. shared housing for a limited period of time, and student housing, where demand from international students has already recovered significantly as a result of the return to face-to-face teaching. In addition, this property type is considered to possess a certain resilience, especially in times of economic uncertainty, so we anticipate investor interest remaining high in this segment.

We expect for the current year that the market values of office properties will again see the strongest average price pressure of all property types and that rental growth will likely slow, driven by potential changes in space requirements and the increasing influence of sustainability standards. We expect underperformance from properties that fail to comply with corporate environmental and sustainability goals along with government climate targets. A significant downside risk for this forecast lies in a sharper than expected decline in the market values of office properties. The market is undergoing a period of price discovery; the small number of transactions is complicating this process, though. If the number of office properties in serious distress increased strongly, yields would rise due to higher risk premiums, while market values would plummet.

Our assessment of logistics properties remains positive overall, as structural demand drivers remain in place, which should lead to rising rental income in the near future. Overall demand will continue to be supported by a shift from just-in-time to just-in-case production. Companies are undertaking this shift in an attempt to counter supply chain challenges and prevent delays, leading to greater demand for warehouse space. The low level of availability is supported by additional demand from retail companies and logistics service providers. However, rising yields should also generally weigh on market values for this property type in 2024.

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. Therefore, we are simulating further potential macro-economic scenarios in addition to our "baseline" scenario.

In line with current Group planning, our baseline scenario assumes the following macro-economic parameters:

in %	2023	2024	2025	2026
“Baseline” scenario				
Gross domestic product (year-on-year change in %)				
Euro zone	0.5	0.6	1.8	2.0
USA	2.4	1.2	1.3	2.2
UK	0.6	0.5	1.5	1.9
Unemployment (%)				
Euro zone	6.6	6.7	6.6	6.4
USA	3.7	4.4	4.3	4.2
UK	4.0	4.5	4.4	4.1
Long-term interest rates (10-year government bonds) (%)				
Euro zone	3.2	2.9	2.8	2.7
USA	4.0	4.1	3.7	3.4
UK	4.0	4.0	3.9	3.5
Portfolio-weighted property price development (2023 basis = 100 %)	100 %	96 %	96 %	96 %

In the Structured Property Financing segment, we aim to originate new business of between € 8 billion and € 9 billion for the 2024 financial year, so that Aareal Bank Group’s property financing portfolio will amount to approximately € 33 billion to € 34 billion, 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

Germany’s housing and commercial property industries are expected to continue to show solid development in 2024, despite the geopolitical and macro-economic uncertainties. The expected ongoing population growth in conjunction with a decline in new construction projects and the trend towards smaller households will not relieve pressure on the housing market; further rent increases should especially hit economic centres. It also remains to be seen how the interest rate cuts expected by the market will affect house and apartment prices as well as the affordability of new construction projects.

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 further course of 2024. We plan to achieve this in particular by continuing to invest in the expansion of the “Housing Industry Ecosystem”, the cross-sector development of interface products, and the expansion into related ecosystems, such as companies from the utilities and waste disposal industries. The intensification of joint activities agreed between Aareal Bank, First Financial and Aareon at the end of the 2023 financial year should also contribute to this in 2024.

In our view, the range of services that connect alternative digital payment solutions to existing systems – thus helping to overcome process gaps (even across industry sectors) – are particularly attractive. Leveraging the AI-supported intelligent invoicing and dunning system of our subsidiary collect.AI (acquired in 2022), we see opportunities to further establish a standard for digital receivables management for our clients in the housing and energy industries in the context of integrating various payment routes.

Further growth is anticipated from the integrated tenant deposit guarantee 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 backdrop and based on the expected positive effects from the agreed intensification of joint activities between Aareal Bank, First Financial and Aareon, we aim to achieve further net commission income growth in 2024 (2023: € 33 million). We further anticipate an average deposit volume from the housing industry of around € 13 billion, which will contribute to significant net interest income.

Aareon segment

Aareon will continue to implement its growth strategy in the 2024 financial year.

Aareon's consolidated sales revenues for the 2024 financial year are expected to increase significantly, to between € 440 million and € 460 million (2023: € 344 million). with revenue growth of the companies acquired in 2023 being the main revenue driver, aside from recurring business with SaaS contracts.

Organic revenue growth in recurring business will be driven by the ongoing expansion of new client business and further up-/cross-selling to existing clients. We do not expect significant client churn for 2024 since Aareon's software is highly relevant for the business processes of its clients. The licence business will continue to decline as a direct consequence of the shifted focus to SaaS contracts. Professional Services revenue is expected to reach about the same level in 2024 as in the year under review.

Organic growth will be complemented by inorganic growth through mergers & acquisitions in line with the corporate strategy. The full consolidation of the companies acquired during 2023 (especially IESA, which was recognised in the Consolidated Financial Statements only for one month in 2023) will thus be growth driver in 2024. In addition, integrated payments solutions specialist Aareal First Financial Solutions AG (which markets BK01 solutions, etc.), of which Aareon acquired a majority stake from Aareal Bank AG as at 31 December 2023, will help Aareon to significantly accelerate revenue growth. Through Aareal First Financial Solutions, Aareal Bank and Aareon have pooled their expertise regarding payments solutions software for the housing industry.

Despite likely inflation-related salary increases and the companies acquired in 2023, total expenses are expected to increase only slightly in 2024, in particular as a result of the strategic measures taken in 2023 to optimise expenses. Especially personnel expenses are expected to remain stable, whilst cost of materials and other expenses are expected to rise, driven by higher hosting expenses in connection with the SaaS contracts and higher travel and marketing expenses.

Adjusted EBITDA[1)] is expected to be significantly higher than in the previous year, coming in at between € 160 million and € 170 million (2023: € 100 million). Aareon will continue its acquisition strategy, which may lead to M&A-related expenses in 2024 as well. No other significant adjustments are planned for 2024.

Strategic focus

Aareal Bank Group's strategy focuses on sustainable business success. Environmental, social and governance aspects are therefore key elements of its business strategy. All of these aspects are covered by short- and medium-term targets. The medium-term strategic development is therefore being pursued under the guiding principle of "Aareal Next Level". The general strategic orientation will continue – with international commercial property financing on the one hand, as well as banking 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 further, in a targeted manner, in order to sharpen their own independent profiles, accelerate the Group's growth overall, and create value for shareholders and other stakeholders.

The Structured Property Financing segment continues to focus on the controlled, risk-conscious expansion of its portfolio volume within its target range, considering ESG criteria and taking advantage of its flexible approach with regard to countries, property types

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

and financing structures. We will continue to use syndications as one of the tools for active portfolio management. In addition, we intend to actively reduce non-performing loans (NPLs) and sustainably lower the non-performing exposure ratio (NPE ratio).

Within the Banking & Digital Solutions segment, Aareal Bank aims to expand its equity-light business in particular, and thus increase net commission income. This will be achieved principally by expanding its product offering, leveraging its USPs in payments and digital solutions, and through further strategic partnerships. The Bank aims to maintain a high average deposit volume from the housing industry.

Aareon's position as the leading supplier of SaaS solutions for the European property sector is set to be expanded. The pace of Aareon's growth is set to be maintained, with profitability rising further through organic growth initiatives as well as initiatives to enhance the existing product portfolio's efficiency and improve the cost/income mix for Aareon Group. An institutionalised M&A pipeline and external debt taken out in August 2023 are in place to 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 further measures are being implemented to enhance the efficiency of the organisational structure, processes and infrastructure.

Atlantic BidCo GmbH's ("Atlantic BidCo") voluntary public takeover offer for Aareal Bank AG was closed in May 2023. In October 2023, Atlantic BidCo published a public delisting offer to acquire all outstanding Aareal Bank shares for an offer price of € 33.20 per share. Following Aareal Bank's delisting at the end of November 2023, Aareal Bank shares are no longer traded in the Regulated Market segment of the Frankfurt Stock Exchange. After completion of the delisting offer in December 2023, Atlantic BidCo GmbH, holding a stake in Aareal Bank AG in excess of 95 %, submitted a demand pursuant to Section 327a (1) of the AktG that the General Meeting adopt a resolution to transfer shares held by minority shareholders to Atlantic BidCo against payment of an appropriate cash compensation (squeeze-out under company law). Atlantic BidCo has indicated that it will inform Aareal Bank of the amount of cash compensation in a further letter (a so-called 'specified demand') once this has been determined.

In addition, Aareal Bank's General Meeting in August 2023 resolved that Aareal Bank shares be converted from bearer to registered shares, which was implemented in October 2023.

Atlantic BidCo is indirectly held by funds controlled, managed or advised by Advent International Corporation ("Advent") and Centerbridge Partners ("Centerbridge") as well as CPP Investment Board Europe S.à r.l., a wholly-owned subsidiary of Canada Pension Plan Investment Board ("CPP Investments"), and other minority shareholders.

Cooperation is based on the Investment Agreement concluded between Aareal Bank Group and Atlantic BidCo in 2022. In this agreement, Atlantic BidCo commits to supporting Aareal Bank AG's strategic ambitions to strengthen its position as a leading international provider of property financings, as well as software, digital solutions and payments services. Risk-conscious growth across all three segments will be facilitated through investments and through combining extensive joint experience in the financial services, software and payments sectors.

Group targets

We expect the environment in the US office property market to remain challenging in 2024, thus anticipating elevated loss allowance levels in the current financial year. The effects of geopolitical and macro-economic uncertainty remain difficult to estimate. Thanks to our strong earnings power, we nonetheless anticipate consolidated operating profit between € 300 million and € 350 million, with marked increases in both earnings per share (EpS) and RoE after taxes compared to the year under review.

In the Structured Property Financing segment, Aareal Bank plans to achieve a portfolio size of around € 33 billion to € 34 billion by the end of the year, market conditions permitting and subject to exchange rate fluctuations. Aareal Bank is planning for new business volume of € 8 billion to € 9 billion on this basis.

For the Banking & Digital Solutions segment, Aareal Bank projects slight growth in net commission income and an average deposit volume from the housing industry of around € 13 billion.

It is expected that Aareon will see increased sales revenue in the region of € 440 million to € 460 million for the current year. Adjusted EBITDA[1] is likely to see a marked increase to between € 160 million and € 170 million.

With regard to capitalisation, Aareal Bank continues to expect a solid CET1 ratio (Basel IV phase-in) of significantly more than the standardised capital requirement of 15 %, despite the planned portfolio growth and subject to further regulatory changes.

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, at www.aareal-bank.com/en/responsibility/reporting-on-our-progress/.

Corporate Governance Statement

The Corporate Governance Statement 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.

Statement pursuant to Section 312 of the AktG

The Management Board has prepared a report on the relationships with affiliated companies (Subordinate Status Report) for the financial year 2023 pursuant to Section 312 of the AktG, issuing the following statement: "Based on the circumstances of which the Management Board was aware at the point in time the legal transactions were entered into, Aareal Bank AG received appropriate consideration for all legal transactions listed in the report on the relationships with Atlantic BidCo GmbH and affiliated companies."

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