
# WE CREATE THE SPACE FOR SUCCESS

Aareal Bank Group – Interim Report
1 January to 30 September 2014

Aareal Bank Group

# Key Indicators

| | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 |
|---|---|---|
| **Income statement** | | |
| Operating profit (€ mn) [1] | 348 | 140 |
| Consolidated profit (€ mn) [1] | 257 | 66 |
| Cost/income ratio (%) [2] | 36.9 | 39.6 |
| Earnings per share (€) [1] | 4.54 | 1.35 |
| RoE before taxes (%) [1] [3] | 18.7 | 7.4 |
| RoE after taxes (%) [1] [3] | 15.2 | 4.8 |

| | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| **Statement of financial position** [4] | | |
| Property finance (€ mn) | 29,570 | 24,550 |
| of which: international (€ mn) | 23,005 | 20,802 |
| Equity (€ mn) | 2,704 | 2,450 |
| Total assets (€ mn) | 49,858 | 42,981 |
| | | |
| **Regulatory indicators** [4] [5] | | |
| Risk-weighted assets (€ mn) | 16,581 | |
| Common equity tier 1 ratio (CET 1 ratio) (%) | 14.2 | |
| Tier 1 ratio (T1 ratio) (%) | 16.1 | |
| Total capital ratio (%) | 22.0 | |
| | | |
| Common equity tier 1 ratio (CET 1 ratio) (%) – fully phased – [6] | 12.0 | |
| | | |
| **Employees** [4] | 2,560 | 2,375 |
| | | |
| **Rating** | | |
| Fitch Ratings, London | | |
| long-term [7] | A- (outlook: negative) | A- (outlook: stable) |
| short-term [7] | F1 (outlook: negative) | F1 (outlook: stable) |
| Fitch Pfandbrief ratings | AAA | AAA |
| oekom | prime | prime |

[1] The disclosures covering the current period under review include negative goodwill from the acquisition of COREALCREDIT BANK AG (Corealcredit) as at 31 March 2014. Corealcredit's operating results have been included in the Income Statement of Aareal Bank Group since the beginning of Q2 2014.

[2] Structured Property Financing segment only

[3] On an annualised basis

[4] Figures as at 30 September 2014, including Corealcredit

[5] Since 1 January 2014, regulatory indicators have been determined in accordance with CRD IV/CRR, based on carrying amounts in accordance with IFRSs. Until 31 December 2013, these indicators were calculated in accordance with the German Solvency Regulation (SolvV) and based on local GAAP (book values in accordance with the German Commercial Code (HGB)). The Bank therefore decided against stating comparative amounts.

[6] Excluding silent participation from the German Financial Markets Stabilisation Fund (SoFFin)

[7] At the end of the first quarter of 2014, rating agency Fitch Ratings changed its outlook for the Long-Term Issuer Default Rating (IDR) of 18 banks within the European Union from "stable" to "negative". The corresponding outlook for an additional 18 European commercial banks remained "negative". This revision reflects a global re-assessment of government support for banks.

# Contents

# Letter from the Management Board

Dear Shareholders,
business associates and Aareal Bank staff,

Global economic growth remained subdued during the third quarter of the 2014 financial year. As in the first two quarters, and the months before, the underlying economic momentum showed regional differences. For instance, economic development in the euro zone – and in the majority of its member states – was more subdued again. At the mid-year point, however, a cautious recovery still appeared to be possible. The US economy maintained its noticeable growth momentum, albeit at a slower pace compared to the previous quarter. Consolidation trends on Asian markets prevailed. Overall, the global economy was increasingly susceptible to international crises, including in the Ukraine or the Middle East. The business environment for Aareal Bank – and for the banking sector as a whole – therefore showed a mixed picture. The persistent low-interest rate policy pursued, and even reinforced, by the European Central Bank (ECB) remained a major challenge.

The ECB continued its expansive monetary policy. In view of the prevailing low inflation in the euro zone, it lowered its benchmark interest rate by an additional 0.1 percentage points, to 0.05 per cent. Furthermore, it lowered its negative interest rate on deposits from commercial banks once more, to -0.2 per cent. In September, the ECB executed its debut Long-Term Refinancing Operation (TLTRO), as announced in June: aggregate funds allocated (which are tied to banks' lending activities) amounted to just over € 80 billion. On top of this, the ECB launched an additional program to buy Pfandbriefe and asset-backed securities (ABS) at the end of October. The purpose of this program, which is scheduled to run for two years, is to stimulate lending in the euro zone. However, the desired effects of these measures, including an economic recovery in the euro zone, have largely failed to materialise so far.

Throughout the third quarter, the banking sector was under the impression of the ECB's Comprehensive Assessment: this initiative, designed to prepare for the assumption of regulatory responsibility by the ECB, comprised a regulatory risk assessment, an Asset Quality Review (AQR), and a stress test. The results of the Comprehensive Assessment were made available to the public at the end of October.

Aareal Bank achieved thoroughly convincing results during this extensive bank audit – both in terms of the AQR, which included a review of the valuation and classification of the Bank's lending exposures, as well as in relation to the subsequent stress test, which analysed the impact of a grave deterioration in the macroeconomic environment on the Bank's capital ratios. Thanks to the good results achieved in the Comprehensive Assessment reviews, the ECB has not imposed any measures upon Aareal Bank.

Aareal Bank achieved a further important milestone in October of this year. The German Federal Financial Supervisory Authority (BaFin) approved the full repayment of the silent participation provided by the German Financial Markets Stabilisation Fund (SoFFin). We have repaid the residual amount of € 300 million to SoFFin. With the full repayment of the silent participation, SoFFin's support to Aareal Bank has therefore come to an end. We are deeply grateful to the German Federal Government, the German parliament, and to SoFFin. The decision, taken in the year 2009, to support our work in times of great uncertainty, contributed to secure our fully viable business model, in a difficult market phase. This allowed Aareal Bank – as a perfectly healthy institution, as it was back then, and continues to be – to remain on its successful path undeterred, even in a market situation that had dramatically intensified at times.

The Bank's very good overall condition is also evident in its persistently positive business performance: Aareal Bank once again posted very good results for the third quarter of 2014. Consolidated operating profit of € 66 million exceeded the figure for the same quarter of the previous year (€ 48 million) by nearly 40 per cent. Once again, this profit increase is largely attributable to the very positive development in net interest income. The unexpectedly high impact of early loan repayments had a positive effect, as did the low funding costs, a marked increase in lending volume (also due to the acquisition of COREALCREDIT BANK AG (Corealcredit)) as well as stable lending margins.

That Aareal Bank once again showed such a very successful performance for the third quarter is yet another affirmation that our strategy is sustainably viable. Our solid business model, our conservative and sustainable business policy, the Bank's strong market position, as well as our determination to consistently exploit opportunities such as the acquisition of Corealcredit, have provided the foundation for Aareal Bank's good development over the past few years.

We can continue to build on this very solid foundation, particularly in the competitive environment prevailing for international commercial property financing, which has continued to intensify. In most European countries, as well as in North America and Asia, growing competition – not least from alternative finance providers – led to greater pressure on margins; in addition, finance providers were prepared to accept higher loan-to-value ratios than in previous years. Investors continued to focus on first-class properties in top locations. Still, persistently high investor liquidity triggered increasing interest in objects with higher risk profiles, outside metropolitan areas and/or the top market segment.

At € 74 million, operating profit achieved in the Structured Property Financing segment reached a record high, once again significantly outperforming the figure for the same quarter of the previous year (€ 52 million). New business of € 3.4 billion exceeded the volume originated in the same period of the previous year by about 50 per cent. The volume of new business in the third quarter benefited from the high level of newly-originated loans, which accounted for € 2.3 billion or 66.0 per cent. New business totalled € 7.6 billion in the first nine months of the year (9m 2013: € 6.7 billion).

At € 36 million, allowance for credit losses in the third quarter was up year-on-year (Q3 2013: € 29 million), but remained within our expectations, and within the pro-rata forecast range of € 100 million to € 150 million for the full financial year. Once again, this demonstrates the continued high quality of our credit portfolio, which grew by around 20 per cent from the year-end 2013 until the end of September 2014, also due to the Corealcredit acquisition.

As in the previous periods, results in our Consulting/Services segment continued to be influenced by two key factors during the third quarter. On the one hand, our IT subsidiary Aareon AG has continued to perform as expected. Cloud computing, the digitisation of communications and the related use of mobile services remain core technological trends in the property management industry. Aareon benefits from these trends, with its ground-breaking product range and thanks to its excellent position in the housing industry.

On the other hand, the segment's banking business remained burdened by the historically low interest rate levels. As the ECB's most recent monetary policy decisions suggest, we will have to deal with this challenging interest rate environment for the foreseeable future. Nonetheless, to us there is no doubt that the importance of the deposit-taking business in the Consulting/Services segment goes far beyond the interest margin generated from the deposits – which is under pressure in the current market environment. For Aareal Bank, deposits from the housing industry are a strategically important additional source of funding for the property financing business, and one that is largely independent of developments on the capital markets. In addition to the German Pfandbrief and unsecured bank bonds, they represent an important pillar in the Bank's long-term funding mix. The deposit-taking business has been, and remains, a strategic competitive advantage. It is thus gratifying that the volume of customer deposits from the housing industry remained at a high level, averaging € 8.7 billion during the quarter under review. We see this as evidence of the very high level of trust which the Bank continues to enjoy as the long-standing lead bank to the German housing industry.

We once again successfully carried out our funding activities during the third quarter of 2014: we benefited from the fact that investor demand focused on low-risk products such as the German Pfandbrief in particular, given the renewed deterioration on financial and capital markets. We thus raised an aggregate of € 0.9 billion in long-term funds, through various refinancing instruments – predominantly via Mortgage Pfandbrief issues and, to a smaller extent, via unsecured bonds. We have thus continued to maintain our long-term funding at a very high level.

As at 30 September 2014, the Bank's Tier 1 ratio (including SoFFin's silent participation) was 16.1 per cent, which is comfortable on an international level. Excluding SoFFin's silent participation and assuming full implementation of Basel III, the Bank's pro-forma Common Equity Tier 1 (CET 1) ratio would be 12.0 per cent. Aareal Bank thus remains very solidly financed and already fully complies today with the capital requirements under Basel III.

The fact that regulatory authorities have also affirmed Aareal Bank's outstanding capitalisation, within the scope of the ECB's Comprehensive Assessment, is particularly gratifying. During the course of the AQR, the ECB-appointed auditors made only marginal valuation adjustments concerning the loan exposures audited, thus affirming Aareal Bank's risk assessments. Apart from the ECB's review, preparing its future role as the Bank's supervisory authority, Aareal Bank continued to optimise its capital base during the quarter under review.

Overall, our summary for the third quarter of the 2014 financial year is a very positive one indeed. We held course – in an increasingly competitive environment, and despite a lack of support from economic development. Looking ahead on the coming months, we are thus confident that we will succeed to successfully continue along this path, even though the business environment is unlikely to improve for the time being. The underlying momentum of the global economy is expected to remain subdued, albeit with regional differences. There are no signs for any broad-based fundamental support of global economic developments. On the contrary: geopolitical uncertainty and a worsening economic outlook are likely to impact on the mood on the financial and capital markets. In fact, initial signs of a worsening sentiment were already evident at the beginning of the fourth quarter. Intensifying competition in the property financing business, and especially the persistent low interest rate environment, remain key challenges for Aareal Bank.

Nonetheless, we remain optimistic for the remainder of the year, also backed by our year-to-date performance. If the strong business trend continues to materialise, consolidated operating profit between € 420 million and € 430 million for 2014 is achievable, including the non-recurring € 152 million effect from the acquisition of Corealcredit. This would translate into consolidated operating profit of € 72 million to € 82 million for the fourth quarter of 2014. In our previous projection, we had anticipated full-year consolidated operating profit at the upper end of a range – raised in August – between € 380 million and € 400 million. Adjusted for the non-recurring effect from the Corealcredit transaction, consolidated operating profit of approximately € 270 million to € 280 million is achievable.

Aareal Bank has demonstrated – not just in the past quarters – that it is able to deal with the challenging environment, thanks to its viable business model and its outstanding workforce. Moreover, streamlined decision-making processes within our mid-sized bank enable us to exploit changes in our business environment, in a risk-aware, profit-oriented and consistent fashion – to the benefit of our clients, our employees and, of course, our shareholders. We will continue working hard to earn your trust in the Bank's performance, every day anew. This has been, and remains our motivation.

**For the Management Board**

Yours Sincerely, Wolf Schumacher

**Dr Wolf Schumacher**
**Chairman**

# Group Management Report

## Report on the Economic Position

### Macro-economic environment

#### Economy

Indicators suggest that the global economy continued to grow only moderately during the third quarter of the year – albeit with marked regional differences. In contrast to the market opinion prevailing at the beginning of the year, the mood in the economy has dampened, especially in the euro zone and in various Asian economies. Geopolitical tensions – which have intensified during the third quarter – are likely to have played a role in this context as well.

Following stagnation during the second quarter, the euro zone is likely to have posted barely any material growth during the quarter under review, with the underlying economic momentum remaining low. In contrast, in some countries outside the euro zone – in particular, in the UK and Poland – there are signs of somewhat more dynamic economic developments.

In the US economy, which also benefited from catch-up effects during the second quarter, there were some indications of further marked economic growth in the quarter under review, albeit more slowly than before.

China has failed to repeat the very high growth rates seen in the past for quite some time already – a trend that is likely to have continued during the third quarter of 2014. Still, growth rates remained high by international comparison. The Japanese economy continued to suffer, particularly as a consequence of consumer reticence following the increase in value-added tax, effective 1 April 2014. As a result, real gross domestic product fell considerably during the second quarter.

Several European labour markets were almost stable during the third quarter – including in the euro zone. Germany and Austria continued to post the lowest unemployment rates, whilst those in France, Italy and Spain remained comparatively high. However, Spain's notably high unemployment rate marked a further decline from the highs seen during the economic crisis. Unemployment in the US declined, especially towards the end of the quarter.

#### Financial and capital markets, monetary policy and inflation

Sentiment on the financial and capital markets also deteriorated during the third quarter. This was triggered mainly by a rise in geopolitical risks, producing a commensurately higher level of risk awareness among investors. Low-risk products such as Pfandbriefe benefited accordingly, registering strong demand. At the beginning of the third quarter, concerns about the future of a major Portuguese commercial bank led to unrest on the country's financial and capital markets. Support measures were made available to the affected bank, from the European rescue programme and by the Portuguese government.

Notwithstanding the fact that interest rate levels were already very low, government bond yields in developed European economies declined further during the quarter under review, in some cases quite markedly. This also applied to Italy and Spain. In the euro zone, expectations of a continuation – or even acceleration – of the European Central Bank's expansive monetary policy played a role in this context, in conjunction with the corresponding monetary policy decision taken in early September. In contrast, government bond yields in some emerging market economies, such as Turkey, rose considerably. Russian government bond yields also rose strongly, probably due to political tensions in the Ukraine conflict. Government bond yields outside Europe diverged considerably from the downtrend predominantly affecting European government bonds. For instance, long-term government bond yields in Japan and the US remained virtually constant.

Long-term interest rate trends[1] also diverged between the various regions during the third quarter. The long-term rates for major European currencies which are most important to us, including the euro, pound sterling and the Swedish krona, continued their sharp decline. Rates for the Canadian dollar, the US dollar, as well as the Japanese yen, all ended the quarter at roughly the same level they had at the beginning. During the third quarter, short-term interest rates[2] declined for the euro as well as for the Swedish krona, against the background of key interest rate cuts in both currencies. Short-term interest rates in the other major currencies in which we are active remained virtually unchanged during the third quarter, close to zero.

The euro lost significant value against the US dollar during the third quarter, on account of diverging expectations about the future monetary policy of the respective central bank. The euro also declined noticeably against pound sterling and the Canadian dollar. Against the Japanese yen, the Danish krone and the Swedish krona, however, it was almost on the same level at the end of the quarter than it was at the beginning – despite some fluctuation during the course of the quarter under review.

In a referendum held in mid-September, a majority of the Scottish population voted against a separation from, and in favour of staying in the UK – thus preventing turbulence on the financial and capital markets.

Monetary policy remained strongly expansive. The European Central Bank (ECB) lowered its key interest rate by 10 basis points in September, to 0.05 %, adjusting its negative interest rate on deposits from commercial banks downwards, from -0.1 % to -0.2 %. Substantiating its decision, ECB cited its intention to support consolidating medium to long-term inflation expectations, and to guide inflation closer to its target of just under 2 %. These measures are designed to improve the monetary policy transmission mechanisms, enhancing lending to businesses. Moreover, the ECB resolved to commence the purchase of asset-backed securities and covered bonds, starting in October. Additionally, it allocated its first long-term repo transaction for commercial banks in September, as resolved in June: aggregate funds allocated – and tied to banks' lending activities – amounted to just over € 80 billion.

At the beginning of the quarter, Sweden's Riksbank significantly cut its key interest rate by 50 basis points, to 0.25 %, in view of an inflation rate close to zero. Likewise, the Turkish central bank lowered its key rate slightly, to 8.25 %, while the Russian central bank raised its rate by 50 basis points, to 8.00 %. The US Federal Reserve continued to "taper" its purchases of government bonds and mortgage-backed bonds during the quarter under review.

Divergence in inflationary trends, which set in some time ago, continued during the quarter under review: the average euro zone inflation rate hit very low levels of 0.4 %, reaching just 0.3 % in September. In some countries such as Italy, inflation was close to zero, whilst Spain and Portugal even saw a slight deflation. At around 1.5 %, the rate of inflation in the UK was clearly above average compared to the other countries of the European Union. The annual average inflation rate in the US was just under 2 %. Reflecting the VAT increase in April of this year and the very expansive monetary policy, Japan's inflation rate exceeded 3 % also in the third quarter, whereas it remained at a moderate level of around 2 % in China.

### Regulatory environment

The emphasis in the banking sector remains on the numerous regulatory and reform measures. The focus remained in particular upon the ECB's Comprehensive Assessment, which included a regulatory risk assessment, the Asset Quality Review, and a stress test. The Comprehensive Assessment commenced prior to the ECB's assumption of supervisory responsibility for all institutions subject to direct supervision by the ECB.

[1] Based on the 10-year swap rate
[2] Calculated on the basis of the 3-month EURIBOR/LIBOR, or comparable rates (depending on the currency)

The environment in which the banks were operating continued to be defined in recent years by an ever more rapid rise in regulatory requirements. These include the comprehensive Basel II framework and its implementation in the EU (CRD I), the implementation of the "Sydney Press Release" in the EU and the revision of the regulation on large exposures (CRD II), the implementation of the short-term package of measures of the Basel Committee (CRD III) and the Basel III reform package (CRR/CRD IV), their implementation in national law, as well as the various amendments to the Minimum Requirements for Risk Management (MaRisk).

## Sector-specific and business developments

### Structured Property Financing segment

We originated new business of € 3.4 billion in the quarter under review, thus exceeding the volume of new business of € 2.3 billion generated in the same period of the previous year, and bringing the total figure for the first three quarters of 2014 to € 7.6 billion (9m 2013: € 6.7 billion).

The increase was attributable to higher activity in newly-originated loans: in the first nine months of the current financial year, the volume amounted to € 5.0 billion, compared to € 3.7 billion in the same period of the previous year. The third quarter of 2014 was no exception from this trend, with newly-originated loans at € 2.3 billion, compared to € 1.2 billion in the third quarter of 2013. The share of newly-originated loans for the first three quarters of 2014 therefore amounted to 65.1 % (2013: 55.2 %) and to 67.1 % (51.6 %) in the third quarter. During the first three quarters of the year, loan renewals decreased compared to the same period of the previous year, given the fact that renewals were due for a smaller share of the portfolio.

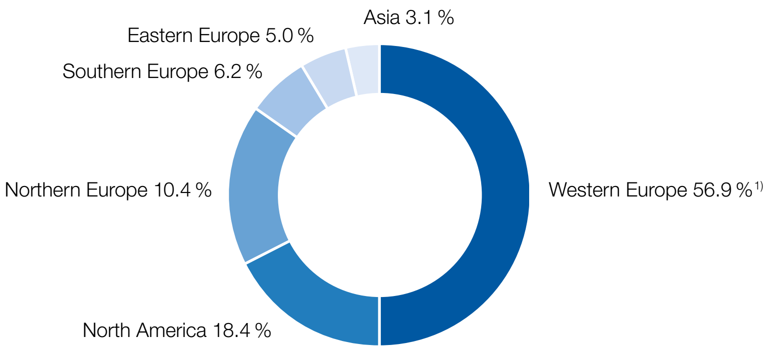
At 78.5 % (2013: 72.1 %), Europe generated the highest share of new business during the first three quarters of 2014, followed by North America with 18.4 % (2013: 22.3 %) and Asia with 3.1 % (2013: 5.6 %)[2].

The volume of Aareal Bank Group's property financing portfolio stood at € 29.6 billion as at 30 September 2014, up by approximately 20 % since the end of the previous year. The increase is attributable to the acquisition of COREALCREDIT BANK AG (Corealcredit), disbursements from strong new business, and exchange rate effects.

The competition in the commercial property financing business remained intensive during the third quarter of 2014, a situation partly attributable to the availability of alternative funding sources competing with banks. Intense competition prevailed in the vast majority of European countries, as well as to North America and various Asian markets, such as China, Japan and Singapore. Margins were still under downside pressure, while lenders continued to show more willingness to accept higher loan-to-value ratios compared to the previous year.

**New business 1 January - 30 September 2014**

by region (%) Total volume: € 7.6 bn




[1] including Germany

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

The demand for commercial property remained high due to the fact that many investors had plenty of capital at their disposal and profited from what appeared to them as more relaxed financing conditions, against the background of the low interest rate environment. In the third quarter 2014, global transaction volumes for commercial properties were again ahead of the corresponding figure of the previous year. The limited supply of first-class commercial property in the leading economic centres, as well as a growing readiness to assume risk and the rising investment pressure, led to increasing investor interest in objects with higher risk profiles, compared to the previous year. Investors have therefore been increasingly willing to buy properties in second-class locations or those that feature potential for creating value, e.g. in the course of modernisation measures. Yields for newly-acquired first-class commercial property were stable or fell slightly compared to the previous quarter, given lively demand.[1] Rents for first-class commercial property were predominantly stable to slightly positive.

### Europe

In the third quarter, the trend of almost unchanged rents for first-class commercial property in European economic centres continued compared to the previous quarter. This development applied to office, retail and logistics properties. Diverging rental development (rising rents) was evident in only a few markets, such as the market for first-class office property in Glasgow, Hamburg and the City of London, or the markets for first-class retail property in Hamburg and Munich. There were only few markets showing decreasing rents for first-class commercial property, such as office properties in Dusseldorf, Geneva and Moscow, as well as for first-class logistics properties in Moscow, Paris and Prague.

The hotel markets continued to present a mixed picture. The important indicator for the hotel industry – average revenue per available hotel room – increased in some big European cities compared with the same period of the previous year. Examples included Berlin, Copenhagen, Madrid, Milan, Munich, and Paris. However, returns in some cities – including Barcelona, Prague and Warsaw, for example – fluctuated considerably during the quarter compared to the previous year.

Transaction volumes in newly-acquired commercial property rose moderately in Europe in the third quarter, compared to the same period of the previous year, due to steady demand from investors. Strong transaction volumes in the larger European markets of Germany, France and the UK were increasingly accompanied by more market activity in the Benelux countries as well as in Central/Eastern, Northern and Southern Europe. Yields for first-class commercial property in the European economic centres were mostly unchanged or declined slightly compared to the previous quarter. It is important to note that a clear trend of slightly decreasing yields prevailed for first-class logistics properties: they only rose in isolated cases – particularly in Moscow.

In Europe, we generated € 2.7 billion of new business in the quarter under review, bringing aggregate new business for the first three quarters to € 6.0 billion. Western Europe accounted for the highest share by far, and also dominated transaction volumes on all markets. Northern Europe, Southern Europe and Eastern Europe followed in terms of new business originated.

### North America (NAFTA states)

As in the previous quarters, rents for US commercial property increased on a national average in the third quarter. This development applied to the office, retail and logistics markets. Several leading economic hubs indicated moderate increases in rents, while the San Francisco office market, for instance, showed a considerable rent increase. On the other hand, rents for office and logistics property barely moved in Washington D.C., for example. On average, the trend of falling vacancy ratios continued in the US.

[1] Falling yields are associated with rising property market values, whilst rising yields correspondingly produce falling values, all other things remaining equal.

In the US hotel sector, average revenues per available hotel room increased in the third quarter over the same period of the previous year. This was supported by an increase in the occupancy ratio as well as in average room rates. Average revenues per available hotel room also increased in Canada and Mexico.

Transaction volumes in North America continued to increase significantly in the third quarter compared to the same period of the previous year. Investment yields for newly-acquired commercial property in the US only changed marginally on average.

Our new business in North America amounted to € 0.7 billion during the third quarter. During the first nine months of 2014, new business therefore has amounted to € 1.4 billion in the region.

### Asia

Rents for first-class commercial property in selected leading Asian cities were stable, or developed positively. In Peking and Shanghai, rents for first-class office, retail and logistics properties were virtually unchanged compared to the previous quarter. Rents for first-class office premises in Tokyo also remained stable, while first-class retail properties saw a steep increase in rents. Rents for logistics properties also improved. In Singapore, rents for first-class office properties rose, while they were close to unchanged for retail and logistics properties.

On the hotel markets in Shanghai and Tokyo – and, to a minor extent, in Singapore – the average revenue per available hotel room increased compared to the third quarter of the previous year. On the contrary, average revenues per available hotel room were largely stable in Beijing.

Transaction volumes in the Asia-Pacific region increased only slightly compared to the third quarter of 2013. During the course of this year there has been an increase in Japan in particular, whilst China has seen a marked decline. Regarding yields for first-class commercial property, the four big cities mentioned above saw barely any movement.

New business volume in Asia was low during the third quarter of 2014, bringing the total figure for the first three quarters of 2014 to € 0.2 billion.

### Acquisition of COREALCREDIT BANK AG (Corealcredit)

Aareal Bank Group closed the acquisition of Corealcredit, announced on 22 December 2013: The purchase was completed with effect from 31 March 2014 (the closing date). Corealcredit is now a legally independent subsidiary under the umbrella of Aareal Bank Group. The (preliminary) purchase price paid amounted to € 343 million. The preliminary nature of this purchase price relates to the possibility of potential compensation payments to the seller. Further information is included in the notes to the consolidated financial statements.

Within the scope of the acquisition of Corealcredit, Aareal Bank assumed assets in the amount of € 6.0 billion and liabilities in the amount of € 5.5 billion. The acquisition resulted in a (preliminary) negative goodwill of € 152 million, which was recognised in income as at the time of first-time consolidation on 31 March 2014. Corealcredit's operative results were included in Aareal Bank Group's consolidated income statement for the first time in the second quarter of 2014. Excluding negative goodwill, Corealcredit's contribution to consolidated operating profit for the period under review amounted to € 5 million. As part of the integration of Corealcredit into Aareal Bank Group, a control and profit and loss transfer agreement was concluded.

## Consulting/Services segment

### Bank division Housing Industry

The housing and commercial property industries in Germany have proven to be a stable market segment during the third quarter of 2014, too. The industry continued to focus on a sustainable development of portfolios, with an emphasis on increasing energy efficiency and the creation of residential space suitable for the elderly. To enhance the sector-specific sustainability activities, the German Sustainability Code (Deutscher Nachhaltigkeitskodex – "DNK") has been amended in line with industry-specific criteria for sustainable corporate management.

The positive development on the residential property market in Germany prevailed, even though the increase in house prices lost some of its momentum. Rents offered in July 2014 were around 2.4 % higher than in the third quarter of 2013. However, differences in rental levels remained between growth regions and those subject to contraction. While structurally weak regions suffered from population drain, demand for residential accommodation increased in many German conurbations. Areas in the wider vicinity of those economic centres benefited in particular. Rental increases for new-built properties stood at 3.4 % in areas with rural districts (Landkreise), moderately above the 3.1 % recorded for those cities independent form district administration (kreisfreie Städte).

Owing to the robust development of the German economy and the stable situation on the housing market, the focus of institutional investors on housing property remained strong. Once more, the majority of buyers were German domestic capital investors, focusing increasingly on housing property in secondary locations. One of the largest residential property transactions was the acquisition of around 13,300 apartments in Lower Saxony, Brandenburg, Mecklenburg-Western Pomerania and Saxony by Westgrund AG.

Our clients continue to make strong use of the combination of our specialist services in conjunction with automated mass electronic payments processing, together with the related advice we offer, as well as cash investment schemes. This enables us to maintain a strong position in the market, despite strong competitive pressure – which is also evident in new client acquisition; business partners acquired in the first three quarters of 2014 currently manage some 185,000 residential units between them.

The volume of deposits remained high, averaging € 8.7 billion during the quarter under review (Q2 2014: € 8.5 billion).

However, the persistently low interest rate environment in the quarter under review continued to burden income generated from the deposit-taking business, and therefore the segment result. Yet the importance of the deposit-taking business in the Consulting/Services segment goes far beyond the interest margin generated from the deposits – which is under pressure in the current market environment. For Aareal Bank, deposits from the housing industry are a strategically important additional source of funding for the lending business, and one that is largely independent of capital markets developments. In addition to the German Pfandbrief and unsecured bank bonds, they represent an important pillar in the Bank's long-term funding mix. Especially in the current capital market environment, Aareal Bank therefore sees this business as representing a particular competitive advantage.

### Aareon

Research and development activities continue to focus on the hot topic of digitisation. Essentially, this involves deploying IT resources in order to optimise external and internal processes, and to offer additional services. Housing enterprises enhance their integration with business partners (B2B), tenants (B2C) and their field service staff (B2E). This is enhanced by networking devices (M2M) and objects via the internet (the "internet of things"). At present, the focus is on digital document management, customer relationship management (CRM), and mobile solutions. In the context of digitisation of the housing industry, Aareon had already extended its product range in 2013, and developed the so-called "digital ecosystem". This constitutes an IT infrastructure comprising a large number of integrated systems. All important business processes, whether renting or maintenance, are supported fully and digitally throughout. ERP systems form the controlling centre at the heart of the digital ecosystem.

During the third quarter, additional customers opted for Wodis Sigma, the majority of which added this service from the exclusive Aareon Cloud, as expected. The IT trend of cloud computing therefore continues on the market.

Demand was visible for the SAP® solutions and Blue Eagle – in Aareon's advisory solutions for SAP® and for consultancy services.

Business volumes generated with GES declined slightly, as planned. Numerous GES customers are in the process of reviewing their long-term IT strategy with a view to a technological upgrade, or have already done so. Aareon usually is involved in such processes as the preferred partner and consultant. Many of these customers are already successful users of Wodis Sigma. Aareon has the necessary resources in place for future migrations of GES customers, to ensure that such migrations are executed smoothly and safely.

In the Integrated Services area, the Mareon service portal, the BauSecura insurance management, and Aareon's invoicing services and Aareon Archiv kompakt, the digital archiving solution launched in 2013, all met with demand.

Data protection is a very important issue for Aareon. Hence, voluntary data protection audits in accordance with section 9a of the German Data Protection Act (BDSG) have been conducted regularly. DQS GmbH (Deutsche Gesellschaft zur Zertifizierung von Managementsystemen) again confirmed Aareon's high level of data protection in July 2014. Aareon and its domestic subsidiaries were awarded for the fifth time with a DQS seal of quality for data protection. This also applies to newly-entered hosting agreements with business partners or Group companies within Europe, which also benefit from the proven high level of data protection at the German locations.

The positive business trend in international business prevailed. New customers were acquired and products were rolled out successfully. The Dutch subsidiary SG|automatisering bv changed its name to Aareon Nederland B.V. in September. Furthermore, it acquired the remaining 49 % of the share capital of its SG|Facilitor B.V. subsidiary, effective 1 July 2014. Aareon Nederland B.V. also acquired the remaining 30 % of the SG|stravis B.V. subsidiary. The product development of digitisation for the Dutch market, which has an international focus, is progressing. In the UK, the mobile services provided by 1st Touch met with ongoing demand. In France, market response to Aareon France's CRM system remains positive.

Profit before taxes and interest (EBIT) for the first nine months of the business year 2014 amounted to € 16 million (previous year: € 16 million).

## Financial position and performance

### Financial performance

#### Group

Consolidated operating profit amounted to € 348 million during the first nine months of the 2014 financial year. Adjusted for the negative goodwill (€ 152 million) from the acquisition of Corealcredit as at 31 March 2014, operating profit amounted to € 196 million and was thus markedly higher year-on-year (9m 2013: € 140 million). The increase was largely attributable to significantly higher net interest income.

Net interest income of € 494 million for the first nine months of the 2014 financial year was up significantly on the same period of the previous year (€ 380 million). The unexpectedly high impact of early loan repayments had a positive effect, as did the low funding costs, a marked increase in lending volume (also due to the acquisition of Corealcredit) as well as stable lending margins. The net figure was burdened, however, by a lack of attractive investment opportunities for liquidity reserves, due to the persistent low interest rate environment.

Allowance for credit losses amounted to € 105 million during the first nine months of the financial year (9m 2013: € 74 million), comprising € 73 million in specific allowance for credit losses plus € 32 million in newly-recognised portfolio-based allowance for credit losses. The higher amount of portfolio-based allowance for credit losses was largely due to a change in individual measurement parameters, and thus non-recurring. Allowance for credit losses was in line with expectations, despite this one-off effect.

**Consolidated net income of Aareal Bank Group**

| € mn | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 |
|---|---|---|
| Net interest income | 494 | 380 |
| Allowance for credit losses | 105 | 74 |
| **Net interest income after allowance for credit losses** | **389** | **306** |
| Net commission income | 116 | 117 |
| Net result on hedge accounting | 3 | -3 |
| Net trading income/expenses | -1 | 14 |
| Results from non-trading assets | 0 | -8 |
| Results from investments accounted for using the equity method | 0 | – |
| Administrative expenses | 325 | 276 |
| Net other operating income/expenses | 14 | -10 |
| Negative goodwill from the acquisition of Corealcredit | 152 | – |
| **Operating profit** | **348** | **140** |
| Income taxes | 62 | 44 |
| **Consolidated net income/loss** | **286** | **96** |
| **Allocation of results** | | |
| Consolidated net income/loss attributable to non-controlling interests | 14 | 15 |
| Consolidated net income/loss attributable to shareholders of Aareal Bank AG | 272 | 81 |
| **Appropriation of profits** | | |
| Consolidated net income/loss attributable to shareholders of Aareal Bank AG | 272 | 81 |
| Silent participation by SoFFin | 15 | 15 |
| **Consolidated profit/loss** | **257** | **66** |

Net commission income of € 116 million was roughly in line with the previous year's figure of € 117 million.

Net trading income/expenses and the net result on hedge accounting, in the aggregate amount of € 2 million, resulted largely from the measurement of derivatives used to hedge interest rate and currency risk.

At € 325 million (9m 2013: € 276 million), administrative expenses were significantly higher than in the previous year, as expected. The increase was due, amongst other factors, to the running costs for Corealcredit, included in expenditure since the second quarter. Furthermore, higher project costs were incurred during the period under review, including those in conjunction with the acquisition of Corealcredit, and regulatory measures such as the Comprehensive Assessment.

Net other operating income/expenses includes non-recurring income from the reversal of provisions for settlement risks.

The negative goodwill is a result of the acquisition of Corealcredit. It represents the difference between the (preliminary) purchase price paid and the higher net balance of assets and liabilities acquired (= net assets) and measured at fair value. Further information is included in the section "Reporting entity structure" in the notes to the consolidated financial statements.

This results in consolidated operating profit of € 348 million for the first nine months of the 2014 financial year (9m 2013: € 140 million). Taking into consideration income taxes of € 62 million and non-controlling interest income of € 14 million, consolidated net income attributable to shareholders of Aareal Bank AG amounted to € 272 million. Taking into consideration the net interest payable on the SoFFin silent participation, the consolidated profit stood at € 257 million (9m 2013: € 66 million).

### Structured Property Financing segment

Consolidated operating profit in the Structured Property Financing segment amounted to € 74 million for the third quarter of 2014, and was therefore considerably higher than the corresponding figure for the previous year (€ 52 million). The increase was largely attributable to significantly higher net interest income.

Segment net interest income amounted to € 182 million in the third quarter of 2014, up significantly year-on-year (Q3 2013: € 131 million). The unexpectedly high impact of early loan repayments had a positive effect, as did the low funding costs, a marked increase in lending volume (also due to the acquisition of Corealcredit) as well as stable lending margins. The net figure was burdened, however, by a lack of attractive investment opportunities for liquidity reserves, due to the persistent low interest rate environment.

Allowance for credit losses during the quarter under review amounted to € 36 million (Q3 2013: € 29 million), and was therefore consistent with the projected range we expected.

At € 64 million (Q3 2013: € 50 million), segment administrative expenses were significantly higher than the previous year, as expected. The increase is due largely to the acquisition of Corealcredit. In addition to the running costs, additional expenses were incurred in conjunction with the social compensation plan entered into during the quarter under review.

Overall, operating profit for the Structured Property Financing segment was € 74 million (Q3 2013: € 52 million). Taking tax expenses of €23 million into consideration (Q3 2013: € 16 million), the segment result for the quarter under review was € 51 million (Q3 2013: € 36 million).

### Consulting/Services segment

Sales revenue of € 42 million generated in the Consulting/Services segment during the third quarter of 2014 was down slightly on the corresponding figure of the previous year (€ 46 million). Aareon's

**Structured Property Financing segment result**

| € mn | Quarter 3 2014 | Quareter 3 2013 |
|---|---|---|
| Net interest income | 182 | 131 |
| Allowance for credit losses | 36 | 29 |
| **Net interest income after allowance for credit losses** | **146** | **102** |
| Net commission income | 1 | 2 |
| Net result on hedge accounting | 0 | 0 |
| Net trading income/expenses | -5 | 3 |
| Results from non-trading assets | 0 | -2 |
| Results from investments accounted for using the equity method | 0 | – |
| Administrative expenses | 64 | 50 |
| Net other operating income/expenses | -4 | -3 |
| Negative goodwill from the acquisition of Corealcredit | – | – |
| **Operating profit** | **74** | **52** |
| Income taxes | 23 | 16 |
| **Segment result** | **51** | **36** |

### Consulting/Services segment result

| € mn | Quarter 3 2014 | Quarter 3 2013 |
|---|---|---|
| Sales revenue | 42 | 46 |
| Own work capitalised | 2 | 1 |
| Changes in inventory | 0 | 0 |
| Other operating income | 2 | 1 |
| Cost of materials purchased | 6 | 6 |
| Staff expenses | 32 | 30 |
| Depreciation, amortisation and impairment losses | 4 | 4 |
| Results from investments accounted for using the equity method | – | – |
| Other operating expenses | 12 | 12 |
| Interest and similar income/expenses | 0 | 0 |
| **Operating profit** | **-8** | **-4** |
| Income taxes | -2 | -1 |
| **Segment result** | **-6** | **-3** |

sales revenue amounted to € 40 million in the third quarter (Q3 2013: € 42 million). The persistent low interest rate environment continued to burden margins from the deposit-taking business that are reported in sales revenues.

Staff expenses in the quarter under review amounted to € 32 million, and were therefore slightly higher than in the same period of the previous year.

On the whole, other items were roughly unchanged from the previous year's levels.

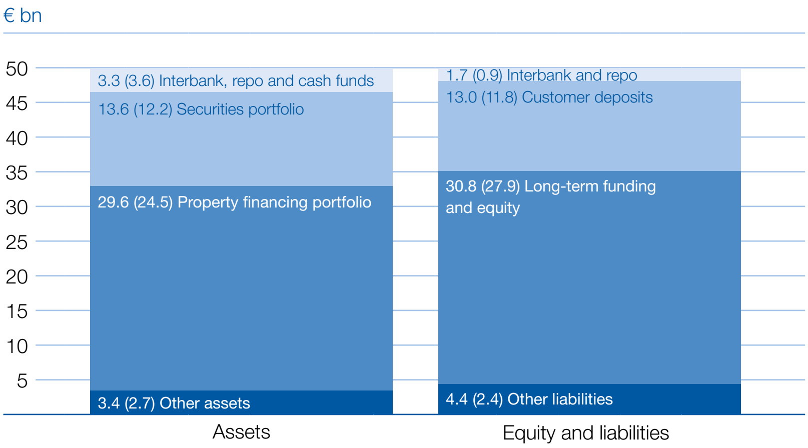
Overall, segment operating profit in the third quarter of 2014 was € -8 million (Q3 2013: € -4 million). Aareon's contribution was € 5 million (Q3 2013: € 5 million).

After taking taxes into consideration, the segment result for the third quarter amounted to € -6 million (Q3 2013: € -3 million).

## Financial position

Aareal Bank Group's consolidated total assets as at 30 September 2014 amounted to € 49.9 billion, after € 43.0 billion as at 31 December 2013.

### Statement of financial position – structure as at 30 Sep 2014 (31 Dec 2013)




### Property financing portfolio

The volume of Aareal Bank Group's property financing portfolio stood at € 29.6 billion as at 30 September 2014, up by approximately 20 % since the end of 2013 (€ 24.5 billion). The increase was attributable to the acquisition of Corealcredit, disbursements from strong new business, and exchange rate effects. This acquisition, effective 31 March 2014, exclusively increased the German property financing portfolio, by € 3.4 billion. Accordingly, the international share of the portfolio fell to 77.8 % (31 December 2013: 84.7 %).

At the reporting date on 30 September 2014, Aareal Bank Group's property financing portfolio was composed as indicated below, compared with year-end 2013.

The portfolio breakdown by region and continent, compared with the end of the previous year, changed as a result of the acquisition of Corealcredit. Whilst the portfolio share of exposures in Germany rose by approx. 7 %, it declined in Southern Europe, Northern Europe and Eastern Europe; in Western Europe, North America and Asia it remained virtually unchanged.

The portfolio allocation by property type remained largely unchanged during the year under review, whereby the share of residential property and retail property financings increased slightly, due to the acquisition of Corealcredit, amongst other things. In contrast, the share of logistics properties declined, whilst the shares of office and hotel properties, as well as other financings, remained almost stable.

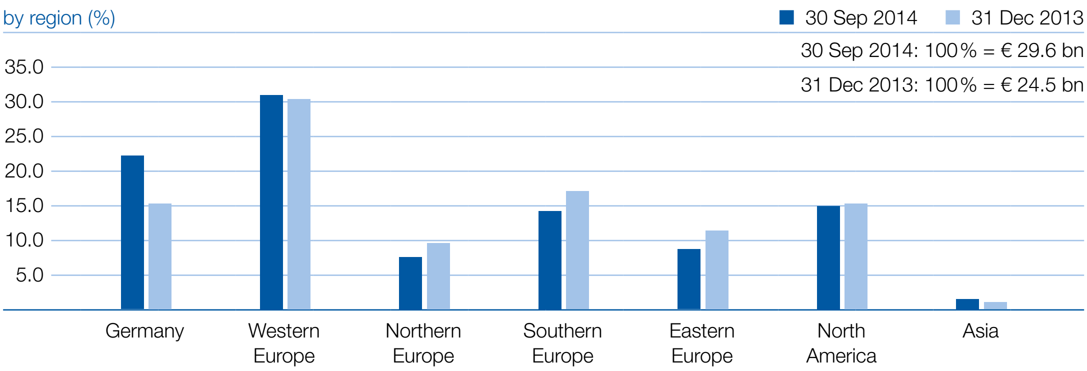
All in all, the high degree of diversification by region and property type within the property financing portfolio was maintained during the period under review.

### Securities portfolio

As at 30 September 2014, the nominal volume of the securities portfolio[1] was € 11.5 billion (31 December 2013: € 10.8 billion). It comprises four asset classes: public-sector borrowers, covered bonds and Pfandbriefe, bank bonds and asset-backed securities (ABS).

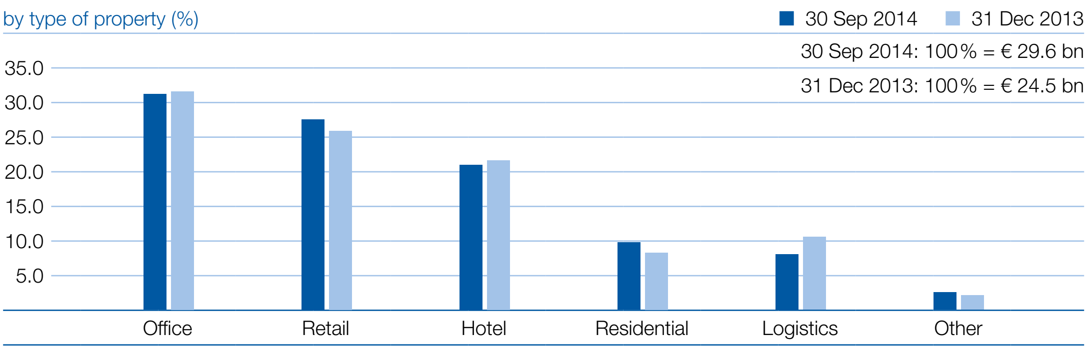
**Property financing volume (amounts drawn)**

by region (%)




**Property financing volume (amounts drawn)**

by type of property (%)




[1] As at 30 September 2014, the securities portfolio was carried at € 13.6 billion (31 December 2013: € 12.2 billion).

97 %[1] of the overall portfolio is denominated in euro. 98 %[1] of the portfolio has an investment grade rating.[2]

## Financial position

### Refinancing and equity

#### Refinancing

Aareal Bank Group continued to successfully conduct its funding activities in the third quarter of 2014, thereby securing its very solid liquidity situation. Total long-term funding as at 30 September 2014 amounted to € 28.7 billion (31 December 2013: € 26.0 billion). This comprises Pfandbrief issues, senior unsecured and subordinated issues. As at the reporting date, Aareal Bank also had € 8.0 billion at its disposal from deposits generated from the business with the housing industry (31 December 2013: € 7.0 billion). Institutional money market investors' deposits amounted to € 5.0 billion (31 December 2013: € 4.8 billion).

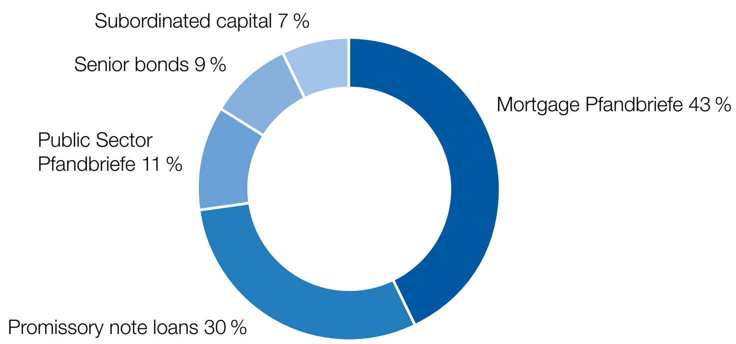
Aareal Bank Group raised € 0.9 billion in long-term funds on the capital market during the third quarter. This comprises Mortgage Pfandbriefe in the amount of € 0.8 billion, as well as unsecured refinancing of almost € 0.1 billion. Aareal Bank has therefore maintained its long-term funding at a high level.

Notable amongst these was the successful public placement of a 3-year, € 500 million Mortgage Pfandbrief issue.

The total volume of long-term funding raised until 30 September 2014 amounted to € 3.0 billion, with Mortgage Pfandbriefe accounting for € 1.6 billion. Unsecured refinancing amounted to € 0.9 billion. In addition, € 0.5 billion in subordinated bonds were placed with investors.

**Capital market funding mix as at 30 September 2014**

% Total volume: € 28.7 bn




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

#### Equity

As at 30 September 2014, Aareal Bank Group's consolidated equity amounted to € 2.1 billion, excluding the SoFFin silent participation and trust preferred securities (31 December 2013: € 1.9 billion).

**Regulatory capital**[3]

| | 30 Sep 2014 |
|---|---|
| € mn | |
| Common Equity Tier 1 (CET 1) | 2,347 |
| Tier 1 | 2,674 |
| Total capital | 3,652 |
| % | |
| Common Equity Tier 1 ratio (CET 1 ratio) | 14.2 |
| Tier 1 ratio | 16.1 |
| Total capital ratio | 22.0 |

[1] Details based on the nominal volume; [2] The rating details are based on the composite ratings.
[3] Since 1 January 2014, regulatory indicators have been determined in accordance with CRD IV/CRR, based on carrying amounts in accordance with IFRSs. Up until 31 December 2013, the rules of the German Solvency Regulation (SolvV), applied on the basis of German Commercial Code (HGB) carrying amounts, were applied for this purpose. The Bank therefore decided against stating comparative amounts.

**Analysis of risk-weighted assets (RWA) as at 30 September 2014[1)]**

| € mn | EAD | Risk-weighted assets (RWA) AIRBA | CRSA | Total | Regulatory capital requirements |
|---|---|---|---|---|---|
| **Credit risks** | **51,912** | **11,528** | **3,187** | **14,715** | **1,177** |
| Companies | 32,403 | 9,452 | 2,151 | 11,603 | 929 |
| Institutions | 7,023 | 815 | 124 | 939 | 75 |
| Public-sector entities | 11,069 | – | 15 | 15 | 1 |
| Other | 1,417 | 1,261 | 797 | 2,158 | 173 |
| **Market price risks** | | | | **542** | **43** |
| **Operational risks** | | | | **1,324** | **106** |
| **Total** | **51,912** | **11,502** | **3,087** | **16,581** | **1,326** |

The regulatory measurement of risk-weighted assets (RWAs) in the area of credit risks is based on both the Advanced Internal Ratings Based Approach (AIRBA) and on the standardised approach (CRSA).

RWAs acquired through the takeover of Corealcredit were determined in accordance with the Credit Risk Standard Approach (CRSA).

## Report on Material Events after the Reporting Date

Having obtained approval from the German Federal Financial Supervisory Authority (BaFin) on 30 October 2014 to repay the silent participation provided by the German Financial Markets Stabilisation Fund (SoFFin) in full, Aareal Bank repaid the residual amount of € 300 million to SoFFin on the same date. In accordance with the repayment agreement, Aareal Bank will additionally pay interest accruing until the repayment date on the next regular maturity date on 31 March 2015 to SoFFin. Furthermore, in line with existing contractual stipulations, the agreement provides for a pro rata temporis share due to SoFFin in any dividends distributed by Aareal Bank, by way of a dividend-linked additional payment for the 2014 financial year. With the full repayment of the silent participation, SoFFin's support to Aareal Bank has therefore come to an end.

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

## Risk Report

### Aareal Bank Group Risk Management

The Annual Report 2013 contains a comprehensive description of Aareal Bank Group's risk management approach, including the corresponding organisational structure and workflows in the lending and trading businesses, as well as the methods and procedures used for measuring and monitoring risk exposure. Within the scope of this interim report, we will once again briefly outline the key components of our risk management structure, together with the key developments during the period under review.

[1)] Since 1 January 2014, regulatory indicators have been determined in accordance with CRD IV/CRR, based on carrying amounts in accordance with IFRSs. Up until 31 December 2013, the rules of the German Solvency Regulation (SolvV), applied on the basis of German Commercial Code (HGB) carrying amounts, were applied for this purpose. The Bank therefore decided against stating comparative amounts.

The business policy set by the Management Board, and approved by the Supervisory Board, provides the conceptual framework for Aareal Bank Group's risk management. Taking this as a basis, and in strict consideration of the Bank's risk-bearing capacity, we have formulated detailed strategies for managing the various types of risk. These risk strategies, as well as the Bank's business strategy, are adapted to the changed environment at least once a year, and adopted by the Management Board and the Supervisory Board. Suitable risk management and risk control processes are deployed to implement the risk strategies, and to ascertain the Bank's ability to bear risk.

## Risk-bearing capacity and risk limits

The Bank's ability to carry and sustain risk is a core determining factor governing the structure of its risk management system. To ascertain its uninterrupted risk-bearing capacity, Aareal Bank has adopted a dual management approach whereby its risk management is primarily based on the assumption of a going concern. This approach ensures that risk positions are only established to an extent that the institution's continued existence will not be threatened should the risks materialise. A secondary management process ensures that risk positions are only established to an extent that even in the event of liquidation there will still be sufficient potential risk cover in order to service all liabilities (the "gone concern" approach). The statements below relate to the going-concern approach which the Bank has implemented as a primary management process.

In accordance with this approach, potential risk cover is determined using data derived from the income statement and from the statement of financial position; this derivation also forms the basis for determining regulatory capital. This involves setting aside the maximum amount of own funds required as potential risk cover to offset risks without causing a breach of minimum requirements pursuant to the German Solvency Regulation (SolvV). Aareal Bank has decided to considerably exceed this minimum requirement, and to prudently apply a Common Equity Tier I (CET I) ratio (calculated in accordance with Basel III) of 8 % to its risk-bearing capacity concept. Only free own funds exceeding this level are applied as potential risk cover, of which a further 12 % is retained as a risk cushion. This cushion is not applied to risk limits, and is thus available for risk types that cannot be quantified (for example, reputational or strategic risks).

We adopt an equally conservative stance with respect to setting risk limits. The aggregation of individual limits is based on the assumption that no risk-mitigating correlation effects exist amongst different types of risk. Taking into account the prior deduction of a minimum Common Equity Tier I (CET I) ratio of 8 %, the value-at-risk models used to quantify risks are based on a confidence interval of 95 % and a one-year holding period (250 trading days). A monthly report submitted to the Management Board provides information regarding the utilisation of individual limits for the material types of risk, as well as on the overall limit utilisation. The following table summarises the Bank's overall risk exposure as at 30 September 2014.

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

**Risk-bearing capacity of the Aareal Bank Group as at 30 September 2014**
**– Going concern approach –**

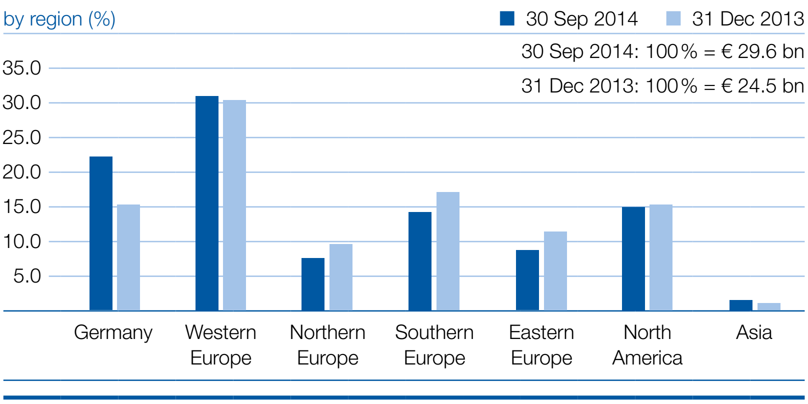
| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Own funds for risk cover potential | 2,530 | 2,504 |
| less 8 % minimum core tier 1 (CET 1) | 1,442 | 1,282 |
| **Freely available funds** | **1,088** | **1,222** |
| **Utilisation of freely available funds** | | |
| Credit risks | 240 | 225 |
| Market risks | 191 | 220 |
| Operational risks | 53 | 44 |
| Investment risks | 37 | 28 |
| **Total utilisation** | **522** | **516** |
| **Utilisation as a percentage of freely available funds** | **48 %** | **42 %** |

## Credit risks

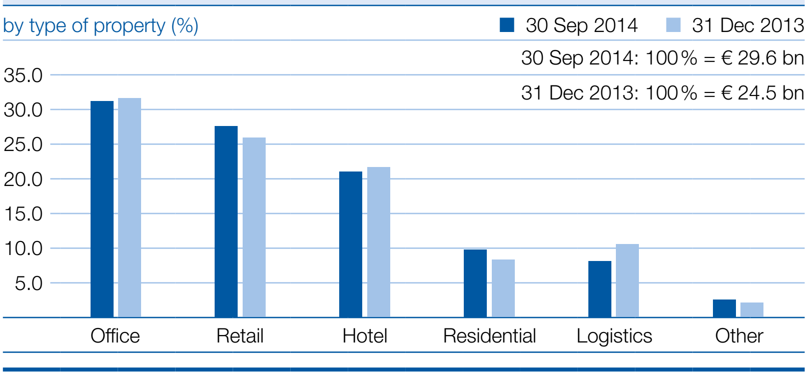
### Definition

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

**Property financing volume (amounts drawn)**




**Property financing volume (amounts drawn)**




### Risk measurement and monitoring

Aareal Bank's structural organisation and business processes are consistently geared towards effective and professional risk management. Regulatory requirements are fully taken into account for the organisation of operations and workflows in the credit and trading business.

Processes in the credit and trading businesses are designed to consistently respect the clear functional separation of Sales units and Credit Management, 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 various risk classification procedures for the initial, regular, or event-driven assessment of counterparty risk; these procedures are adapted specifically to meet the requirements of the relevant business activity and are subject to permanent review and improvement. Responsibility for development, quality assurance, and monitoring implementation of risk classification procedures, is held outside of the Sales units.

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

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

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

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

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, at an early stage.

### 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 carried out by the Bank's senior management. The Risk Controlling division is responsible for the continuous monitoring of country limits and for periodical reporting on limit utilisation.

### Market price risks

#### Definition

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

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

#### Risk measurement and monitoring

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

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

A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. Determined on a daily basis for the Group and all its operating units, the VaR figure takes into account the correlation between individual risk types. Statistical parameters used in the VaR model are calculated directly from a 250-day historical data pool maintained within the Bank. The loss potential is determined applying a 95 % confidence interval and a 250-day holding period.

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

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

When interpreting the VaR figures stated below, it should be taken into account that these refer to the overall portfolio (thus including all non-trading positions as defined in IFRSs). Hence, the analysis provided represents a very extensive disclosure of market price risks by industry standards.

| € mn | MAX | MIN | Mean | Limit |
|---|---|---|---|---|
| **Q3 2014 (2013 year-end values)**<br>**95%, 250-day holding period** | | | | |
| Aareal Bank Group – general market price risk | 186.0 (260.8) | 109.1 (137.1) | 137.4 (184.5) | – (–) |
| Group VaR (interest rates) | 175.5 (248.8) | 95.7 (136.2) | 124.2 (177.3) | – (–) |
| Group VaR (FX) | 58.8 (46.5) | 45.3 (31.2) | 52.0 (39.0) | – (–) |
| VaR (funds) | 2.6 (7.0) | 0.0 (0.3) | 0.3 (3.6) | 20.0 (20.0) |
| Aggregate VaR in the trading book (incl. specific VaR) | 0.0 (0.0) | 0.0 (0.0) | 0.0 (0.0) | 5.0 (5.0) |
| Trading book VaR (interest rates) | 0.0 (0.0) | 0.0 (0.0) | 0.0 (0.0) | – (–) |
| Trading book VaR (FX) | 0.0 (0.0) | 0.0 (0.0) | 0.0 (0.0) | – (–) |
| VaR (equities) | 0.0 (0.0) | 0.0 (0.0) | 0.0 (0.0) | – (–) |
| Group VaR (specific risks) | 135.6 (227.7) | 88.9 (132.9) | 107.7 (183.6) | – (–) |
| Aggregate VaR – Aareal Bank Group | 226.7 (318.6) | 142.9 (205.2) | 175.1 (262.2) | 390.0 (400.0) |

To ensure that Aareal Bank's figures are comparable to those published by other institutions, the risk parameters shown below were determined for a one-day holding period:

| € mn | MAX | MIN | Mean | Limit |
|---|---|---|---|---|
| **Q3 2014 (2013 year-end values)** | | | | |
| **95%, 1-day holding period** | | | | |
| Aareal Bank Group – general market price risk | 11.8 (16.5) | 6.9 (8.7) | 8.7 (11.7) | – (–) |
| Group VaR (interest rates) | 11.1 (15.7) | 6.1 (8.6) | 7.9 (11.2) | – (–) |
| Group VaR (FX) | 3.7 (2.9) | 2.9 (2.0) | 3.3 (2.5) | – (–) |
| VaR (funds) | 0.2 (0.4) | 0.0 (0.0) | 0.0 (0.2) | 1.3 (1.3) |
| Aggregate VaR in the trading book (incl. specific VaR) | 0.0 (0.0) | 0.0 (0.0) | 0.0 (0.0) | 0.3 (0.3) |
| Trading book VaR (interest rates) | 0.0 (0.0) | 0.0 (0.0) | 0.0 (0.0) | – (–) |
| Trading book VaR (FX) | 0.0 (0.0) | 0.0 (0.0) | 0.0 (0.0) | – (–) |
| VaR (equities) | 0.0 (0.0) | 0.0 (0.0) | 0.0 (0.0) | – (–) |
| Group VaR (specific risks) | 8.6 (14.4) | 5.6 (8.4) | 6.8 (11.6) | – (–) |
| Aggregate VaR – Aareal Bank Group | 14.3 (20.1) | 9.0 (13.0) | 11.1 (16.6) | 24.7 (25.3) |

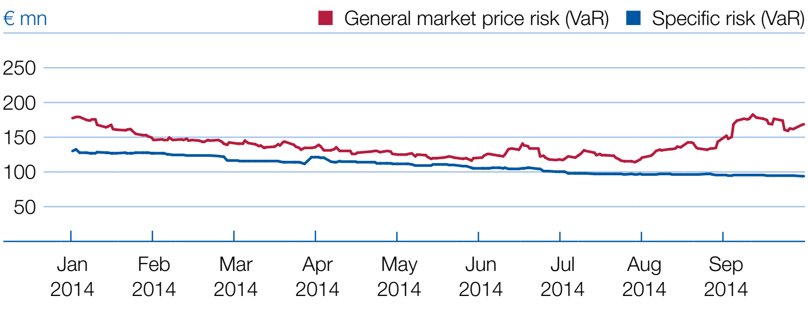
### Aggregate VaR – Aareal Bank Group

Group-wide limits are being continuously monitored as part of the analysis of the Bank's risk-bearing capacity. These limits were adjusted during the first quarter, due to the consolidation of Corealcredit into Aareal Bank Group. No limit breaches were detected even after this re-calibration.

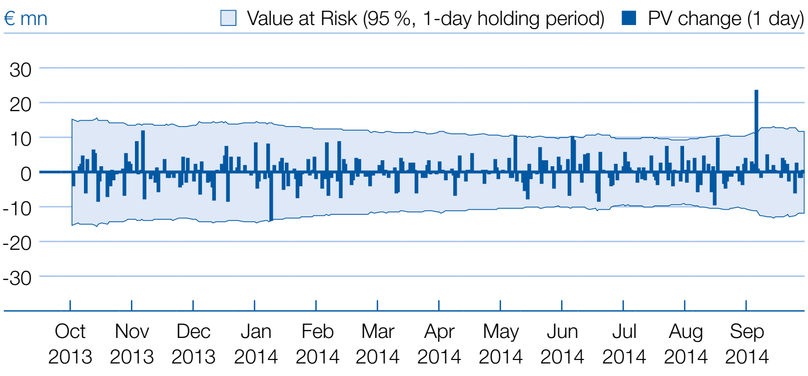
### Backtesting

The quality of forecasts made using this statistical model is checked through a weekly backtesting process. The quality of the statistical procedure used to measure risk is checked using a binomial test, whereby daily profits and losses from market fluctuations are compared with the upper projected loss limit (VaR) forecast on the previous day (known as "clean backtesting"). In line with the selected confidence level of 95 %, only a small number of events are expected to break out of the VaR projection (≤ 17 for a 250-day period). No negative outliers at Group level occurred during the last 250 trading days, affirming the high forecasting quality of the VaR model we use.

**General market price risk and specific risk during 2014**




**Present values and 1-day VaR during 2013/2014**



### Trading book

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

## Liquidity risks

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

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 appropriateness of the Bank's liquidity is assessed in a liquidity report prepared using an internal liquidity risk model: the aggregate of all potential cash inflows and outflows over a three-month period is compared to the liquidity stock. There were no liquidity shortages throughout the period under review. The requirements of the liquidity ratio in accordance with the Liquidity Ordinance, which is relevant to liquidity management, were always complied with, as were the limits set by reference to the liquidity run-off profile. Further details are provided in the comments on the Bank's liquidity in the section on "Refinancing and Equity".

## Operational risks

Aareal 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 includes legal risks. Aareal Bank's legal department (Corporate Development – Legal) compiles all information concerning any legal disputes involving Aareal Bank Group, whether in or out of court. The involvement of the legal department is based on corresponding Group-wide guidelines. The Bank's decentralised operating legal entities, as well as the legal departments of subsidiaries submit semi-annual as well as event-driven reports on legal risks identified to Aareal Bank's legal department, which reports to the Management Board, also (at least) on a semi-annual basis. Moreover, information about legal risks is also included in operational risk reporting. Strategic, reputational and systematic risks are not covered by operational risk management. These risks are managed largely through qualitative measures.

Aareal Bank's policy for managing and monitoring operational risks is geared to achieving a risk-minimising or loss-limiting effect at an early stage, by employing a pro-active approach. The Risk Report in the 2013 Annual Report contains a detailed description of controlling tools employed by the Bank to manage operational risk, plus the relevant responsibilities.

Within the scope of the acquisition of Corealcredit, Aareal Bank also assumed legal, tax and credit risks, among others. These risks were assessed on a conservative basis and are hedged comprehensively.

The current analysis conducted using these control instruments has shown that the Bank is not exposed to disproportionate operational risks; nor did it indicate any material risk concentration.

Operational risk management also includes the reporting to the Bank's Management Board about outsourced activities and processes.

**Investment risks**

We define 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.

Due to the special character of some exposures (e.g. marketing risks), special methods and procedures are employed to deal with investment risk. All relevant Group entities are subject to regular audits, including a review and assessment of their risk situation. A quarterly investment risk report is submitted to the Bank's Management Board. There were no significant changes in investment risk during the period under review.

## Report on Expected Developments

### Macro-economic environment

#### Economy

Compared to the previous year, the world economy is likely to post only marginally higher growth rates – albeit with considerable regional differences. The economic environment and outlook have deteriorated again over the last few months, particularly in the euro zone and a number of countries in Asia. The underlying momentum of the global economy will remain subdued – the burdens to dynamic growth are too large. These include the consolidation processes in various economies and the still-high level of unemployment in many euro zone countries, as well as the deterioration of the financial framework conditions in some emerging economies brought about by capital outflows at the start of the year. The tensions between the Ukraine and Russia represent additional major burdens and serious risk factors to the economic development in Europe. As a consequence, the European economy might be significantly compromised through trade channels, via developments in the commodities sector, and through financial interdependence. Moreover, further geopolitical tensions may compromise economic development – for example, through additional burdens to economic sentiment or trade channels. Although uncertainty surrounding the European sovereign debt crisis has eased, a renewed escalation (and hence, a renewed burden to the economy) cannot be ruled out. Economic development would benefit from a decline in these uncertainty factors, however, as well as from the deleveraging processes in the private sector of major economies such as the US and the UK.

Thus, the future economic development is currently subject to a series of risk and uncertainty factors, and other burdens. There is a lack of broad fundamental support for economic development. That is why overly slow or inadequate risk defences are increasing the threat that systemic risks pose to monetary stability or the stability of the euro zone. The persisting low interest rate environment, which is likely to prevail for quite some time in the euro zone in particular, is associated with considerable risks and side-effects. Possible threats are posed by the potential of capital markets bubbles and a mis-allocation of capital – both would endanger financial stability – as well as weakening reform and consolidation efforts in the public, private and banking sectors.

We anticipate economic momentum in the euro zone remaining subdued for the final quarter of the financial year, and only a slight increase in real gross domestic product for the full year 2014 – as suggested by the aforementioned burdening factors, such as persistently high unemployment levels and the impact of the tensions between the Ukraine and Russia, as well as the restrictive fiscal policy in some countries. In addition, the threat of deflation cannot be ruled out for the euro zone, in particular with regard to certain member states such as Italy and Spain. This would also have considerable implications for economic development due to restrained demand. Forecasts for the euro zone and some member states have been lowered. In Germany, we expect moderate real GDP growth, above the euro zone average, for 2014.

The Spanish economy has stabilised, opening potential for moderate growth. Only slight economic growth – at comparatively lower levels – is expected for Belgium, the Netherlands and Austria. We anticipate marginal growth in real GDP in France, whilst economic development in Italy now seems to be weaker than at the beginning of the year; we expect real GDP to remain constant or decline marginally for the full year. Our expectations for Finland are similar.

However, we anticipate stronger economic growth for many European economies outside the euro zone. Especially in the UK, Poland and the Czech Republic, we consider notable growth to be likely this year, whilst lower yet moderate growth rates are forecast for Denmark, Sweden and Switzerland. Economic growth in Turkey will be substantially lower year-on-year in our view. The Russian economy is suffering from tensions with the situation regarding the Ukraine, and the sanctions imposed. Against this background, we expect the Russian economy to grow only slightly.

In the US, the growth rate of real GDP is expected to remain on the previous year's level for 2014, leading to a moderate growth rate overall, but still clearly above the level in the euro zone. The growth expectations are supported by the fact that private households have apparently concluded their debt reduction processes, which should stimulate consumption. This is further emphasised by increasing investments in housing construction, and fiscal policies that constitute barely any restrictions. Although US interest rates might increase slightly, following the termination of the Federal Reserve's bond purchasing programme at the end of October, this is not expected to have a major impact on investment activity. Nonetheless, it still poses a certain degree of risk. Economic growth in Canada is also likely to remain at the previous year's levels, whilst Mexico is expected to post a somewhat stronger growth rate.

In various countries of the Asian-Pacific region, economies will grow slightly less dynamically than in the previous year. We believe a moderate slowdown in growth compared with the previous year is likely in China and Japan, as well as in Singapore. Even so, growth rates in China will remain high by international standards. We anticipate slight economic growth in Japan.

Unemployment will change only marginally, or fall slightly in numerous European countries this year. Thus, unemployment levels will remain high – especially in Southern Europe, even though Spanish unemployment is likely to come down from very high levels. The unemployment rate in the US is expected to show a marked decline.

### Financial and capital markets, monetary policy and inflation

Although the situation on the financial and capital markets of developed economies has clearly eased further, compared to previous years, sentiment has deteriorated – particularly due to geopolitical uncertainty and the recent deterioration of the economic outlook. We believe that this situation is burdened with considerable risks and uncertainty. While uncertainty about the further development of the European sovereign debt crisis has meanwhile eased considerably, risks continue to persist, and it cannot be ruled out that the financial and capital markets are still very susceptible to shocks, should the sovereign debt crisis escalate again. The financial and capital markets of various emerging economies would also be exposed to uncertainty, if investors were to again withdraw large amounts of capital – as seen at the beginning of the year.

Against the background of low inflation, the majority of central banks in the developed economies will probably keep key interest rates at low levels for the remainder of the year. The Bank of England (BoE) might increase key interest rates only slightly towards the end of the year. Consequently, under current conditions, short-term interest rates are also expected to remain at low levels. The US Federal Reserve ended its bond purchasing programme at the end of October, which might trigger a slight increase in US long-term interest rates.

Inflation in the euro zone is likely to remain on a very low level for the remainder of the year, due to subdued economic development. In certain euro zone countries, such as Italy and Spain, there is an ongoing risk of deflation. Outside the euro zone, several countries – such as Poland, Sweden and Switzerland – are expected to show low inflation rates (or none at all) until year-end. On the other hand, we expect inflation to be higher (yet moderate) in the UK, whilst inflation in China and the US is also expected to be moderate. Japanese inflation is likely to increase to about 3 %, due to a value-added tax hike and an expansive monetary policy. Clearly higher inflation rates are expected in Russia and Turkey. Geopolitical tensions might, however, drive up commodity prices and hence inflation in various regions, which needs to be taken into account in any inflation forecast.

### Regulatory environment

The trend towards a tighter regulatory framework in the banking business is set to persist during the coming years. Accordingly, Aareal Bank will continue to focus on the related measures for implementation into the Bank's business activities.

The European Banking Authority in particular has raised requirements and ties up additional resources. Furthermore, additional regulatory requirements will need to be dealt with. These include the Minimum Requirements for the Design of Recovery Plans (MaSan) on a national level as well as the EU Bank Recovery and Resolution Directive (BRRD). The ECB has assumed regulatory responsibility for larger banks within the euro zone – including Aareal Bank – with effect from the 4th of November.

Regulators have yet to come up with final details for some of these additional regulatory requirements; likewise, the various technical regulatory standards still have to be finalised. To nevertheless facilitate the timely implementation, we have already started to deal with and pursue the various issues in numerous projects – devoting considerable resources to this task.

## Sector-specific and business developments

### Structured Property Financing segment

Competition in the commercial property financing business remains intensive. We are assuming that the intensity of competition will remain in place for the rest of the year. The finance providers are likely to become ever more willing to accept lower margins and higher loan-to-value ratios. This applies for numerous European countries and for North America, as well as for countries in the Asia / Pacific region, including for example, China, Japan and Singapore. In Italy and Spain, where lending is likely to be more cautious overall, we expect a moderate relaxation of lending conditions and intensifying competition, too.

Whilst financings of first-class commercial properties in corresponding locations are likely to remain in the focus of finance providers, the willingness to finance properties with a higher risk profile, and large-volume projects, will continue to grow noticeably.

At present, commercial property markets are characterised by high levels of investor liquidity, making commercial property an attractive investment for investors looking for yield in the current low interest rate environment. We expect this situation will remain largely unchanged for the rest of the year. The resulting demand for commercial property is likely to support property values. We cannot rule out the threat of bubbles on property markets in the course of the low interest rate environment. A muted recovery in many economies and high unemployment in many parts of Europe must be taken into consideration in relation to future developments on the commercial property markets.[1]

[1] Assessments of individual sub-markets and properties may deviate from the general description of developments on commercial property markets outlined below.

Against this background, we assume an increase (on average) this year in commercial property values for most of the European markets that are relevant to us. These increases are, however, likely to vary for each country. The major markets of Germany and the UK are likely to remain in the focus of investors. We thus anticipate significant increases in commercial property values for 2014, also in light of the quite positive economic outlook. Our expectations for property values in Denmark and Poland are similar. A slight to moderate increase in the average values for commercial property is likely, in our view, in Belgium, Austria and Switzerland. A corresponding recovery in commercial property prices is also assumed for Italy and Spain, with somewhat greater momentum in Spain. In Sweden and France, property values are likely to remain virtually stable on average. The effects of the political tension between Russia and the Ukraine – and the corresponding sanctions – upon the Russian commercial property market cannot be assessed with any certainty at present. A slight to moderate fall in property values is possible on average in Finland, the Netherlands and Turkey, due to muted economic development.

The high levels of liquidity and investor demand in the US, together with the relatively positive economic outlook there, indicate a moderate average increase in commercial property values, despite the projected slight increase in interest rates. We assume property values in Canada will remain stable.

For the Asian markets, the picture is more complex: Considering expected interest rate increases, we adopt a more reticent stance in our assessment for China, and anticipate a moderate decline in property values. We assume property values in Singapore to remain largely stable and expect noticeable growth in Japan.

The developments outlined above should, in our view, tend to apply to office, retail and logistics property markets. On the hotel markets, we find a mixed picture in Europe and Asia, which will prevail going forward, based on our assessment. With regard to North America, we assume that the upward trend in hotel sector revenues will continue on average to a moderate extent compared with the previous year.

The market is characterised by high levels of investor liquidity and a limited supply of premium properties. Accordingly, funds are likely to flow far more heavily into markets and properties outside the premium segment.

Macro-economic risks and uncertainty factors will continue to be important for the further development of the commercial property markets. If these factors were to materialise in a way that places a significant burden on forecast economic developments, or the economy even falls into a marked recession, this would likely trigger significant declines in property values and rents.

Our original forecast for new business in the current year was between € 8 billion and € 9 billion. Reflecting the positive year-to-date business development and the prospects for the remainder of the year, we now expect aggregate new business at around € 10 billion for the full year 2014. Our property financing portfolio will increase considerably compared to year-end 2013. The regional focus will remain on Western Europe and North America; we continue to strive for a broad diversification by region and by property type.

We want to continue to use club deals and syndicated financing in the future, to allow us to participate in large-volume financings and to diversify risk.

## Consulting/Services segment

### Bank division Housing Industry

We also expect developments within the German housing and commercial property industries to remain solid for the remainder of the year. Sustainable portfolio development will continue to prevail in this sector. Against the background of demographic change, it is becoming increasingly important to create affordable housing that is also suitable for the elderly, alongside attendance and care services.

Positive sentiment on the residential property market is expected to prevail. Due to the ongoing urbanisation trend, we expect demand for apartments in German economic centres to rise. However, the increase in the offered rental prices is likely to be less dynamic. We expect moderate rises in property prices – particularly for properties in medium to good-quality locations, given increasing new construction activity.

In view of the low interest rate levels, residential properties are still considered solid tangible assets by national and international investors. Hence, strong demand for residential property is expected to prevail for the rest of the year. We expect a notable increase in transaction activity, mainly for secondary locations on the small and medium-sized market segment. Against the background of a limited number of large-volume portfolio sales, we anticipate average transaction volumes to be smaller than in the previous year.

We see good opportunities during the last quarter of 2014 to acquire new clients and to intensify business relationships with our existing client base. This also applies to our payments services for utilities and the waste disposal industry.

Looking at the volume of deposits taken, we expect consolidation at a high level, with a slightly positive trend, both in relation to current account balances and rental deposits. Segment results will continue to be burdened by persistently low interest rate levels. However, the importance of this business goes way beyond the interest margin generated from the deposits, which is under pressure in the current market environment. This is because the deposits from the housing industry represent a strategically important additional source of funding for Aareal Bank.

### Aareon

The digitisation of the property industry, and the related use of CRM solutions and mobile applications, are becoming increasingly important. In this context, the IT trend of cloud computing will become further established on the market for property management software.

For 2014, in its operative business, Aareon expects a slight increase in consolidated sales revenues and in earnings before interest and taxes (EBIT). The acquisition of Sweden's Incit AB in 2013 in particular as well as the strong overall growth in the international business are decisive factors here. In addition, EBIT in Aareon's operative business will be burdened by € 1.5 million to € 2.5 million in investments related to special projects for the Group's internationalisation and digitisation.

Operating revenues and EBIT in Aareon's domestic operations are forecast to remain virtually unchanged from 2013's levels.

Aareon expects slightly declining sales revenues and EBIT in its ERP products segment in 2014, whereas sales revenues for Wodis Sigma are expected to rise slightly mainly through migration projects by GES customers. The increased demand for Wodis Sigma as a service from the exclusive Aareon Cloud leads to higher maintenance fees in the year under review and subsequent years. At the same time, licence fees generated through the traditional software sales model are lower. Business in the GES product line during the 2013 financial year was largely characterised by major one-off projects and the implementation of SEPA. Given the non-recurring character of these effects and the continued migration of GES clients to Wodis Sigma, Aareon expects slightly lower product revenues in 2014. The company now expects stable sales revenues from the SAP® solutions and Blue Eagle product lines.

Significant sales revenue growth is expected in the Integrated Services business segment for the current year; contributing factors include demand for the Aareon Archiv kompakt product as well as the Aareon CRM and Mobile Services solutions (all of which were launched in 2013). In this context, Aareon also anticipates a positive development in sales revenues for Integrated Services Consulting. Because of a high level of development work, EBIT in this segment is set to remain at the previous year's level.

In the International Business segment, significant operative sales and EBIT growth is expected in 2014, among other things due to the acquisition of Sweden's Incit AB.

Overall, Aareon forecasts a marginal increase in sales revenues for the year under review, with operative EBIT of around € 28 million, slightly higher year-on-year. The operative EBIT margin is expected to be around 16 %. After the impact of special projects, the EBIT is anticipated at approximately € 26 million, and the EBIT margin at around 14 %-15 %.

### Group targets

If the strong business trend continues to materialise, consolidated operating profit between € 420 million and € 430 million is achieveable, including the non-recurring € 152 million effect from the acquisition of Corealcredit. This would translate into consolidated operating profit of € 72 million to € 82 million for the fourth quarter of 2014. In our previous projection, we had anticipated full-year consolidated operating profit at the upper end of a range – raised in August – between € 380 million and € 400 million. Adjusted for the non-recurring effect from the Corealcredit transaction, consolidated operating profit of approximately € 270 million to € 280 million is achievable.

RoE before taxes, excluding the aforementioned non-recurring effect, is now likely to be around 10 %.

We now expect net interest income of between € 650 million and € 680 million, which would also exceed the previously-communicated range of € 610 million to € 640 million. Allowance for credit losses is expected to remain in the upper half of the communicated, unchanged range between € 100 million and € 150 million. As in previous years, the Bank cannot rule out additional allowance for unexpected credit losses that may be incurred during 2014.

Net commission income for the full year 2014 is expected in a range between € 160 million and € 170 million, and thus slightly below the previously forecast range (€ 170 million to € 180 million). Administrative expenses are expected in an unchanged range between € 430 million and € 450 million.

New business in the Structured Property Financing segment is now expected to amount to approximately € 10 billion for the full year 2014.

In the Consulting/Services segment, we now anticipate a slightly lower profit before taxes over the previous year for Aareon of around € 26 million.

# Consolidated Financial Statements
# Statement of Comprehensive Income

## Income Statement

| | Notes | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 |
|---|---|---|---|
| € mn | | | |
| Interest income | | 745 | 624 |
| Interest expenses | | 251 | 244 |
| **Net interest income** | 1 | **494** | **380** |
| Allowance for credit losses | 2 | 105 | 74 |
| **Net interest income after allowance for credit losses** | | **389** | **306** |
| Commission income | | 137 | 136 |
| Commission expenses | | 21 | 19 |
| **Net commission income** | 3 | **116** | **117** |
| Net result on hedge accounting | 4 | 3 | -3 |
| Net trading income/expenses | 5 | -1 | 14 |
| Results from non-trading assets | 6 | 0 | -8 |
| Results from investments accounted for using the equity method | | 0 | – |
| Administrative expenses | 7 | 325 | 276 |
| Net other operating income/expenses | 8 | 14 | -10 |
| Negative goodwill from the acquisition of Corealcredit | 9 | 152 | – |
| **Operating profit** | | **348** | **140** |
| Income taxes | | 62 | 44 |
| **Consolidated net income/loss** | | **286** | **96** |
| **Allocation of results** | | | |
| Consolidated net income/loss attributable to non-controlling interests | | 14 | 15 |
| Consolidated net income/loss attributable to shareholders of Aareal Bank AG | | 272 | 81 |
| **Appropriation of profits** | | | |
| Consolidated net income/loss attributable to shareholders of Aareal Bank AG | | 272 | 81 |
| Silent participation by SoFFin | | 15 | 15 |
| **Consolidated profit/loss** | | **257** | **66** |
| € | | | |
| Earnings per share | | 4.54 | 1.35 |
| Diluted earnings per share | | 4.54 | 1.35 |

Earnings per share are determined by dividing the earnings attributable to ordinary shareholders of Aareal Bank AG by the weighted average of shares outstanding during the reporting period.

# Statement of Comprehensive Income

## Reconciliation from Consolidated Net Income/Loss to Total Comprehensive Income

| € mn | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 |
|---|---|---|
| **Consolidated net income/loss** | **286** | **96** |
| Items that will not be reclassified subsequently to profit or loss | | |
| **Changes in the reserve from remeasurements of defined benefit plans** | **-36** | **–** |
| Remeasurements | -52 | – |
| Taxes | 16 | – |
| Items that are reclassified subsequently to profit or loss | | |
| **Changes in revaluation surplus** | **64** | **40** |
| Gains and losses on remeasuring AfS financial instruments | 87 | 53 |
| Reclassifications to the income statement | – | – |
| Taxes | -23 | -13 |
| **Changes in hedging reserves** | **14** | **-1** |
| Profit/loss from derivatives used to hedge future cash flows | 16 | -2 |
| Reclassifications to the income statement | 4 | – |
| Taxes | -6 | 1 |
| **Changes in currency translation reserves** | **2** | **-2** |
| Profit/loss from translating foreign operations' financial statements | 2 | -2 |
| Reclassifications to the income statement | – | 0 |
| Taxes | – | – |
| **Other comprehensive income** | **44** | **37** |
| **Total comprehensive income** | **330** | **133** |
| **Allocation of total comprehensive income** | | |
| Total comprehensive income attributable to non-controlling interests | 14 | 15 |
| Total comprehensive income attributable to shareholders of Aareal Bank AG | 316 | 118 |

# Statement of Comprehensive Income

## Income Statement (Quarterly Development)

| € mn | Quarter 3 2014 | Quarter 3 2013 |
|---|---|---|
| Interest income | 261 | 214 |
| Interest expenses | 80 | 81 |
| **Net interest income** | **181** | **133** |
| Allowance for credit losses | 36 | 29 |
| **Net interest income after allowance for credit losses** | **145** | **104** |
| Commission income | 43 | 47 |
| Commission expenses | 6 | 7 |
| **Net commission income** | **37** | **40** |
| Net result on hedge accounting | 0 | 0 |
| Net trading income/expenses | -5 | 3 |
| Results from non-trading assets | 0 | -2 |
| Results from investments accounted for using the equity method | 0 | – |
| Administrative expenses | 109 | 94 |
| Net other operating income/expenses | -2 | -3 |
| Negative goodwill from the acquisition of Corealcredit | – | – |
| **Operating profit** | **66** | **48** |
| Income taxes | 21 | 15 |
| **Consolidated net income/loss** | **45** | **33** |
| | | |
| **Allocation of results** | | |
| Consolidated net income/loss attributable to non-controlling interests | 4 | 5 |
| Consolidated net income/loss attributable to shareholders of Aareal Bank AG | 41 | 28 |

# Statement of Comprehensive Income

## Reconciliation from Consolidated Net Income/Loss to Total Comprehensive Income (Quarterly Development)

| € mn | Quarter 3 2014 | Quarter 3 2013 |
|---|---|---|
| **Consolidated net income/loss** | **45** | **33** |
| Items that will not be reclassified subsequently to profit or loss | | |
| **Changes in the reserve from remeasurements of defined benefit plans** | **-14** | **–** |
| Remeasurements | -20 | – |
| Taxes | 6 | – |
| Items that are reclassified subsequently to profit or loss | | |
| **Changes in revaluation surplus** | **20** | **12** |
| Gains and losses on remeasuring AfS financial instruments | 28 | 17 |
| Reclassifications to the income statement | – | – |
| Taxes | -8 | -5 |
| **Changes in hedging reserves** | **9** | **-2** |
| Profit/loss from derivatives used to hedge future cash flows | 12 | -3 |
| Reclassifications to the income statement | 1 | – |
| Taxes | -4 | 1 |
| **Changes in currency translation reserves** | **3** | **0** |
| Profit/loss from translating foreign operations' financial statements | 3 | 0 |
| Reclassifications to the income statement | – | – |
| Taxes | – | – |
| **Other comprehensive income** | **18** | **10** |
| **Total comprehensive income** | **63** | **43** |
| **Allocation of total comprehensive income** | | |
| Total comprehensive income attributable to non-controlling interests | 4 | 5 |
| Total comprehensive income attributable to shareholders of Aareal Bank AG | 59 | 38 |

# Segment Reporting

## Segment Results

| € mn | Structured Property Financing | | Consulting/ Services | | Consolidation/ Reconciliation | | Aareal Bank Group | |
|---|---|---|---|---|---|---|---|---|
| | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 |
| Net interest income | 493 | 373 | 0 | 0 | 1 | 7 | 494 | 380 |
| Allowance for credit losses | 105 | 74 | | | | | 105 | 74 |
| **Net interest income after allowance for credit losses** | **388** | **299** | **0** | **0** | **1** | **7** | **389** | **306** |
| Net commission income | 3 | 7 | 116 | 118 | -3 | -8 | 116 | 117 |
| Net result on hedge accounting | 3 | -3 | | | | | 3 | -3 |
| Net trading income/expenses | -1 | 14 | | | | | -1 | 14 |
| Results from non-trading assets | 0 | -8 | | | | | 0 | -8 |
| Results from investments accounted for using the equity method | 0 | | | | | | 0 | |
| Administrative expenses | 188 | 147 | 139 | 130 | -2 | -1 | 325 | 276 |
| Net other operating income/expenses | 11 | -9 | 3 | -1 | 0 | 0 | 14 | -10 |
| Negative goodwill from the acquisition of Corealcredit | 152 | | | | | | 152 | |
| **Operating profit** | **368** | **153** | **-20** | **-13** | **0** | **0** | **348** | **140** |
| Income taxes | 68 | 47 | -6 | -3 | | | 62 | 44 |
| **Consolidated net income/loss** | **300** | **106** | **-14** | **-10** | **0** | **0** | **286** | **96** |
| **Allocation of results** | | | | | | | | |
| Consolidated net income/loss attributable to non-controlling interests | 12 | 13 | 2 | 2 | | | 14 | 15 |
| Consolidated net income/loss attributable to shareholders of Aareal Bank AG | 288 | 93 | -16 | -12 | 0 | 0 | 272 | 81 |
| Allocated equity | 1,326 | 1,159 | 109 | 92 | 943 | 1,001 | 2,378 | 2,252 |
| Cost/income ratio (%) | 36.9 | 39.6 | 116.4 | 110.7 | | | 51.9 | 56.4 |
| RoE before taxes (%) [1] | 35.8 | 16.1 | -26.8 | -21.5 | | | 18.7 | 7.4 |
| **Employees (average)** | **860** | **740** | **1,646** | **1,564** | | | **2,506** | **2,304** |
| **Segment assets** | **40,592** | **35,870** | **9,266** | **7,482** | | | **49,858** | **43,352** |

[1] On an annualised basis

# Segment Reporting

## Segment Results (Quarterly Development)

| | Structured Property Financing | | Consulting/ Services | | Consolidation/ Reconciliation | | Aareal Bank Group | |
|---|---|---|---|---|---|---|---|---|
| | Quarter 3 2014 | Quarter 3 2013 | Quarter 3 2014 | Quarter 3 2013 | Quarter 3 2014 | Quarter 3 2013 | Quarter 3 2014 | Quarter 3 2013 |
| € mn | | | | | | | | |
| Net interest income | 182 | 131 | 0 | 0 | -1 | 2 | 181 | 133 |
| Allowance for credit losses | 36 | 29 | | | | | 36 | 29 |
| **Net interest income after allowance for credit losses** | **146** | **102** | **0** | **0** | **-1** | **2** | **145** | **104** |
| Net commission income | 1 | 2 | 36 | 40 | 0 | -2 | 37 | 40 |
| Net result on hedge accounting | 0 | 0 | | | | | 0 | 0 |
| Net trading income/expenses | -5 | 3 | | | | | -5 | 3 |
| Results from non-trading assets | 0 | -2 | | | | | 0 | -2 |
| Results from investments accounted for using the equity method | 0 | | | | | | 0 | |
| Administrative expenses | 64 | 50 | 46 | 44 | -1 | 0 | 109 | 94 |
| Net other operating income/expenses | -4 | -3 | 2 | 0 | 0 | 0 | -2 | -3 |
| Negative goodwill from the acquisition of Corealcredit | | | | | | | | |
| **Operating profit** | **74** | **52** | **-8** | **-4** | **0** | **0** | **66** | **48** |
| Income taxes | 23 | 16 | -2 | -1 | | | 21 | 15 |
| **Consolidated net income/loss** | **51** | **36** | **-6** | **-3** | **0** | **0** | **45** | **33** |
| **Allocation of results** | | | | | | | | |
| Consolidated net income/loss attributable to non-controlling interests | 4 | 4 | 0 | 1 | | | 4 | 5 |
| Consolidated net income/loss attributable to shareholders of Aareal Bank AG | 47 | 32 | -6 | -4 | 0 | 0 | 41 | 28 |
| | | | | | | | | |
| Allocated equity | 1,326 | 1,159 | 109 | 92 | 943 | 1,001 | 2,378 | 2,252 |
| Cost/income ratio (%) | 37.1 | 38.6 | 119.6 | 109.8 | | | 51.8 | 55.1 |
| RoE before taxes (%) [1] | 20.9 | 16.5 | -29.3 | -19.9 | | | 10.3 | 7.7 |

[1] On an annualised basis

# Segment Reporting

## Consulting/Services Segment – Reconciliation of the Income Statement

### Reconciliation of the segment result from the income statement classification aligned to an industrial enterprise to a bank income statement classification (which is used for the purposes of segment reporting)

| € mn | | | Income statement classification – bank | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Net interest income | Net commission income | Results from non-trading assets | Results from investments accounted for using the equity method | Administrative expenses | Net other operating income/expenses | Impairment of goodwill | **Operating profit** | Income taxes | **Segment result** |
| | **Q3 2014** | | 0 | 36 | | | 46 | 2 | | **-8** | -2 | **-6** |
| | **Q3 2013** | | 0 | 40 | | | 44 | 0 | | **-4** | -1 | **-3** |
| **Income statement classification – industrial enterprise** | | | | | | | | | | | | |
| Sales revenue | Q3 2014 | 42 | | 42 | | | | | | | | |
| | Q3 2013 | 46 | | 46 | | | | | | | | |
| Own work capitalised | Q3 2014 | 2 | | | | | 2 | | | | | |
| | Q3 2013 | 1 | | | | | 1 | | | | | |
| Changes in inventory | Q3 2014 | 0 | | | | | | 0 | | | | |
| | Q3 2013 | 0 | | | | | | 0 | | | | |
| Other operating income | Q3 2014 | 2 | | | | | | 2 | | | | |
| | Q3 2013 | 1 | | | | | | 1 | | | | |
| Cost of materials purchased | Q3 2014 | 6 | | 6 | | | | | | | | |
| | Q3 2013 | 6 | | 6 | | | | | | | | |
| Staff expenses | Q3 2014 | 32 | | | | | 32 | | | | | |
| | Q3 2013 | 30 | | | | | 30 | | | | | |
| Depreciation, amortisation and impairment losses | Q3 2014 | 4 | | | | | 4 | | | | | |
| | Q3 2013 | 4 | | | | | 4 | | | | | |
| Results from investments accounted for using the equity method | Q3 2014 | | | | | | | | | | | |
| | Q3 2013 | | | | | | | | | | | |
| Other operating expenses | Q3 2014 | 12 | | | | | 12 | 0 | | | | |
| | Q3 2013 | 12 | | | | | 11 | 1 | | | | |
| Interest and similar income/expenses | Q3 2014 | 0 | 0 | | | | | | | | | |
| | Q3 2013 | 0 | 0 | | | | | | | | | |
| **Operating profit** | **Q3 2014** | **-8** | **0** | **36** | | | **46** | **2** | | | | |
| | **Q3 2013** | **-4** | **0** | **40** | | | **44** | **0** | | | | |
| Income taxes | Q3 2014 | -2 | | | | | | | | | -2 | |
| | Q3 2013 | -1 | | | | | | | | | -1 | |
| **Segment result** | **Q3 2014** | **-6** | | | | | | | | | | |
| | **Q3 2013** | **-3** | | | | | | | | | | |

# Statement of Financial Position

| € mn | Notes | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|---|
| **Assets** | | | |
| Cash funds | | 78 | 1,222 |
| Loans and advances to banks | 10 | 3,303 | 2,531 |
| Loans and advances to customers | 11 | 31,057 | 25,924 |
| Allowance for credit losses | 12 | -444 | -361 |
| Positive market value of derivative hedging instruments | | 2,387 | 1,838 |
| Trading assets | 13 | 411 | 307 |
| Non-trading assets | 14 | 12,018 | 10,668 |
| Investments accounted for using the equity method | | 1 | 1 |
| Intangible assets | 15 | 105 | 107 |
| Property and equipment | 16 | 97 | 98 |
| Income tax assets | | 39 | 24 |
| Deferred tax assets | | 215 | 110 |
| Other assets | 17 | 591 | 512 |
| **Total** | | **49,858** | **42,981** |
| **Equity and liabilities** | | | |
| Liabilities to banks | 18 | 2,489 | 1,589 |
| Liabilities to customers | 19 | 27,843 | 25,476 |
| Certificated liabilities | 20 | 11,288 | 10,124 |
| Negative market value of derivative hedging instruments | | 2,551 | 1,603 |
| Trading liabilities | 21 | 646 | 286 |
| Provisions | 22 | 673 | 289 |
| Income tax liabilities | | 101 | 36 |
| Deferred tax liabilities | | 9 | 9 |
| Other liabilities | 23 | 163 | 203 |
| Subordinated capital | 24 | 1,391 | 916 |
| Equity | 25, 26, 27 | | |
| Subscribed capital | | 180 | 180 |
| Capital reserves | | 721 | 721 |
| Retained earnings | | 1,322 | 1,112 |
| Other reserves | | -61 | -105 |
| Silent participation by SoFFin | | 300 | 300 |
| Non-controlling interests | | 242 | 242 |
| Total equity | | 2,704 | 2,450 |
| **Total** | | **49,858** | **42,981** |

# Statement of Changes in Equity

| € mn | Subscribed capital | Capital reserves | Retained earnings | Other reserves: Reserve from defined benefit plans | Other reserves: Revaluation surplus | Other reserves: Hedging reserves | Other reserves: Currency translation reserves | Silent participation by SoFFin | Total | Non-controlling interest | Equity |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Equity as at 1 Jan 2014** | **180** | **721** | **1,112** | **-40** | **-50** | **-17** | **2** | **300** | **2,208** | **242** | **2,450** |
| Total comprehensive income for the period | | | 272 | -36 | 64 | 14 | 2 | | 316 | 14 | 330 |
| Payments to non-controlling interests | | | | | | | | | | -14 | -14 |
| Dividends | | | -45 | | | | | | -45 | | -45 |
| Silent participation by SoFFin | | | | | | | | | | | |
| Costs associated with the silent articipation by SoFFin | | | -15 | | | | | | -15 | | -15 |
| Other changes | | | -2 | | | | | | -2 | | -2 |
| **Equity as at 30 Sep 2014** | **180** | **721** | **1,322** | **-76** | **14** | **-3** | **4** | **300** | **2,462** | **242** | **2,704** |

| € mn | Subscribed capital | Capital reserves | Retained earnings | Other reserves: Reserve from defined benefit plans | Other reserves: Revaluation surplus | Other reserves: Hedging reserves | Other reserves: Currency translation reserves | Silent participation by SoFFin | Total | Non-controlling interest | Equity |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Equity as at 1 Jan 2013** | **180** | **721** | **1,020** | **-39** | **-99** | **-13** | **4** | **300** | **2,074** | **243** | **2,317** |
| Total comprehensive income for the period | | | 81 | | 40 | -1 | -2 | | 118 | 15 | 133 |
| Payments to non-controlling interests | | | | | | | | | | -15 | -15 |
| Dividends | | | | | | | | | | | |
| Silent participation by SoFFin | | | | | | | | | | | |
| Costs associated with the silent articipation by SoFFin | | | -15 | | | | | | -15 | | -15 |
| Other changes | | | | | | | | | | | |
| **Equity as at 30 Sep 2013** | **180** | **721** | **1,086** | **-39** | **-59** | **-14** | **2** | **300** | **2,177** | **243** | **2,420** |

# Statement of Cash Flows (condensed)

| € mn | 2014 | 2013 |
|---|---|---|
| **Cash and cash equivalents as at 1 January** | **1,222** | **3,667** |
| Cash flow from operating activities | -1,264 | -2,888 |
| Cash flow from investing activities | -301 | 1,469 |
| Cash flow from financing activities | 421 | -90 |
| **Total cash flow** | **-1,144** | **-1,509** |
| Effect of changes in exchange rates | 0 | 0 |
| **Cash and cash equivalents as at 30 September** | **78** | **2,158** |

# Notes (condensed)

## Basis of Accounting

### Legal framework

Aareal Bank AG is a listed public limited company incorporated under German law, with its registered office in Wiesbaden, Germany. It is the parent company of an international property finance and services group.

This quarterly financial report for the period ended 30 September 2014 was prepared pursuant to the provisions of section 37y no. 3 of the German Securities Trading Act (Wertpapierhandelsgesetz – "WpHG") in conjunction with section 37x (3) of the WpHG. It comprises the present interim condensed consolidated financial statements, as well as an interim group management report (see Group Management Report), and was approved for publication by the Management Board on 5 November 2014.

Aareal Bank AG prepares its condensed interim consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs) applicable within the European Union (EU) as at the reporting date, in connection with the provisions pursuant to section 315a (1) of the German Commercial Code (Handelsgesetzbuch – "HGB"). In particular, the interim consolidated financial statements comply with the requirements for interim financial reporting set out in IAS 34. The reporting currency is the euro (€).

### Reporting entity structure

Subsidiaries of Aareal Bank AG are included in the consolidated financial statements by way of full consolidation. Companies over which Aareal Bank AG may exercise a significant influence ("associates") are included in the consolidated financial statements, using the equity method.

Aareal Finanz- und IT Beteiligungen GmbH (formerly Aareal IT Beteiligungen GmbH), Wiesbaden, a subsidiary of Aareal Bank AG, acquired all of the shares of COREALCREDIT BANK AG (Corealcredit), Frankfurt/Main, which specialises in commercial property financing in Germany. A corresponding agreement was concluded on 22 December 2013 with the previous owner, a fund owned by financial investor Lone Star (seller). The (provisional) cash purchase price amounted to € 343 million. The closing of the transaction was completed after the approval of the respective authorities and the fulfilment of additional conditions as at 31 March 2014. Accordingly, Aareal Bank Group obtained control over Corealcredit and included the acquired company in the consolidated financial statements of Aareal Bank Group as at 31 March 2014 (date of initial consolidation).

Through the acquisition of Corealcredit, Aareal Bank exploited an attractive opportunity for external growth at a favourable point in time. With this transaction, Aareal Bank further expands its position as one of the leading specialists in commercial property financing. The reasons for the business combination also include optimising the allocation of equity capital, as well as realising potential synergies which result from the combination of both companies, due to their very similar business models.

In accordance with IFRS 3, all identifiable assets and liabilities of the acquired entity have to be measured at their fair value at the time of acquisition (closing). These fair values also represent the amounts recognised upon initial consolidation. The excess of the net assets (i.e. the balance of assets and liabilities acquired and measured at fair value) over the (preliminary) purchase price paid is recognised as negative goodwill in the income statement, and directly increases the equity of Aareal Bank Group. This income currently amounts to € 152 million and is reported in the statement of comprehensive income in a separate item. This income primarily results from the utilisation of a favourable market environment for such transactions.

Since the transaction was only completed at the end of the first quarter 2014, the allocation of the purchase price in accordance with IFRS 3 and the related determination of the fair values for assets acquired and liabilities assumed are still provisional. There have been no material adjustments to the purchase price allocation since the date of initial consolidation. The final determination of fair values may yet give rise to material adjustments.

The following overview shows the provisional purchase price allocation in accordance with IFRS 3 at the time of acquisition:

| € mn | Fair value as at 31 Mar 2014 (preliminary) |
|---|---|
| Cash funds | 9 |
| Loans and advances to banks | 880 |
| Loans and advances to customers | 3,247 |
| Allowance for credit losses (portfolio-based) | -17 |
| Positive fair values of derivative hedging instruments and trading assets | 150 |
| Non-trading assets | 1,393 |
| Intangible assets | 2 |
| Property and equipment | 1 |
| Income tax assets | 30 |
| Deferred tax assets | 152 |
| Other assets | 105 |
| **Total assets acquired** | **5,952** |
| | |
| Liabilities to banks | 1,280 |
| Liabilities to customers | 2,024 |
| Certificated liabilities | 1,143 |
| Negative fair values of derivative hedging instruments and trading liabilities | 387 |
| Provisions incl. contingent liabilities | 371 |
| Income tax liabilities | 101 |
| Other liabilities | 14 |
| Subordinated capital | 137 |
| **Total liabilities assumed** | **5,457** |
| | |
| **Total net assets acquired** | **495** |
| Negative goodwill | 152 |
| **(Preliminary) purchase price paid** | **343** |

Taking into account the (preliminary) purchase price paid in the amount of € 343 million, the transaction led to an increase in total net assets, as shown in the consolidated statement of financial position, in the amount of the negative goodwill (currently: € 152 million).

The costs associated with the business combination amounted to € 9 million and were recognised as administrative expenses, predominantly in the 2013 financial year.

Within the scope of the acquisition of Corealcredit, Aareal Bank assumed legal, tax and credit risks. These risks were assessed on a conservative basis and have been hedged comprehensively in the financial statements. The obligations in connection with the risks assumed are recognised in the statement of financial position at fair value, in line with the related claims for reimbursement or recourse. Accordingly, recognition and measurement in the IFRS consolidated financial statements differ from recognition and measurement in the financial statements of Corealcredit prepared under the German Commercial Code. In the consolidated statement of financial position, the obligations as well as the claims for reimbursement or recourse are reported under Provisions, Income tax liabilities or Other assets, respectively.

The fair value of the claims for reimbursement or recourse existing to the seller as well as to third parties in relation to tax and legal risks amounted to € 79 million as at the acquisition date. The seller provided cash collateral in the amount of € 50 million to cover individual credit risks.

Ongoing litigation mainly refers to legal actions initiated by holders of Corealcredit profit-participation certificates in relation to loss assumption in the past, which – according to the plaintiffs – was unjustified. This has led to strongly reduced repayments compared to the nominal receivables at final maturity of the profit-participation certificates. Tax risks relate to risks from ongoing tax audits.

In the case of a positive outcome of the current legal disputes from the perspective of Aareal Bank AG, there may be compensation payments to the seller, in an amount between nil and € 73 million, which would lead to a utilisation of the provisions recognised for this purpose – with no effect on profit or loss. Concerning the part of the credit portfolio that was acquired subject to credit-related purchase price discounts, compensation payments to the seller may occur in the future, in an amount between nil and € 97 million plus interest; such payments would also be recognised directly in equity. The potential level of such compensation payments largely corresponds to the surplus amount of future borrower payments relative to the carrying amount of the corresponding accounts receivable. Compensation payments made to the seller to date (and recognised directly in equity) totalled € 9 million. The fair value of contingent consideration was € 2 million as at 30 September 2014.

The measurement of legal, tax and credit risks is subject to several uncertainties. One of the issues related to legal risks is the lack of comparable case law. As far as tax risks are concerned, there are discussions with tax audit about the assessment of underlying facts. The assessment of risks often requires significant estimates made by the management. The final amount of the cash outflows may deviate significantly from the measurement previously made in accounting. The time period and the actual amount of any potential cash outflows in connection with liabilities assumed cannot be determined exactly. It is expected that the majority of cash outflows will occur until the year-end 2017.

The fair value of the accounts receivable acquired as part of the business combination amounts to € 4.1 billion as at 31 March 2014, comprising € 3.2 billion in loans and advances to customers and € 0.9 billion in loans and advances to banks. The gross amount of these receivables' contractually agreed cash flows amounted to € 4.7 billion, comprising € 3.7 billion in loans and advances to customers and € 1.0 billion in loans and advances to banks. € 97 million of contractually-agreed cash flows from these loans and advances to customers are considered uncollectable.

The effects upon the income statement of the present interim consolidated financial statements are € 36 million in interest income and € 5 million in operating profit, both of which are attributable to Corealcredit. If the business combination had taken effect at the beginning of the period under review, Aareal Bank Group would probably have reported additional interest income in the amount of approximately € 17 million as well as additional operating profit of approximately € 3 million.

## Accounting policies

Unless specifically indicated otherwise, the accounting policies applied in the preparation of the consolidated financial statements 2013 were also applied in the preparation of these condensed interim consolidated financial statements, including the calculation of comparative figures.

The following financial reporting standards (IASs/IFRSs) and interpretations (SICs and IFRICs) were required to be applied for the first time in the reporting period:

### IFRS 10, IFRS 11, IFRS 12, IAS 27 and IAS 28

IFRS 10 replaces the guidance on control and consolidation included in IAS 27 Consolidated and Separate Financial Statements and SIC-12 Consolidation – Special Purpose Entities. The standard changes the definition of "control". According to the new definition, the same criteria are applied to all companies to determine whether a company controls an investee. The amendments to IFRS 10, which relate to investment entities, introduce new rules regarding the inclusion of controlled subsidiaries at investment entities. The application of IFRS 10 did not have any effects on the reporting entity structure of Aareal Bank in the reporting period.

IFRS 11 replaces IAS 31 Interests in Joint Ventures and SIC-13 Jointly Controlled Entities – Non-Monetary Contributions by Venturers that were previously applicable to the accounting for joint ventures. IFRS 11 governs the accounting for situations in which a company has joint control over a joint venture or a joint operation. The new standard eliminates the proportionate consolidation of joint ventures. In future, joint ventures will have to be accounted for using the equity method. In case of a joint operation, assets, liabilities, income and expenses directly attributable to the joint operator have to be recorded in the consolidated financial statements of that joint operator. The first-time application of IFRS 11 did not result in any adjustments required to be recorded within Aareal Bank Group.

IFRS 12 clarifies the disclosures required to be made by companies that apply the new standards IFRS 10 Consolidated Financial Statements and IFRS 11 Joint Arrangements. This standard replaces the disclosure requirements currently included in IAS 27, IAS 28 and IAS 31. The disclosure obligations set out in IFRS 12 are required to be applied to the fullest extent as at 31 December 2014.

**Amendments to IAS 32 – Offsetting Financial Assets and Financial Liabilities**

The amendments clarify some details in relation to offsetting financial assets and financial liabilities. As before, financial assets and financial liabilities are offset only when a company has a legally enforceable right to set off, and intends either to settle on a net basis or to realise the asset and settle the related liability simultaneously. The clarifications do not have any impact on the financial statements of Aareal Bank Group.

**Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)**

The amendments to IAS 39 provide companies with relief from provisions related to the discontinuation of hedge accounting. Changes to derivative contracts required as a result of the introduction of new laws or regulations, such as a switch to a central clearing counterparty, do not lead to a discontinuation of the hedging relationship in accordance with IAS 39. The amendments to IAS 39 have not had any material consequences for the financial statements of Aareal Bank Group.

**IFRIC 21**

IFRIC 21 Levies is an interpretation of IAS 37 Provisions, Contingent Liabilities and Contingent Assets and states that a company is not obliged to recognise levies imposed by government until the activity that gives rise to a levy by law has occurred. The first-time application of IFRIC 21 does not have any impact on the financial statements of Aareal Bank Group.

## Notes to the Statement of Comprehensive Income

### (1) Net interest income

| € mn | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 |
|---|---|---|
| Interest income from | | |
| Property loans | 597 | 492 |
| Public-sector loans | 11 | 13 |
| Other lending and money market operations | 66 | 44 |
| Debt and other fixed-income securities | 71 | 75 |
| Current dividend income | – | 0 |
| **Total interest income** | **745** | **624** |
| Interest expenses for | | |
| Bonds issued | 78 | 80 |
| Registered mortgage bonds | 25 | 21 |
| Promissory note loans | 60 | 67 |
| Subordinated capital | 24 | 17 |
| Term deposits | 29 | 40 |
| Payable on demand | 19 | 18 |
| Other interest expenses | 16 | 1 |
| **Total interest expenses** | **251** | **244** |
| **Total** | **494** | **380** |

### (2) Allowance for credit losses

| € mn | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 |
|---|---|---|
| Additions | 143 | 95 |
| Reversals | 29 | 23 |
| Direct write-offs | 3 | 6 |
| Recoveries on loans and advances previously written off | 12 | 4 |
| **Total** | **105** | **74** |

The additions to the allowance for credit losses include an amount of € 32 million related to the recognition of portfolio-based valuation allowances. The recognition of these valuation allowances is attributable, among others, to a change in measurement parameters used for the determination of the portfolio-based valuation allowance and, to that extent, is largely a one-off effect. Our forecast for the entire financial year (€ 100 million to € 150 million) is not affected by this one-off effect. Please also refer to our explanations in Note (12).

### (3) Net commission income

| € mn | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 |
|---|---|---|
| Commission income from | | |
| Consulting and other services | 125 | 122 |
| Trustee loans and administered loans | 2 | 2 |
| Securities transactions | – | – |
| Other lending and money market operations | 6 | 7 |
| Other commission income | 4 | 5 |
| **Total commission income** | **137** | **136** |
| Commission expenses for | | |
| Consulting and other services | 15 | 15 |
| Trustee loans and administered loans | – | – |
| Securities transactions | 1 | 1 |
| Securitisation transactions | – | – |
| Other lending and money market transactions | 1 | 1 |
| Other commission expenses | 4 | 2 |
| **Total commission expenses** | **21** | **19** |
| **Total** | **116** | **117** |

Commissions from consulting and services primarily include commissions for IT services.

### (4) Net result on hedge accounting

| € mn | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 |
|---|---|---|
| Ineffective portion of fair value hedges | -1 | -1 |
| Ineffective portion of cash flow hedges | 4 | -2 |
| Ineffective portion of net investment hedges | 0 | 0 |
| **Total** | **3** | **-3** |

### (5) Net trading income/expenses

| € mn | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 |
|---|---|---|
| Net income/expenses from positions held for trading | 8 | 12 |
| Currency translation | -9 | 2 |
| **Total** | **-1** | **14** |

Net trading income/expenses was primarily attributable to the measurement of derivatives used to hedge interest rate and currency risks.

### (6) Results from non-trading assets

| € mn | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 |
|---|---|---|
| Result from debt securities and other fixed-income securities | 0 | -8 |
| of which: Loans and receivables (LaR) | 0 | -8 |
| Held to maturity (HtM) | – | – |
| Available for sale (AfS) | 0 | – |
| Result from equities and other non-fixed income securities | 0 | 0 |
| of which: Available for sale (AfS) | 0 | – |
| Designated as at fair value through profit or loss (dFVtPL) | 0 | 0 |
| Results from equity investments (AfS) | 0 | – |
| **Total** | **0** | **-8** |

### (7) Administrative expenses

| € mn | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 |
|---|---|---|
| Staff expenses | 192 | 167 |
| Other administrative expenses | 117 | 94 |
| Depreciation, amortisation and impairment of property and equipment and intangible assets | 16 | 15 |
| **Total** | **325** | **276** |

### (8) Net other operating income/expenses

| € mn | 1 Jan-30 Sep 2014 | 1 Jan-30 Sep 2013 |
|---|---|---|
| Income from properties | 11 | 13 |
| Income from the reversal of provisions | 1 | 0 |
| Income from goods and services | 2 | 2 |
| Miscellaneous | 28 | 9 |
| **Total other operating income** | **42** | **24** |
| Expenses for properties | 14 | 7 |
| Expenses for services used | 0 | 0 |
| Write-downs of trade receivables | 0 | 0 |
| Expenses for other taxes | 3 | 2 |
| Miscellaneous | 11 | 25 |
| **Total other operating expenses** | **28** | **34** |
| **Total** | **14** | **-10** |

Miscellaneous other operating income includes one-off income in the amount of € 18 million from the reversal of provisions for settlement risks.

### (9) Negative goodwill from the acquisition of Corealcredit

Further information is included in the section "Reporting entity structure" in the notes to the consolidated financial statements.

## Notes to the Statement of Financial Position

### (10) Loans and advances to banks

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Money market receivables | 1,553 | 2,373 |
| Promissory note loans | 121 | 122 |
| Securities repurchase agreements | 1,608 | – |
| Other loans and advances | 21 | 36 |
| **Total** | **3,303** | **2,531** |

Loans and advances to banks are allocated to the measurement category "Loans and receivables" (LaR).

### (11) Loans and advances to customers

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Property loans | 28,411 | 23,848 |
| Promissory note loans | 1,531 | 1,435 |
| Other loans and advances | 1,115 | 641 |
| **Total** | **31,057** | **25,924** |

Loans and advances to customers are allocated to the measurement category "Loans and receivables" (LaR).

The increase in property loans mainly results from the consolidation of Corealcredit Bank AG as at 31 March 2014. In connection with the assets acquired and liabilities assumed within the context of the acquisition of the company, please refer to our statements in the section "Reporting entity structure" in the notes to the consolidated financial statements.

## (12) Allowance for credit losses

### 30 September 2014

| € mn | Specific valuation allowances | Portfolio impairment allowance | Total allowance for credit losses for recognised items | Provisions in the lending business for unrecognised items | Total allowance for credit losses and provisions in the lending business |
|---|---|---|---|---|---|
| **Allowance for credit losses as at 1 January** | **296** | **65** | **361** | **10** | **371** |
| Additions | 111 | 32 | **143** | 0 | **143** |
| Write-downs | 39 | – | **39** | – | **39** |
| Reversals | 29 | – | **29** | 1 | **30** |
| Unwinding | 11 | – | **11** | – | **11** |
| Changes in basis of consolidation | – | 17 | **17** | 3 | **20** |
| Currency adjustments | 2 | 0 | **2** | 0 | **2** |
| **Balance as at 30 September** | **330** | **114** | **444** | **12** | **456** |

### 31 December 2013

| € mn | Specific valuation allowances | Portfolio impairment allowance | Total allowance for credit losses for recognised items | Provisions in the lending business for unrecognised items | Total allowance for credit losses and provisions in the lending business |
|---|---|---|---|---|---|
| **Allowance for credit losses as at 1 January** | **218** | **84** | **302** | **18** | **320** |
| Additions | 151 | – | **151** | 0 | **151** |
| Write-downs | 50 | – | **50** | 3 | **53** |
| Reversals | 9 | 19 | **28** | 5 | **33** |
| Unwinding | 12 | – | **12** | – | **12** |
| Changes in basis of consolidation | – | – | **–** | – | **–** |
| Currency adjustments | -2 | 0 | **-2** | – | **-2** |
| **Balance as at 31 December** | **296** | **65** | **361** | **10** | **371** |

The allowance for risks associated with unrecognised items relates to loans and advances to customers and loans and advances to banks classified as "Loans and receivables" (LaR). These allowances are reported under allowance for credit losses on the asset side of the statement of financial position. The provisions recognised for risks associated with unrecognised items relate to contingent liabilities and loan commitments. These provisions are reported under provisions on the liability side of the statement of financial position.

The addition to the portfolio-based valuation allowance (additions) is mainly attributable to a harmonisation related to the inclusion of the so-called LIP factor (LIP – Loss Identification Period). While different

LIP factors were used until 31 December 2013 for each exposure class in the context of the determination of the portfolio-based valuation allowance, the LIP factor has been generally harmonised to 1 for all exposure classes as at 31 March 2014. The effect from the adjustment of the LIP factor amounts to € 35 million. The forecast in relation to the allowance for credit losses for the entire financial year (€ 100 million to € 150 million) is not affected by this.

The increase in the balance of portfolio-based valuation allowances (changes in basis of consolidation) results from the initial consolidation of Corealcredit as at 31 March 2014. In connection with the assets acquired and liabilities assumed within the context of the acquisition of the company, please refer to our statements in the section ”Reporting entity structure” in the notes to the consolidated financial statements.

### (13) Trading assets

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Positive market value of trading assets | 411 | 307 |
| **Total** | **411** | **307** |

Trading assets are allocated to the measurement category ”Held for trading” (HfT). They are mainly used to hedge economic market price risks.

### (14) Finanzanlagen

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Debt and other fixed-income securities | 11,996 | 10,647 |
| of which: Loans and receivables (LaR) | 4,217 | 4,259 |
| Held to maturity (HtM) | 1,056 | – |
| Available for sale (AfS) | 6,723 | 6,388 |
| Equities and other non-fixed income securities | 20 | 20 |
| of which: Available for sale (AfS) | 20 | 20 |
| Designated as at fair value through profit or loss (dFVtPL) | – | – |
| Interests in affiliated companies (AfS) | – | – |
| Other investments (AfS) | 2 | 1 |
| **Total** | **12,018** | **10,668** |

The item ”Debt and other fixed-income securities” mainly consists of public-sector bonds as well as asset-covered bonds (Pfandbriefanleihen) and bank bonds.

This rise in debt and other fixed-income securities mainly results from the consolidation of Corealcredit as at 31 March 2014. In connection with the assets acquired and liabilities assumed within the context of the acquisition of the company, please refer to our statements in the section ”Reporting entity structure” in the notes to the consolidated financial statements.

### (15) Intangible assets

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Goodwill | 66 | 66 |
| Proprietary software | 13 | 14 |
| Other intangible assets | 26 | 27 |
| **Total** | **105** | **107** |

### (16) Property and equipment

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Land and buildings and construction in progress | 76 | 77 |
| Office furniture and equipment | 21 | 21 |
| **Total** | **97** | **98** |

### (17) Other assets

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Properties | 434 | 413 |
| Trade receivables (LaR) | 26 | 34 |
| Miscellaneous | 131 | 65 |
| **Total** | **591** | **512** |

### (18) Liabilities to banks

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Money market liabilities | 1,659 | 838 |
| Promissory note loans | 388 | 385 |
| Registered mortgage Pfandbriefe | 353 | 254 |
| Registered public-sector Pfandbriefe | 41 | 46 |
| Other liabilities | 48 | 66 |
| **Total** | **2,489** | **1,589** |

Liabilities to banks are allocated to the measurement category ”Liabilities measured at amortised cost” (LaC).

### (19) Liabilities to customers

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Money market liabilities | 13,191 | 11,779 |
| Promissory note loans | 8,144 | 7,802 |
| Registered mortgage Pfandbriefe | 3,490 | 3,186 |
| Registered public-sector Pfandbriefe | 3,018 | 2,709 |
| **Total** | **27,843** | **25,476** |

Liabilities to customers are allocated to the measurement category "Liabilities measured at amortised cost" (LaC).

The increase in liabilities to customers mainly results from the consolidation of Corealcredit as at 31 March 2014. In connection with the assets acquired and liabilities assumed within the context of the acquisition of the company, please refer to our statements in the section "Reporting entity structure" in the notes to the consolidated financial statements.

### (20) Certificated liabilities

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Bearer mortgage Pfandbriefe | 8,576 | 7,179 |
| Bearer public-sector Pfandbriefe | 30 | 35 |
| Other debt securities | 2,682 | 2,910 |
| **Total** | **11,288** | **10,124** |

Certificated liabilities are allocated to the measurement category "Liabilities measured at amortised cost" (LaC).

The increase in bearer mortgage Pfandbriefe mainly results from the consolidation of Corealcredit. In connection with the assets acquired and liabilities assumed within the context of the acquisition of the company, please refer to our statements in the section "Reporting entity structure" in the notes to the consolidated financial statements.

### (21) Trading liabilities

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Negative market value of trading assets | 646 | 286 |
| **Total** | **646** | **286** |

Trading liabilities are allocated to the measurement category "Held for trading" (HfT). They are mainly used to hedge economic market price risks.

### (22) Provisions

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Provisions for pensions and similar obligations | 270 | 148 |
| Other provisions, including contingent liabilities [1] | 403 | 141 |
| **Total** | **673** | **289** |

[1] The contingent liabilities recognised in connection with the acquisition of Corealcredit, pursuant to IFRS 3.23, amounted to € 33 million as at 30 September 2014 (date of initial consolidation – 31 March 2014: € 38 million).

The increase in provisions for pensions and similar obligations as well as the increase in other provisions mainly results from the consolidation of Corealcredit. In connection with the provisions and contingent liabilities assumed and recognised within the context of the acquisition of the company, please refer to our statements in the section "Reporting entity structure" in the notes to the consolidated financial statements.

### (23) Other liabilities

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Liabilities from outstanding invoices | 3 | 8 |
| Deferred income | 10 | 11 |
| Liabilities from other taxes | 32 | 29 |
| Trade payables (LaC) | 13 | 9 |
| Other liabilities (LaC) | 105 | 146 |
| **Total** | **163** | **203** |

### (24) Subordinated capital

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Subordinated liabilities | 1,125 | 524 |
| Profit-participation certificates | 73 | 166 |
| Contributions by silent partners [1] | 193 | 226 |
| **Total** | **1,391** | **916** |

[1] The silent participation by SoFFin is classified as equity in accordance with IFRSs; it is therefore not reported under contributions by silent partners, but as a separate item in equity.

Items of subordinated capital are allocated to the measurement category ”Liabilities measured at amortised cost” (LaC).

The Bank issued subordinated liabilities in the nominal amount of € 0.5 billion during the period under review.

The increase in subordinated liabilities is additionally due to the consolidation of Corealcredit. In connection with the assets acquired and liabilities assumed within the context of the acquisition of that company, please refer to our statements in the section ”Reporting entity structure” in the notes to the consolidated financial statements.

### (25) Equity

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Subscribed capital | 180 | 180 |
| Capital reserves | 721 | 721 |
| Retained earnings | 1,322 | 1,112 |
| Other reserves | | |
| Reserve from remeasurements of defined benefit plans | -76 | -40 |
| Revaluation reserve | 14 | -50 |
| Hedging reserves | -3 | -17 |
| Currency translation reserves | 4 | 2 |
| Silent participation by SoFFin | 300 | 300 |
| Non-controlling interests | 242 | 242 |
| **Total** | **2,704** | **2,450** |

### (26) Treasury shares

No treasury shares were held during the period under review.

### (27) Dividends

The Annual General Meeting of Aareal Bank AG on 21 May 2014 resolved to pay a dividend of € 0.75 per no-par value share, totalling € 44,892,915.75, from net retained profit (Bilanzgewinn) of € 49,892,915.75 as reported under the German Commercial Code (HGB) for the financial year 2013. The Annual General Meeting also resolved to transfer the remaining distributable profit of € 5,000,000.00 to Other retained earnings.

Within Aareal Bank Group's consolidated statement of financial position, a dividend payment reduces the retained earnings item within consolidated equity.

## Reporting on Financial Instruments

### (28) Presentation of the fair value hierarchy in accordance with IFRS 13

The following table shows the carrying amounts of financial instruments held by Aareal Bank Group which are reported at fair value in the statement of financial position, according to the three-tier fair value hierarchy pursuant to IFRS 13.72 et seq. The classification into the individual hierarchy levels is based on the inputs used for fair value measurement.

**30 September 2014**

| € mn | Fair value total | Fair value level 1 | Fair value level 2 | Fair value level 3 |
|---|---|---|---|---|
| **Positive market value of derivative hedging instruments** | **2,387** | **–** | **2,387** | **–** |
| **Assets held for trading** | **411** | **–** | **411** | **–** |
| Trading derivatives | 411 | – | 411 | – |
| **Non-trading assets available for sale** | **6,743** | **6,663** | **80** | **–** |
| Fixed-income securities | 6,723 | 6,660 | 63 | – |
| Equities/funds | 20 | 3 | 17 | – |
| **Negative market value of derivative hedging instruments** | **2,551** | **–** | **2,551** | **–** |
| **Liabilities held for trading** | **646** | **–** | **646** | **–** |
| Trading derivatives | 646 | – | 646 | – |

**31 December 2013**

| € mn | Fair value total | Fair value level 1 | Fair value level 2 | Fair value level 3 |
|---|---|---|---|---|
| **Positive market value of derivative hedging instruments** | **1,838** | **–** | **1,838** | **–** |
| **Assets held for trading** | **307** | **–** | **307** | **–** |
| Trading derivatives | 307 | – | 307 | – |
| **Non-trading assets available for sale** | **6,408** | **6,318** | **90** | **–** |
| Fixed-income securities | 6,388 | 6,315 | 73 | – |
| Equities/funds | 20 | 3 | 17 | – |
| **Negative market value of derivative hedging instruments** | **1,603** | **–** | **1,603** | **–** |
| **Liabilities held for trading** | **286** | **–** | **286** | **–** |
| Trading derivatives | 286 | – | 286 | – |

The fair value of financial instruments is allocated to Level 1 of the fair value hierarchy if it is determined on the basis of unadjusted quoted prices in active markets for identical assets or liabilities. The determination of the fair value is based on the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. Another factor to be taken into account is whether Aareal Bank can enter into a transaction for the relevant asset or liability at the price in that market at the measurement date.

Fair values determined using inputs other than quoted prices included within Level 1 that are observable for the financial instrument, either directly or indirectly, are included in Level 2 of the fair value hierarchy. Financial instruments whose fair value is allocated to Level 2 of the fair value hierarchy are measured using various valuation techniques.

In the case of fixed-income securities or equities for which no current market price is available, the fair value is determined on the basis of comparable market prices to the extent possible. To this end, quoted prices on active markets for largely identical securities, or quoted prices on inactive markets for identical or similar securities, are used by adjusting the last available market price or the current fair value of another largely identical instrument, to take into account any changes in risk or new information known as at the measurement date. In the absence of comparable market prices for securities, they are measured through an analysis of future payments using the fully-capitalised earnings value approach, where the inputs are based on observable market data. These approaches include the discounted cash flow (DCF) method which is used to determine the present value of contractual cash flows until the expected end of the term. The present value is determined based on the benchmark curve applicable for the relevant market, taking into account mark-ups based on credit quality and liquidity. The valuation model used for options included in the transaction is the commonly used Black-Scholes model, or appropriate numerical procedures.

The fair value of OTC derivatives included in the trading portfolio as well as of OTC hedging derivatives is determined on the basis of sector-specific standardised measurement models, such as the present value method or option pricing models. These techniques are based on inputs quoted on active markets, such as interest rates, yield curves and credit spreads. The fair value of foreign exchange forwards is generally based on current forward exchange rates quoted on active markets. Fair values determined using valuation techniques where one or more material inputs are not based on observable market data are assigned to Level 3 of the fair value hierarchy. Products that are allocated to this level are currently not held by Aareal Bank Group.

In the first nine months of 2014, there were no transfers between the hierarchy levels for the various financial instruments.

Aareal Bank reviews the allocation of a financial instrument in the fair value hierarchy on the previous year's balance sheet date of the preceding quarter in comparison with the allocation on the current reporting date, to determine whether reclassifications occurred between the individual levels of the fair value hierarchy. The date for recognising reclassifications into the hierarchy levels and for recognising reclassifications from the hierarchy levels is the same.

### (29) Comparison of carrying amounts and fair values of the financial instruments

The following table is a comparison of the fair values of the financial instruments with their carrying amounts. The presentation is made for each class of financial instrument.

| € mn | Carrying amount 30 Sep 2014 | Fair value 30 Sep 2014 | Carrying amount 31 Dec 2013 | Fair value 31 Dec 2013 |
|---|---|---|---|---|
| **Cash on hand and balances with central banks** | **78** | **78** | **1,222** | **1,222** |
| Loans and advances to banks (LaR) | 3,303 | 3,303 | 2,531 | 2,530 |
| Loans and advances to customers (LaR) | 30,613 | 32,633 | 25,563 | 27,298 |
| Non-trading assets (LaR) | 4,217 | 4,056 | 4,259 | 4,018 |
| Other assets (LaR) | 74 | 82 | 62 | 67 |
| **Total loans and receivables** | **38,207** | **40,074** | **32,415** | **33,913** |
| **Non-trading assets held to maturity** | **1,056** | **1,059** | **–** | **–** |
| **Non-trading assets available for sale** | **6,743** | **6,743** | **6,408** | **6,408** |
| **Positive market value of derivative hedging instruments** | **2,387** | **2,387** | **1,838** | **1,838** |
| **Assets held for trading** | **411** | **411** | **307** | **307** |
| Liabilities to banks (LaC) | 2,489 | 2,502 | 1,589 | 1,601 |
| Liabilities to customers (LaC) | 27,843 | 27,849 | 25,476 | 25,412 |
| Certificated liabilities (LaC) | 11,288 | 11,391 | 10,124 | 10,192 |
| Other liabilities (LaC) | 121 | 122 | 163 | 156 |
| Subordinated capital (LaC) | 1,391 | 1,419 | 916 | 914 |
| **Total liabilities measured at amortised cost** | **43,132** | **43,283** | **38,268** | **38,275** |
| **Negative market value of derivative hedging instruments** | **2,551** | **2,551** | **1,603** | **1,603** |
| **Liabilities held for trading** | **646** | **646** | **286** | **286** |
| **Financial guarantee contracts** | **88** | **88** | **120** | **120** |
| **Loan commitments** | **1,406** | **1,406** | **1,852** | **1,852** |

### (30) Day-one profit or loss

Aareal Bank Group has entered into transactions that were not effected on the principal market or the most advantageous market for the asset or liability concerned. In these cases the transaction price does not correspond to the fair value of the asset or liability, because the determination of the fair value using a valuation technique which assumes a transaction on a principal market results in a fair value that deviates from the transaction price. The financial instruments are carried at the transaction price upon initial recognition. The difference between the transaction price and the fair value measured based on the valuation model (the so-called day-one profit or loss) is amortised over the term of the transaction in the income statement, since the fair value of these financial instruments of the trading portfolio is determined using valuation models whose inputs are not fully based on observable market factors.

The table below shows the development of the day-one profit during the quarter under review. The day-one profit is recognised as an item to be deducted from the carrying amount of trading assets:

| € mn | 2014 | 2013 |
|---|---|---|
| **Balance as at 1 January** | **27** | **10** |
| Additions from new transactions | 11 | 14 |
| Reversals through profit or loss in the period | 6 | 3 |
| Changes in basis of consolidation | 9 | – |
| **Balance as at 30 September** | **41** | **21** |

### (31) Reclassification of financial assets

In 2008 and 2009, Aareal Bank Group took advantage of the opportunity to reclassify certain financial assets into another measurement category. Specifically, securities with an aggregate volume of € 6.2 billion were reclassified from the IFRS measurement categories ”Available for sale” (AfS) and ”Held for trading” (HfT), to ”Loans and receivables” (LaR). In all cases, we opted for reclassification since there was no longer an active market for the securities concerned (in spite of their good quality), and due to our intention to hold these issues for a longer term. Depending on prevailing market conditions, Aareal Bank Group may use this reclassification option again in the future.

The following table compares the carrying amounts of the reclassified assets to their fair values:

| € mn | Carrying amount 30 Sep 2014 | Fair value 30 Sep 2014 | Carrying amount 31 Dec 2013 | Fair value 31 Dec 2013 |
|---|---|---|---|---|
| **from AfS to LaR** | **3,848** | **3,665** | **3,849** | **3,600** |
| Asset-backed securities | 27 | 28 | 27 | 27 |
| Senior unsecured bank bonds | 300 | 306 | 372 | 380 |
| Covered bank bonds | 429 | 449 | 495 | 509 |
| Public-sector issuers | 3,092 | 2,882 | 2,955 | 2,684 |
| **from HfT to LaR** | **105** | **111** | **121** | **115** |
| Asset-backed securities | 105 | 111 | 121 | 115 |
| **Total** | **3,953** | **3,776** | **3,970** | **3,715** |

If the Bank had not opted for reclassification, this would have resulted in a € 12 million profit (before tax) for the first nine months of the current financial year (9m 2013: profit of € 27 million), and € 46 million (after tax) (previous year: € 87 million) would have been recognised in the revaluation surplus.

### (32) Bond and property financing portfolio in selected European countries

The following table is a breakdown of the bonds issued by public-sector entities and bank bonds of selected European countries, included in non-trading assets:

**Bond portfolio as at 30 September 2014**

| | Carrying amount | | | Revaluation reserve[1] | | | Unrealised gains / losses[1] |
|---|---|---|---|---|---|---|---|
| € mn | LaR + HtM | AfS | Total | LaR | AfS | Total | |
| Greece | – | – | **–** | – | – | **–** | – |
| Ireland | – | – | **–** | – | – | **–** | – |
| Italy | 1,190 | 726 | **1,916** | -45 | 10 | **-35** | -99 |
| Portugal | 66 | 185 | **251** | 0 | 0 | **0** | -7 |
| Spain | 679 | 209 | **888** | -3 | 6 | **3** | -28 |
| **Total** | **1,935** | **1,120** | **3,055** | **-48** | **16** | **-32** | **-134** |
| Total as at 31 Dec 2013 | 1,834 | 952 | **2,786** | -51 | -22 | **-73** | -177 |

[1] figures given on an after-tax basis

The revaluation surplus for bonds of the "Loans and receivables" (LaR) category is attributable to securities which were reclassified in the years 2008 and 2009 from the measurement category "Available for sale" (AfS) to the measurement category "Loans and receivables" (LaR). Unrealised gains and losses refer to securities accounted for amortised cost (LaR + HtM). When determining such unrealised gains and losses, the effects from interest rate-driven measurement of hedged securities were taken into account.

The maturities of the bonds set out above are mainly within the long-term range.

The presented AfS securities with a carrying amount of € 1,120 million (31 Dec 2013: € 939 million) were allocated to Level 1 of the fair value hierarchy pursuant to IFRS 7 and measured based on quoted prices on active markets. No Level 2 securities were allocated to the fair value hierarchy as at the current record date (31 December 2013: € 13 million). No quoted market prices of the fair value hierarchy level 1 were available for Level 2 securities as at the balance sheet date, however, measurement is also directly or indirectly based on observable market prices. Aareal Bank Group does not hold securities measured according to Level 3 of the fair value hierarchy.

The following table is a breakdown of property financing in selected European countries included in loans and advances to customers:

**Property financing portfolio as at 30 September 2014**

| | Carrying amount[1] | Average LTV | Non-performing loans |
|---|---|---|---|
| | € mn | % | € mn |
| Greece | – | | – |
| Ireland | – | | – |
| Italy | 3,120 | 72,1 | 500 |
| Portugal | – | | – |
| Spain | 1,060 | 88,0 | 79 |
| **Total** | **4,180** | | **579** |
| Total as at 31 Dec 2013 | 4,174 | | 515 |

[1] Not including valuation allowances

## Other Notes

### (33) Contingent liabilities and loan commitments

| € mn | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Contingent liabilities on guarantees and indemnity agreements | 88 | 120 |
| Loan commitments | 1,406 | 1,852 |
| of which: irrevocable | 875 | 1,328 |

### (34) Employees

The number of Aareal Bank Group employees at 30 September 2014 is shown below:

| | 30 Sep 2014 | 31 Dec 2013 |
|---|---|---|
| Salaried employees | 2,415 | 2,251 |
| Executives | 145 | 124 |
| **Total** | **2,560** | **2,375** |
| of which: Part-time employees | 444 | 423 |

The increase in the number of employees mainly results from the consolidation of Corealcredit as at 31 March 2014.

The average number of Aareal Bank Group employees in 2014 is shown below:

| | 1 Jan-30 Sep 2014 | 1 Jan-30 Dec 2013 |
|---|---|---|
| Salaried employees | 2,367 | 2,196 |
| Executives | 139 | 123 |
| **Total** | **2,506** | **2,319** |
| of which: Part-time employees | 433 | 427 |

### (35) Related party disclosures in accordance with IAS 24

In the first nine months of the 2014 financial year there were no material transactions with related parties that would have to be reported here.

**(36) Events after the interim reporting period**

Having obtained approval from the German Federal Financial Supervisory Authority (BaFin) on 30 October 2014 to repay the silent participation provided by the German Financial Markets Stabilisation Fund (SoFFin) in full, Aareal Bank repaid the residual amount of € 300 million to SoFFin on the same date. In accordance with the repayment agreement, Aareal Bank will additionally pay interest accruing until the repayment date on the next regular maturity date on 31 March 2015 to SoFFin. Furthermore, in line with existing contractual stipulations, the agreement provides for a pro rata temporis share due to SoFFin in any dividends distributed by Aareal Bank, by way of a dividend-linked additional payment for the 2014 financial year. With the full repayment of the silent participation, SoFFin's support to Aareal Bank has therefore come to an end.

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

## Executive Bodies of Aareal Bank AG

### Supervisory Board

**Marija G. Korsch [1) 2) 3) 4) 5)], Frankfurt/Main**
Chairman of the Supervisory Board
Former partner of Bankhaus Metzler seel.
Sohn & Co. Holding AG

**Erwin Flieger [1) 2) 4) 5)], Geretsried**
Deputy Chairman of the Supervisory Board
Chairman of the Supervisory Boards of
Bayerische Beamten Versicherungsgruppe

**York-Detlef Bülow [1) 2) 3) 6)], Messel**
Deputy Chairman of the Supervisory Board
Aareal Bank AG

**Christian Graf von Bassewitz [3) 4) 5)], Hamburg**
Banker (ret'd.); former Spokesman of the General
Partners of Bankhaus Lampe KG

**Manfred Behrens, Scharbeutz**
CEO/Chairman of the Management Board of
Swiss Life Deutschland Holding GmbH
(until 31 March 2014)

**Thomas Hawel [6)], Saulheim**
Aareon Deutschland GmbH

**Dieter Kirsch [2) 4) 6)], Nackenheim**
Aareal Bank AG

**Dr. Herbert Lohneiß [4) 5)], Gräfelfing**
Former Chief Executive Officer of
Siemens Financial Services GmbH (ret'd)

**Joachim Neupel [3) 4) 5)], Dreieich**
Chairman of the Audit Committee
German Chartered Accountant, tax consultant

**Richard Peters, Kandel**
President and Chairman of the Management Board
of Versorgungsanstalt des Bundes und der Länder

**Prof. Dr. Stephan Schüller [1) 2) 3)], Hamburg**
Spokesman of the General Partners of
Bankhaus Lampe KG

**Helmut Wagner [6)], Hahnheim**
Aareon Deutschland GmbH

### Management Board

**Dr Wolf Schumacher**
Chairman of the Management Board

**Dagmar Knopek**
Member of the Management Board

**Hermann Josef Merkens**
Member of the Management Board

**Thomas Ortmanns**
Member of the Management Board

[1)] Member of the Executive and Nomination Committee; [2)] Member of the Remuneration Control Committee; [3)] Member of the Audit Committee;
[4)] Member of the Risk Committee; [5)] Member of the Committee for Urgent Decisions; [6)] Employee representative

# Offices

## Wiesbaden Head Office

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## Structured Property Financing

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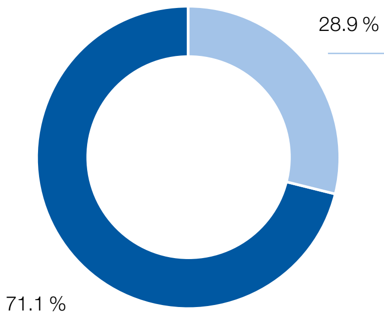
# Shareholder Structure | Financial Calendar

## Shareholder Structure

■ Free float ■ Aareal Holding Verwaltungsgesellschaft mbH



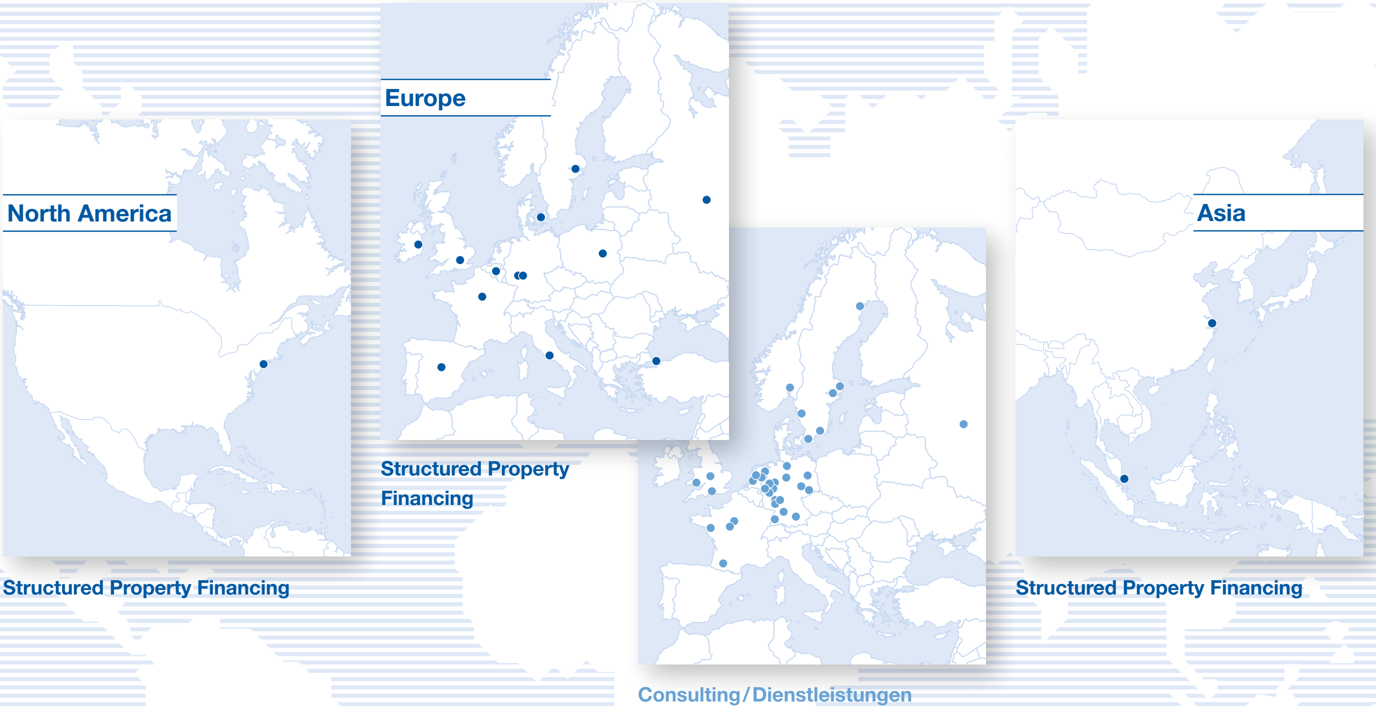

| | |
|---|---|
| 6.9 % | Bayerische Beamten-Lebensversicherung a.G. |
| 6.9 % | Swiss Life AG |
| 5.2 % | Versorgungsanstalt des Bundes und der Länder |
| 4.7 % | Dr. August Oetker Finanzierungs- und Beteiligungs-Gesellschaft mbH |
| 2.7 % | Basler Lebensversicherungs-AG und Basler Sachversicherungs-AG |
| 1.4 % | Deutscher Ring Krankenversicherungsverein a.G. |
| 1.1 % | Condor-Lebensversicherungs Aktiengesellschaft |

as of 30 September 2014

## Financial Calendar

| | |
|---|---|
| 25 February 2015 | Presentation of preliminary results for the 2014 financial year |
| 27 March 2015 | Presentation of annual report as of 31 December 2014 |
| 7 May 2015 | Presentation of interim report as of 31 March 2015 |
| 20 May 2015 | Annual General Meeting – Kurhaus, Wiesbaden |
| 11 August 2015 | Presentation of interim report as of 30 June 2015 |
| 10 November 2015 | Presentation of interim report as of 30 September 2015 |

# Locations




**Aareal Bank, Real Estate Structured Finance:** Brussels, Copenhagen, Dublin, Istanbul, London, Madrid, Moscow, New York, Paris, Rome, Shanghai, Singapore, Stockholm, Warsaw, Wiesbaden | **Aareal Valuation GmbH:** Wiesbaden | **Aareal Estate AG:** Wiesbaden | **Corealcredit Bank AG:** Frankfurt/Main

**Aareal Bank, Housing Unit:** Berlin, Essen, Hamburg, Leipzig, Munich, Stuttgart, Wiesbaden | **Aareon AG:** Berlin, Coventry, Dortmund, Emmen, Enschede, Essen, Gorinchem, Hamburg, Hilversum, Hückelhoven, Karlskrona, Leipzig, Lund, Mainz, Meudon-la-Forêt, Mölndal, Munich, Nantes, Norrtälje, Orléans, Oslo, Piteå, Southampton, Stockholm, Stuttgart, Swansea, Toulouse | **Deutsche Bau- und Grundstücks-AG:** Berlin, Bonn, Dresden, Frankfurt/Main, Freiburg, Hannover, Leipzig, Moscow, Munich, Wuppertal | **Aareal First Financial Solutions AG:** Mainz

as of 30 September 2014

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11/2014

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