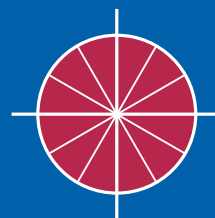

ANNUAL REPORT
AAREAL BANK AG
2006



2006



Aareal Bank

KEY FIGURES

	2006	2005	Change	Change
Income Statement	€ mn	€ mn	€ mn	
Operating profit	107	-46	153	
Profit before taxes	179	17	162	
Net income	117	-33	150	
Portfolio data (31 December)	€ mn	€ mn	€ mn	%
Property financing	20,573	19,087	1,486	8
of which international	13,932	10,747	3,185	30
Shareholder's equity	1,289	1,185	104	9
Total assets	39,513	37,396	2,117	6

	31 Dec 2006	31 Dec 2005
Regulatory indicators ¹⁾	%	%
Core capital ratio (German Banking Act)	7.5	8.3
Total capital ratio (German Banking Act)	13.3	14.7
Rating		
Fitch Ratings, London		
Long-term	A-	BBB+
Short-term	F2	F2

¹⁾ Based on the confirmed financial statements

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MANAGEMENT REPORT

2006 was a very challenging and successful financial year for Aareal Bank AG, the parent company of Aareal Bank Group. The operative implementation of the strategic realignment, which was set out in a six-point programme, was concluded ahead of schedule. The systematic and risk-adequate expansion of new business, the sustained reduction of the NPL portfolio and consistent focus on our core expertise in particular, contributed to the significant improvement in the bank's economic position. The positive outcome was reflected amongst other things, in the restoration of the bank's ability to pay a dividend for 2006, and Fitch Ratings' upgrade of our bank rating to A-.

Business and environment

Corporate structure and business activities

Aareal Bank AG is one of the leading international specialist property banks and the parent company of Aareal Bank Group.

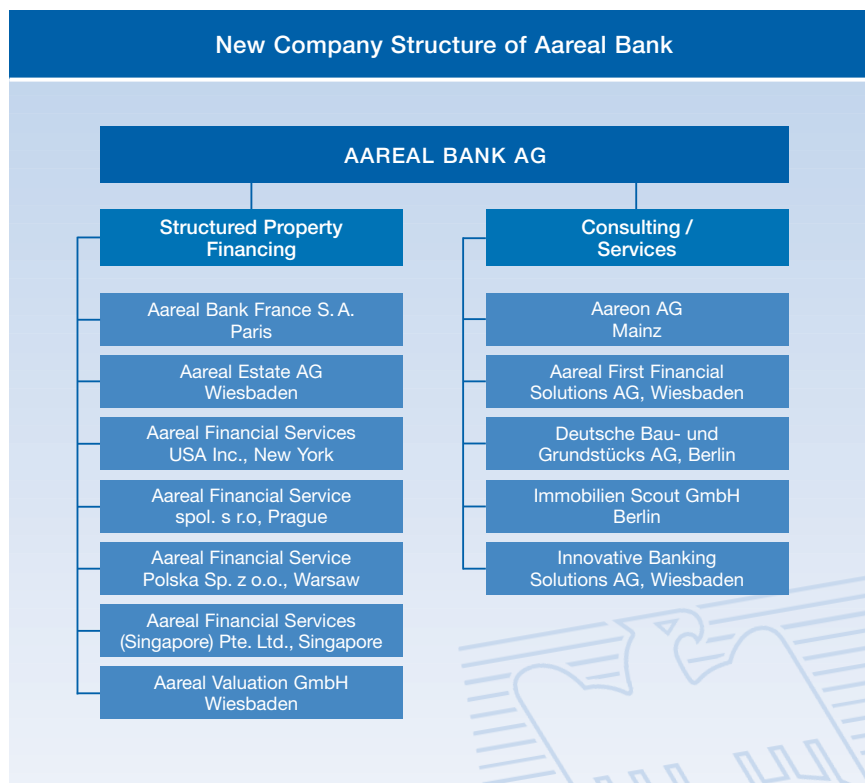
The Group's business model for the future comprises two segments:

1. Structured Property Financing

Traditionally, Structured Property Financing, which brings together all the property finance and treasury activities of Aareal Bank, is at the core of Aareal Bank Group.

Aareal Bank has more than 15 years experience in domestic and international commercial property finance. One of our particular strengths lies in our portfolio, which is broadly diversified by region and by types of property. We provide property financing solutions in over 25 countries. Our extensive network of regional market experts and industry specialists allows us to offer financing solutions tailored to meet our customers' requirements in all target markets.

Aareal Bank has established itself as an active issuer on the capital market, where it issues traditional as well as structured securities to cater for a broad investor base.





Securities are issued in liquid currencies as private placements with individual issuing features or as benchmark bonds.

2. Consulting/Services

Aareal Bank Group's Consulting/Services segment offers the institutional housing sector a comprehensive range of services for managing residential property portfolios and processing payment flows.

Disposal of Property Asset Management

A decision was reached during the financial year under review that Property Asset Management no longer represented a core business activity of Aareal Bank Group. For this reason, the bank disposed of Aareal Asset Management GmbH in December 2006.

Management Board

The Management Board, comprising five members, manages the company independently and is in this respect bound to the enterprise's best interests.

The appointment and removal of members of the Management Board and changes to the company Memorandum and Articles of Association are made in accordance with the German Public Limited Companies Act (Aktiengesetz – AktG).

Main components of the compensation system for members of the Management Board

The Executive Committee of the Supervisory Board determines the structure and amount of remuneration for members of the Management Board. It sets salaries and other remuneration components.

Aareal Bank AG has entered into fixed-term service contracts with the members of its Management Board.

In addition to fixed salary components, which are paid in twelve identical monthly instalments, the members of the Management Board receive a variable remuneration, which is made up of a long-term and a short-term component.

A target system has been adopted to determine the variable remuneration component, based on Group net income in accordance with the International Financial Reporting Standards (IFRS), as well as on qualitative and quantitative targets, which are defined on an annual basis.

The long-term component is paid in the form of phantom shares. The basis for calculating the number of performance shares is the weighted average price based on the five exchange-trading days (Xetra®) after publication of the Financial Statements that have been confirmed by the Supervisory Board. The phantom shares must be held

for a period of three years after the date of purchase. Subsequently, the shares may be redeemed, in whole or in part, within a period of a further three years after no more than five working days after publication of the quarterly report. Upon redemption of the shares, the relevant proportion of phantom shares is converted at the weighted average price as reported by Bloomberg on the redemption date and the resulting amount is paid as taxable income.

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

In the case of a change of control and a resulting loss of membership in the Management Board, the members affected receive, in settlement of their total remuneration, their fixed remuneration as well as a contractually agreed compensation for the variable remuneration, paid in monthly instalments during the remaining term of the agreements. In addition, the members of the Management Board receive a lump-sum payment of up to 75 % of their annual fixed remuneration.

If, in case of a change of control, members of the Management Board resign from office or are not willing to extend their office in spite of an offer on the part of the Company,

the respective member of the Management Board receives, in settlement of the total remuneration, an amount not exceeding 50 % of the relevant fixed remuneration and the contractually agreed compensation for the variable remuneration. In addition, the relevant member of the Management Board receives a lump-sum payment of up to 50 % of the annual fixed remuneration.

Company management

Aareal Bank Group is managed using various economic indicators.

For the banking activities, these are mainly operating profit, RoE and the cost/income ratio. Divisions that are not assigned to the banking business are also managed on the basis of economic indicators for measuring profitability and efficiency, such as for example, the EBIT margin.

Strategic realignment

The strategic realignment of Aareal Bank up to the end of 2006 was set out in a clearly-defined six-point programme:

1. Sustained growth in new business

Commercial property financing is Aareal Bank Group's key source of income. Hence, the main objectives of the realignment were to expand and further diversify new lending

commitments and extend the existing client base. Expanding the refinancing base through mortgage bonds and improving Aareal bank's rating also play a central role.

2. Reducing the non-performing loan (NPL) portfolio

Another key issue of the realignment was the consistent and speedy reduction of Aareal Bank's non-performing loan portfolio. This realignment was not only concluded earlier than planned during the financial year under review; it also extended to a greater degree than originally envisaged.

3. Leveraging the bank's mid-sized corporate structure

Aareal Bank Group's mid-sized corporate structure represents one of its competitive advantages. In order to take even greater advantage of this strength, the complex investment portfolio was reviewed to assess its compatibility with Aareal Bank's core expertise. Non-core investments were sold and Aareal Bank Group segments realigned.

4. Upgrading the organisational structure

The organisational structure was streamlined, interfaces reduced and lines of communication shortened - all with a view to further enhancing efficiency. A strict cost management programme was also introduced.

5. Emphasising a modern corporate culture

The expansion of the corporate culture also represented a key building block in the realignment process. Binding management guidelines combined with clearly defined personal expertise and management tools, together with transparency in the performance assessment are all prerequisites for open and intelligent management. This impacts on the employees' corporate identification and hence on the ability to implement necessary changes.

6. Transparency in managing our business

Open external communication strengthens the level of confidence shown in the company, while open internal communication creates the basis for confidence and for staff loyalty. It impacts favourably on their motivation. A key issue of the realignment therefore was to create a level of transparency that exceeds the status quo, as well as in relation to the objectives and planning of Aareal Bank Group.

Macroeconomic and industry-specific parameters

2006 was defined by historically low interest rates worldwide. Nevertheless, this was not reflected in a uniform economic trend. The US once again commanded pole position in the economic cycle as the driver of global economic growth. As far back as mid-2004, the Federal Reserve Bank (Fed) gradually started to increase the fed funds rate from a historical low of 1 % up to 5.25 % in mid July.

The step-by-step approach with which the central banks reacted to less volatile macro-economic data reduced the uncertainty in relation to short-term interest rates and contributed generally to low yields, lower yield volatility and flat yield curves.

Global economic growth was approx. 5.1 % in the year under review. The growth rates of approx. 3.5 % in the US and of approx. 3 % in Europe are somewhat lower than the global average; they also lag considerably behind the growth rates in China (approx. 10 %) or India (approx. 8 %). However, given the historic record price of oil and various other raw materials in 2006, and in view of the slightly higher interest rates, this growth can be described as being very solid.

This positive trend is also reflected in the commercial property markets. These are defined by higher liquidity, and at the same time by a short supply of attractive invest-

ment properties in terms of quality. Accordingly, the prices for such properties have risen considerably in the year under review.

Demand was supported by higher – but still relatively low – interest rates, that continued to provide investors with access to cost-effective borrowing. Pension funds are also substantially increasing the ratio of property relative to their overall investments, thus channelling liquidity into the sector. Asset managers, such as private equity funds and fund management companies have also increased their share of property investments. This is accompanied by a strategy of internationalisation in the property business that matches the business model of Aareal Bank.

Business development

In the course of the 2006 financial year, Aareal Hyp AG was merged into Aareal Bank AG, with retrospective effect from 01 January 2006. As a result of the integration of the mortgage bank subsidiary, Aareal Bank acquired the licence to issue Pfandbriefe (asset-covered bonds). This merger means that the financial ratios are only comparable to a certain extent with the previous year.

Key markets and new commitments

We extended our international presence in property financing further in the 2006 financial year and successfully implemented our new location concept. Where appropriate, we also aggregated our sales resources across borders, thus enhancing the efficiency of our distribution network. The development and implementation of a new distribution strategy for the German market, especially through the appointment of key staff to strategically important positions, has led to a significant improvement in efficiency.

The aggregate volume of new loan commitments within Aareal Bank AG was increased substantially in the 2006 financial year by more than 50 %, from € 6.4 billion to € 9.8 billion, with international business accounting for roughly 84 %. On a Group level, we generated a total of € 9.9 billion in new business during the period under review.

Scandinavia

We observed stable to slightly rising rental levels and rising property prices last year in Scandinavia. This is due to the high demand still evident from international investors for commercial property in the region. Besides Sweden and Denmark, Finland has also now established itself as a target market for international investors. Interest in Norway

on the other hand is still relatively minor. There is a trend for investors to view Scandinavia as a cross-border economic region. By implementing our Nordic hub in Stockholm, we have been able to anticipate this trend early on. New loan commitments have accordingly grown to more than € 1.9 billion.

Germany

The German market is focused mainly on the regions of Hamburg, Berlin, Cologne-Dusseldorf, Rhine-Main, Rhine-Neckar, Stuttgart and Munich. The long period of stagnation led to a sharp drop in rents and to high vacancy levels on the market for office property. However, the situation varies from region to region. International investors have been very active on the German property market for some years now. Initially, interest was centred in particular on residential property portfolios, while this trend meanwhile includes all types of property. This surge in demand combined with numerous property sales by the public sector led to a continuous growth in turnover on the property market.

We are optimally positioned in Germany, with our four offices in Berlin, Hamburg, Munich and Wiesbaden. Here in Europe's second-largest economy, we generated the second-highest volume of new commitments (€ 1.6 billion) after Scandinavia in 2006; this equates to an increase of almost 60 % over the previous year.

Italy

Our offices in Rome and Milan provide optimum cover of the important property regions in Italy for domestic and national customers. Investment yields have declined in recent years in keeping with the trend in other European markets. Italy continues to attract international investors, however. Vacancy rates are low to moderate.

Similar to last year, our good market position in Italy allowed us to achieve a high volume of new commitments in the year under review. At € 1.5 billion, Italy accounted for approx. 15 % of our new business.

Central and Eastern European Countries (CEE)

We have observed high turnover in office space and declining vacancy ratios, combined with stable rents, in the property markets of Poland, Slovakia and the Czech Republic. The return on property is converging increasingly towards the other EU states.

Russia's property market is concentrated on the greater Moscow region and to a lesser extent on St. Petersburg. High demand and the scarcity of all types of modern properties has driven up rents. Vacancy rates are low. In terms of the volume of new rentals, Moscow is one of Europe's most active property locations.

We have achieved good market penetration in CEE, particularly in Poland, and substantially increased the volume of new loan commitments in the previous financial year to a total of € 1.2 billion.

Benelux

At just under € 0.8 billion, the volume of new business in the Benelux region is also strong. Overall, the Benelux countries are equally defined by stable rents and return on investments.

United Kingdom

Since the year 2000, initial yields in the United Kingdom have continued to decline on stable to slightly rising rents, especially in London and its top locations. The dynamic environment has attracted a large number of international investors to this market.

Our new businesses in this region has increased from € 0.6 billion in the previous year to a good € 0.7 billion in the year under review.

France and Spain

In France and Spain, shopping centres are particularly important due to the comparatively high level of consumer demand by European standards. Overall, rents are stable in these two markets - with a tendency towards slightly lower returns on investment.

We committed to new financings of approx. € 0.3 and 0.4 billion in France and Spain respectively.

North America (NAFTA states)

We are also active in the world's largest property market. There is a trend towards falling vacancy rates in the US inner-city market for office property. Demand for office space has risen considerably in the major urban areas, and the construction of new office properties in selected local markets is on the increase at the same time. Investment yields in first-class locations are at historical lows. On the other hand, the demand for apartments in condominium ownerships, especially for expensive allocator projects, is diminishing. Vacancies in existing residential properties vary according to region, but, in general, they are low.

Occupancy rates on the hotel market are rising; the national average daily room rate has also increased.

The property market in Canada is characterised by very stable prices for residential property. We have also detected a rising presence of international investors in this market.

International investors are showing sporadic interest in Mexico. In the financial year under review, we supported existing customers with financing solutions for two resort hotels in the Gulf of Mexico.

At a good € 0.8 billion, the volume of new business in North America is on par with the previous year.

Asia / Pacific region

Direct investment in Asia by international investors continues to rise, with more than 50 % allocated last year to Japan and China.

During 2006, we started to expand our presence as a provider of property finance in the Asia / Pacific region. We generated new business in the amount of good € 0.1 billion, providing a financing solution for an office property in China, a logistics property in Japan and resort hotels in Macao and on the Maldives.

Results of operations

Despite the integration of Aareal Hyp AG and its loan portfolio, net interest income declined in 2006 compared with the previous year to € 374 million due to the high level of strategic portfolio sales.

The bank was still receiving fees in 2005 from a compensation arrangement for the management of loans extended by Aareal Hyp. Although this income discontinued following the integration of Aareal Hyp, net commission income climbed by 27.9 % to € 59.1 million. This rise is attributable for one to the strong volume of new business,

as well as to higher early repayments and related charges.

The net result on financial operations amounts to € -1.1 million (2005: € -1.5 million).

At € 224.6 million, administrative expenses are unchanged from the previous year. Taking Aareal Hyp into consideration in the figure for the previous year, administrative expenses show a slight decline.

The balance of other operating items amounted to € -17.8 million after € -15.4 million the year before. These items include amongst other things the project costs for our NPL transactions in 2006. Net loan loss provisions of € 82.3 million are in line with the € 80-90 million range projected. Our risk costs have therefore returned to a normal level.

Operating profit before loan loss provisioning thus amounts to € 107.3 million compared with € -46.5 million the year before.

Net other income and expenses of € 72 million include a write-up of around € 66 million on our indirect interest in Deutsche Interhotel Holding GmbH (DIH) as a result of the sale agreement concluded for the properties and operating SPVs with effect from 01 January 2007.

Net income after deduction of tax expenses of € 61.9 million totalled € 117.4 million.

This means that the bank achieved its objective of restoring its ability to pay a dividend again in 2006.

Financial situation

Total assets

Aareal Bank AG's consolidated total assets as at 31 December 2006 amounted to € 39.5 billion, after € 37.4 billion as at 31 December 2005.

Financial situation

Property financing portfolio

The volume of Aareal Bank AG's property financing amounted to € 20.6 billion as at year-end 2006, which represents an increase of 7.9 % compared with 31 December 2005. The crucial factor here was the merger of Aareal Hyp AG into Aareal Bank with retrospective effect from 01 January 2006.

Thanks to the merger of Aareal Hyp's portfolio and the strong level of new loan commitments on Aareal Bank's balance sheet, the volume of international financing solutions rose by 28.7 %, from € 10.8 billion to € 13.9 billion.

Despite the merger of the German portfolio of Aareal Hyp, which amounted to

€ 1.1 billion at year-end 2005, the German property financing portfolio declined from € 8.3 billion as at 31 December 2005 to € 6.7 billion as at 31 December 2006.

This decline is due to the reduction in business not in line with our strategy, above all to the two NPL transactions. This reduction comprises a core component of our strategic realignment that we concluded in the 2006 financial year.

Germany thus accounts for only 32 % of the overall portfolio, compared with 44 % at the end of 2005. Overall, this enabled us to achieve a more balanced loan portfolio with a high degree of diversification.

Of the overall loan portfolio held by Aareal Bank, € 15.6 billion was attributable to commercial property finance and € 5.0 billion to residential housing finance as at 31 December 2006.

Portfolio management and exit strategies

Our Credit Treasury team uses syndicated loans and securitisations to manage our property financing portfolio.

As part of our exit strategy for non-performing loans, during the year under review we concentrated on the structuring and sale of NPL portfolios.

As at 31 December 2006, the volume of Aareal Bank's financing solutions placed in the market via securitisations amounted to € 3.5 billion. This corresponds to a decline of € 0.8 billion compared with the previous year.

We syndicated lending volume in excess of just under € 400 million in the period under review, where the focus was on international syndication. The volume of syndicated lending was considerably higher in 2005, at around € 800 million. Besides focusing our resources on NPL transactions, our diminishing portfolio was also a motive behind our cautious stance in relation to syndicated loans.

Reducing the NPL portfolio

Following our debut with two successful true sale transactions in 2005, we sold a third portfolio of non-performing loans at the start of 2006. The total volume of this third transaction was € 345 million including interest and fees of € 80 million.

We finally sold our fourth, and to date, largest NPL portfolio in September 2006 – with an aggregate volume of approx. € 1.4 billion, including interest and fees. Our target to reduce the NPL to below € 1 billion by the end of 2006 was therefore exceeded already in September.

These portfolio transactions and individual workout processes enabled us to reduce the

NPL portfolio from € 2,085 million as at 31 December 2006 to approx. € 643 million.

Refinancing

Refinancing structure

Aareal Bank refinances its lending activities on the capital market mainly in medium-term maturities, which it complements with long-term measures. It refinances its money market activities through customer deposits and interbank transactions.

Aareal Bank benefits particularly from the new German Pfandbrief Act (Pfandbriefgesetz). Aareal Bank is increasingly using

Pfandbrief issues to refinance its international portfolio. In the medium term, it will increasingly exploit the possibilities of the new German Pfandbrief Act to boost the share of Pfandbriefe in its refinancing mix. The cover assets pool of Aareal mortgage bonds is very international and broadly diversified, including issues from 15 countries. Pfandbrief issues are an important instrument for Aareal Bank Group in its endeavour to expand its investor base, and to reduce its refinancing costs. New investors, especially in Europe, are attracted to asset-covered bonds, in particular jumbo Pfandbriefe owing to their liquidity and quality.

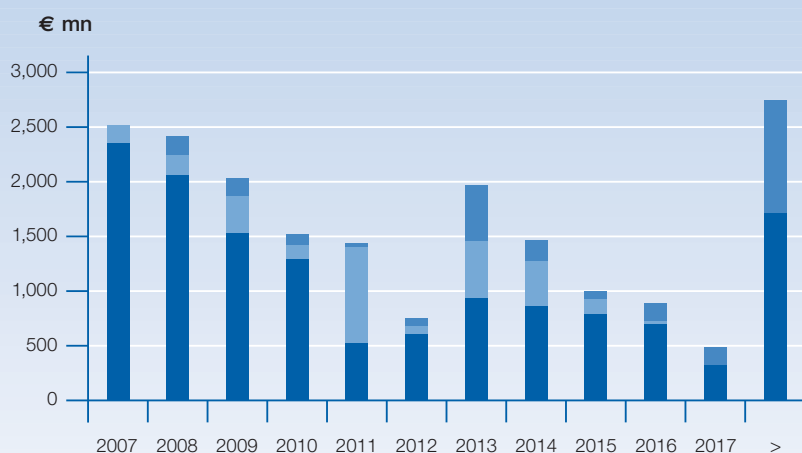
Aareal Bank is an active issuer of uncovered promissory note loans, registered bonds and bearer instruments.

Aareal Bank's MTN programme is an internationally recognised documentation framework for securities issues. Sized at € 10 billion, it allows drawings in subordinate, uncovered debt securities, as well as in mortgage bonds and public-sector covered securities, in all the required currencies and structures.

Settlement of payment transactions for commercial housing clients generates residual current account balances and term deposits of over € 1 billion or over € 3 billion respectively on a monthly average. The volume has been stable and rising slightly over recent years.



Maturity structure of the long-term refinancing mix as at 31 Dec 2006



A € 5 to 10 billion portfolio of liquid, high-quality securities serves as the liquidity reserve, thus facilitating the generation of large-volume short-term liquidity, depending on the situation.

Issuance

Aareal Bank successfully expanded refinancing activities on the capital markets, having expanded its investor base both nationally and internationally.

It raised approx. € 4.6 billion in medium- and long-term funds in 2006 (including Aareal Bank's debut € 1 billion jumbo mortgage Pfandbrief and € 275 million in public bearer bonds).

The majority of private placements (more than € 2.8 million) were issued in the form of registered securities, including promissory note loans and registered mortgage bonds. Furthermore, approximately € 500 million in bearer bonds (mainly MTNs) were placed on the capital markets.

In the context of these transactions, the bank succeeded to further reduce its funding costs. We achieved this for example, by expanding the share of Pfandbriefe and demand-oriented structured interest rate products in the funding mix.

The increasing degree of internationalisation in Aareal Bank's capital market activities is obvious. More than 55 % of allocated orders

for the successful debut jumbo Pfandbrief issue were attributable to international investors from 13 countries. We also target new investor groups through Pfandbrief issues denominated in the currencies of our cover assets pool, which is diversified internationally. Aareal Bank issued Pfandbriefe denominated in US dollars and Danish kroner within the scope of private placements during the year as a whole. Following an extensive roadshow in Scandinavia, we successfully placed a debut Aareal Bank benchmark Pfandbrief in Swedish kroner.

Shareholders' equity

Issued share capital

Aareal Bank AG's issued share capital amounts to € 128,265,477 and is divided into 42,755,159 notional no-par value shares (unit shares). Aareal Holding Verwaltungsgesellschaft mbH held 37.23 % of the voting rights as at 31 December 2006.

Shares

Pursuant to the Memorandum and Articles of Association of Aareal Bank AG, the Management Board is authorised to increase, on one or more occasions, the company's share capital by up to a maximum total amount of € 46,639,504.00 (Authorised Capital) by issuance of new bearer shares for contribution in cash or in kind (where such contribution in kind may represent the

full contribution, or part thereof), subject to the approval of the Supervisory Board; this authority will expire on 14 June 2010. The authorisation granted by the Annual General Meeting for the Authorised and Conditional Capital is disclosed in the Notes (please refer to page 56).

Regulatory indicators

Aareal Bank AG's liable capital in accordance with section 10a of the German Banking Act (KWG), based on confirmation of the 2006 financial statements, amounted to € 2,368 million, of which core capital accounted for € 1,317 million. The capital ratios according to the German Banking Act (Grundsatz I) are 7.5 % for the core capital ratio and at 13.3 % for the total capital ratio. Aareal Bank AG's risk-weighted assets according to the German Banking Act amount to € 17,767 million (including market risk of € 241 million), based on confirmation of the 2006 financial statements.

Report on material events after the reporting date

An agreement was reached with DEPFA Deutsche Pfandbriefbank AG (DEPFA) at the start of 2007 with regard to offsetting the effects arising from the completed tax audit

of a subsidiary. This applies to a participation transferred to Aareal Bank AG within the scope of the split of DEPFA, and will be recognised in 2007 when some conditions precedent that have to be met exclusively by Aareal Bank have been fulfilled.

Outlook

Development of the environment

In view of the high degree of liquidity on the markets, we can expect a positive economic climate and a favourable investment climate again in 2007. The five leading central banks believe that we can expect a positive growth trend for the global economy in 2007 for the fifth consecutive year. This assessment is in line with the expectations of the International Monetary Fund (IMF), which is forecasting growth of 4.9 % for 2007.

International property markets

We are forecasting that property prices will at least remain stable. The risk of a setback in property prices will be countered by continually placing the sustained cash flow stability of the charged properties at the core of our lending decisions and our credit monitoring.

We expect rents in **Scandinavia** to remain constant or to rise slightly in the short- to medium-term.

We are forecasting higher sales growth on the German property market and believe **Germany** is about to enter a phase of higher rents, albeit in individual market segments rather than across the board.

Rents should be stable in **Italy** this year. The change announced in the taxation framework is fuelling uncertainty among international investors and will tend to lead to higher rental yields, so that property prices could come under slight pressure.

We are forecasting stable to slightly rising rents in **CEE** for Poland, the Czech Republic and Slovakia. We also expect the yield differential relative to Western European countries to remain unchanged until the EU accession states have been largely integrated and have introduced the euro as their currency.

The **North American market** should continue to attract large numbers of international investors; rents and property prices should remain stable or rise slightly. We are planning to substantially increase business volumes in this region over the next three years.

Based on our belief that the environment in the **Asia/Pacific region** should develop favourably in the long term, we want to

step up our commitment in a visible and targeted manner, above all in China and Japan, within the framework of our growth strategy.

Corporate development

The successful conclusion of our realignment has created a solid base for our operations. Aareal Bank AG's core target for the next three years is to achieve profitable growth in our operative business. We plan to substantially develop our new business in the next three financial years, on unchanged risk/return ratios. We are also expecting fewer high early repayments in our loan portfolio in the years ahead. Aggregate organic portfolio growth should be in the region of 8-10 % per annum on slightly increased average maturities.

We will counter the risk of greater competitive pressure and a decline in the portfolio through ongoing high early repayments through targeted market investments, especially in North America and Asia. This represents a part of our growth strategy for the next three years, which we have designed to follow the six-point programme immediately. This strategy is geared towards gradually increasing the operating profit and net RoE of the Aareal Bank Group during the period up to 2009. Within this context, Aareal Bank Group aims to achieve net RoE of between 12 % and 13 % by the year 2009.

Risk Report

The ability to correctly assess risks, and to manage them in a targeted manner, is a core skill in banking. Accordingly, being able to control risks in all their relevant variations is a key success factor in a competitive environment. Besides this purely economic motivation for a state-of-the-art risk management system, regulatory requirements have been increasing as well. It was against this background that we continued to develop our risk management system, allocating significant resources, during the financial year under review.

Areas of responsibility for risk management and monitoring

The overall responsibility for risk management and risk monitoring remains with the Management Board and the Supervisory Board of Aareal Bank.

The adjacent diagram provides an overview of the responsibilities assigned to the respective organisational units.

Risk situation and risk management at Aareal Bank AG

The business policy set by the Management Board and approved by the Supervisory Board provides the conceptual framework

Areas of responsibility for risk management and monitoring			
Overall responsibility: Management Board and Supervisory Board of Aareal Bank AG			
Type of risk		Risk management	Risk monitoring
Market price risks		Treasury; Dispo Committee	Risk Controlling
Liquidity risks		Treasury	Risk Controlling
Credit risks	Property Finance Individual exposures	Credit Management	Risk Controlling, Credit Office
	Property Finance Portfolio risks	Credit Management, Credit Office	Risk Controlling
	Transactions with financial institutions	Treasury; Counterparty and Country Limit Committee	Risk Controlling
	Country risks	Treasury, Credit Management, Counterparty and Country Limit Committee	Risk Controlling
Operational risks		Process owners	Risk Controlling
Process-independent monitoring: Internal Audit			

for risk management. Taking this as a basis, and strictly considering the bank's risk-bearing capacity (as discussed below), we have formulated detailed strategies for managing the various types of risk, which are designed to ascertain risks are dealt with consciously and professionally. Accordingly, these strategies include general policies, to ensure a uniform understanding of risks across all parts of the bank, and providing a cross-sectional, binding framework applicable to all departments.

In line with the overall business strategy, risk strategies are revised at least once a year, and are approved by the Management Board.

Risk-bearing capacity and risk limits

The bank's ability to carry and sustain risk – which is defined by the amount of aggregate risk cover – is a core determining factor governing the structure of its risk management system. Aggregate risk cover is defined as the core capital (tier I capital) in accordance with the BIS definition, plus the budgeted net income before taxes. We have deliberately opted for a very conservative definition of aggregate risk cover; the calculation does not include additional funds such as supplementary and subordinated capital, and existing reserves. The aggregate risk cover is updated at least once a year, and additionally in the event of significant changes occurring.

We have thus implemented a system based upon limits that are differentiated according to the type of risk, with limits set in a way so as to ensure Aareal Bank's ability to bear risk at any time. We employ a limit system incorporating two harmonised perspectives: on the one hand, limits determined according to the value-at-risk method limit the risk for the individual risk categories. On the other hand, we use a system of nominal limits in the lending business (e.g. country limits, counterparty limits, construction phase limits) and for market price risk (e.g. stress limits).

Ongoing development during the financial year under review

We continued to develop and refine our risk management methodology and procedures, in a targeted manner, during the financial year under review. Specific measures included implementing the Minimum Requirements for Risk Management, and the Investment Risk Control unit.

Implementing MARisk

The German Federal Financial Supervisory Authority ("BaFin") published Minimum Requirements for Risk Management ("MARisk") at the end of 2005. Designed to replace the former Minimum Requirements for the Credit Business of Credit Institutions ("MaK"), Minimum Requirements for the Trading Activities of Credit Institutions ("MaH") and Minimum Requirements

for Specifications of the Internal Audit of Credit Institutions ("MaIR"), MARisk have introduced certain additional requirements for banks' internal management and control processes. Such additional requirements, which include regulations governing the risk-bearing capacity, and regarding the management of liquidity risk and operational risks, have become mandatory for all banks subject to the German Banking Act since 01 January 2007.

We implemented the MARisk, including the newly-introduced requirements, during the year 2006, within the scope of a major internal project.

Investment Risk Control

Aareal Bank AG's risk exposure is concentrated on risks generally associated with banking, such as credit risk, market price risk, liquidity risk, and operational risk. Some of Aareal Bank's subsidiaries, however, are exposed to a variety of other types of risk, which we include in our centralised risk management system through an Investment Risk Control concept. For this purpose, Investment Control conducts regular audits of all relevant subsidiaries, reviewing and assessing their risk situation in detail.

The results are submitted to the Management Board of Aareal Bank, within the framework of ongoing risk reporting.

1. Credit risks

1.1 Credit risks in the Property Finance business

Credit risks in Aareal Bank AG's property finance business are related to a deterioration in the borrower's credit quality, a loss in the value of collateral, or risks upon disposal of the financed property. Credit risk materialises where a financing partner's economic situation deteriorates, or where this partner cannot meet his contractual obligations fully or in time. Collateralisation risks result from the threat of a loss in value of collateral, which can occur through property-specific or market-induced factors. The financed property can be subject to risks arising during completion, renting and/or sale.

Risk management on an individual transaction level

Risk management in Aareal Bank's lending business analyses, monitors and manages the risks involved during the completion phase of the financed property, as well as the medium- and long-term risks arising from a deterioration in credit quality or loss in collateral value. Every financing transaction is based on planning agreed upon in advance. The bank is compensated for this imputed risk, measured according to the planned financing structure, with an appropriate pricing premium.

Risk management recognises and evaluates negative deviations from the plan, allowing it to minimise the potential risks by taking appropriate countermeasures. The differentiated early warning systems and management tools employed by the bank are specifically designed for the particular features of the commercial property lending business.

Early warning system and management tools employed in the completion phase of the financed property

Risk management during the completion phase is aimed at making risks transparent and manageable.

This requires the continuous monitoring of risks, and quantifying them using rating procedures. Accordingly, the rating system is a key tool for supporting the lending decision (as discussed below).

Moreover, we ensure that disbursement is made after the agreed collateral is pledged, after fulfilment of further conditions for payment, and according to construction progress. Periodic disbursement checks are carried out for this purpose.

The new rating procedure as an early warning system and management tool

During the financial year under review, the bank made extensive use of the new rating procedure (implemented in 2005), which is geared towards the specific requirements

of Basel II. The key elements of this rating procedure are outlined below.

The property rating evaluates property-specific indicators and qualitative aspects. As the fundamental basis of property rating, the future ability to cover interest and principal payments is determined as part of cash flow planning (identifying cash flow surpluses or shortfalls) and, if applicable, the risk associated with the completion and/or marketability of the properties financed.

In addition to these quantitative data, qualitative aspects are also taken into consideration, in particular the projection regarding future cash flow developments.

The corporate rating evaluates adequate ratios (particularly regarding profitability and financial situation) on the basis of the last financial statements as well as qualitative aspects regarding the company, such as its internal structures, sales capability and the quality of its management. The new rating methodology also includes variations for borrowers from property-specific industries as well as for other companies.

The impact of the property rating/corporate rating on the final rating is always determined on the basis of the share of the relevant company's investments financed by the bank, and detailed information available on the company's assets. If available, the rating also takes into account an assessment of the group background and

any special factors reflecting certain specific features of the company or the financing.

In addition, the collateral provided has an impact on the rating result, with the collateral being evaluated with regard to its individual value (and absence of impairment) and estimated fluctuations in that value (e.g. as a result of property cycles), using different criteria (such as property location/type).

Early warning system and management tools employed during the loan term

To monitor the credit quality of its financing counterparties (such as borrowers or guarantors), the bank employs standardised tools such as periodic monitoring, ratings, portfolio reporting, etc. during the entire term of the loan. The results of these checks are taken into account in the rating. If the credit rating is downgraded, the bank routinely implements measures to either maintain risks at an acceptable level, or to reduce them.

Collateral is checked for impairment on a regular basis, in line with applicable provisions, and the rating adjusted in the event of significant changes.

Lending exposure is also subject to a continuous IT-based monitoring process (depending on a classification in terms of risk and size), which is conducted in regular intervals, to report on and manage any

major changes involving the exposures. The rating is also checked and adjusted if necessary on an annual basis. In the event of major market fluctuations, portfolios or sub-portfolios are monitored independent of their individual risk content.

Handling of exposures identified as subject to higher risk exposure by the early warning system

Depending on their risk content, loans identified by the bank's early warning system as being subject to higher risk exposures are classified either as "on watch" or "risk prevention". "On watch" exposures are loans in regard to which a deterioration of the risk indicators is still within a reasonable range from a risk perspective, i.e. no sustained risk exposure is foreseeable and the loans remain under observation. The "risk prevention" category contains exposures having a sustained risk that are subject to close supervision.

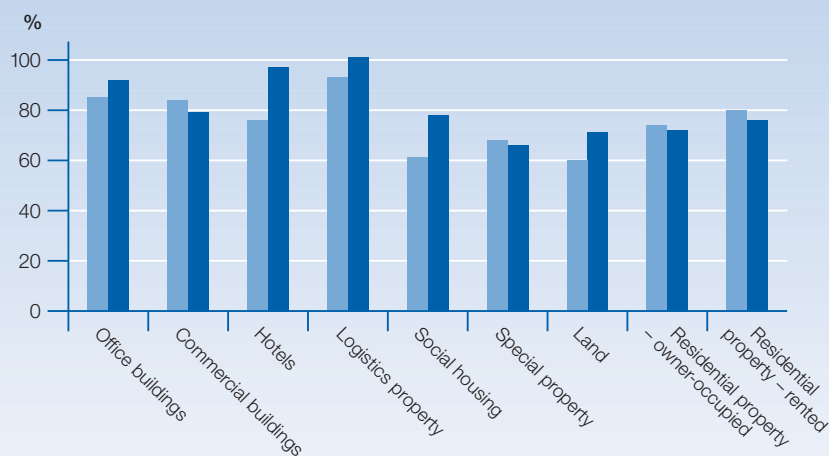
In the event of a restructuring of loans or of recovery procedures, any further handling of the exposures in question is transferred to the Workout unit. For all loans identified as high risk, the monitoring frequency is tightened accordingly. The IT-based allocation enables continuous portfolio monitoring.

Collateralisation

Over the last three years, the volume-weighted loan-to-value ratio for the entire property portfolio (performing loans) was between 77 % and 78 % of the mortgage lending value for German business, and between 73 % and 83 % for international business.

the change in property prices in different sub-markets and the market value adjusted to the current financial position. Value adjustments recognised at a Group portfolio level are determined using historical default data. The risk parameters used for calculation are primarily based on the average loan-to-value ratio of the Group's property financing portfolio, that is determined in regular intervals.

Loan-to-value ratio (volume-weighted, based on lending value), by property category



International
Germany

Risk provisioning

Using guidelines that are applicable to the property finance business throughout the Group, the bank calculates the potential risk of default for individual cases and sets aside appropriate specific loan loss provisions. Particular consideration is given to

Following the split of the former DePfa Group, DEPFA Deutsche Pfandbriefbank AG relinquished legal responsibility, to a certain extent, for the future performance of the property finance business to Aareal Bank AG. In cases where Aareal Bank has not already assumed liability for property loans, it is responsible for the management thereof under the Agency Agreement entered into.

Risk management from a portfolio perspective

We understand credit risk management as the identification, measurement and subsequent management of risks at a portfolio level. The bank continued to expand and refine its risk management toolkit during the period under review. Specifically, this included implementing procedures to determine risk parameters introduced within the Basel II framework: PD (probability of default) and LGD (loss given default).

Since 2001, one of the main tools for managing credit risk arising from the property

finance business has been the analytical credit risk model used in the bank. Based on this model, the bank's decision-makers are informed on a quarterly basis of the performance of large-sized property finance exposures and of their risk content.

Utilising this model means we have already met most of the requirements of the Basel Committee on the identification, assessment, monitoring and management of credit risk concentrations.

The evaluation of portfolio risks on a value-at-risk basis differentiates between expected and unexpected loss. Expected loss reflects the average loss that is anticipated for a one-year period on the basis of the historical data. Unexpected loss, which is also referred to as credit value-at-risk ("CVaR") states the amount of economic equity capital that must be available to cover losses over and above the expected loss.

Besides the EAD (exposure at default), LGD and PD parameters, correlation effects within the sub-portfolios that arise from the portfolio composition are also taken into account through determining so-called "sectors" when calculating the portfolio risk. Allocating financing solutions to the same sector reflects joint economic dependencies.

The ratio between unexpected and expected loss is used as a key variable for the risk content of individual segments within the

portfolio. Individual segments can be compared on the basis of this variable. We use confidence levels of 99.90 %, 99.95 % and 99.99 % to calculate the CVaR.

The main risk contributors can be identified by determining the extent to which each individual financing transaction contributes to the VaR of the portfolio under observation. The impact of the main risk contributors on the overall portfolio risks is determined by analysing the concentration risk.

Furthermore, the portfolio assessed is analysed by type of property finance and by country, which can identify risk concentrations in individual markets. Additionally, the hypothetical elimination of the main risk contributors permits a simulation of their impact on the portfolio as a whole.

The effects of a more volatile economy are examined using a stress test. For this purpose, the volatilities of the probabilities of default are intensified and the loss ratios of the financings are increased. During a further stress test, the ratings of the financings contained in the portfolio are downgraded by one notch.

The changes to the portfolio structure and to the VaR that arise during a given observation period are illustrated in a separate analysis.

1.2 Counterparty risks of Financial Institutions

We define counterparty risk in relation to financial institutions as the potential losses in value or foregone profit, which may occur through unexpected default or deterioration of the credit quality of trading counterparties with whom the bank has entered into securities transactions, money market, interest rate or currency derivatives, as well as securities repurchase transactions.

The individual credit quality assessment of the bank's counterparties is particularly important to the approval, monitoring and management process. An internal rating process is therefore employed for financial institution counterparties. This process, which complies with the requirements set out by the Basel II accord (IRB approach), allows all financial institutions to be reliably classified in internal rating classes, taking into consideration both quantitative and qualitative data. The internal ratings can be compared with those of the external agencies by means of the default probability associated with the rating classes.

The choice of counterparty in trading with financial institutions generally remains geared towards names with first-class ratings.

Counterparty-specific credit exposure risk is monitored through a limit system applicable throughout the bank that is directly linked to the Treasury front office system, and

which provides real-time information on limits and limit utilisation. Internal ratings are used to determine counterparty limits in the Treasury business. All limits are subject to an annual review process. Should a counterparty's internal rating deteriorate during the course of a year, the limit will be reviewed and, if necessary, reduced. In addition to the overall counterparty limit, Aareal Bank's limit system provides for separate sub-limits for replacement risks, the risks associated with outstanding delivery, covered bonds (Pfandbriefe) and guaranteed as well as non-guaranteed securities.

Limit compliance is monitored through the Risk Controlling unit, which submits regular reports on limit utilisation, internal rating changes, and any breaches of limits to the Management Board. Furthermore, a multi-stage procedure of escalation ensures that infringements of limits are reduced in good time.

Existing netting master agreements and collateral agreements are taken into account when determining the credit risk exposure related to derivatives. In this way, counterparty risk is adequately captured, whilst reducing both the level of required capital cover and the utilisation of the bank's internal counterparty limits.

Counterparty risk in interbank trading at a portfolio level is monitored and managed using a credit risk model, from which both the expected and unexpected loss is deri-

ved (credit value-at-risk or "CVaR"). This model also incorporates concentration and diversification effects. CVaR corresponds to the maximum amount by which the actual loss can exceed the anticipated loss for a given confidence interval. Limits for CVaR are defined in line with the analysis of the bank's capability to carry and sustain risk. The Risk Controlling unit is responsible for monitoring compliance with trading limits for financial institutions, and for reporting regularly to the Management Board.

1.3 Country risks

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). These types of risks arise only if the borrower is located in a different country from the lender, or if the financed property is located in another country.

With the main focus of the business being on the member states of the European Union and North America, exposure is concentrated in countries with very low risk potential. Geographical diversification and the avoidance of concentration risks are therefore of greater importance to us, from the bank's overall perspective, than the

observation of transfer risks. The system for managing country risk, utilised within the overall management of the bank, was designed in such a way that it takes both criteria into consideration.

For financings in countries being subject to latent transfer risks, Aareal Bank has taken out transfer risk insurance.

Country risk management is conducted by various units within the bank. The Counterparty and Country Limit Committee carries out a risk assessment of the relevant countries, grades them in country risk groups, and conducts an annual review in terms of country rating. The limits are set by the Management Board. The Risk Controlling unit is responsible for the continuous monitoring of country limits and for reporting on limit utilisation.

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

2. Market price risks

Market price risk is broadly defined as the threat of losses due to changes in market parameters. Aareal Bank's market price risk exposure predominantly comprises interest rate risks, whilst currency risks are largely eliminated through hedges. Risk exposure

from equities and similar holdings hold lesser importance, whereas 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. Aareal Bank Group's market risks are managed by Treasury and monitored daily by the Risk Controlling unit.

Up-to-date reporting to management on the bank's risk profile provides the basis for all short-, medium- and long-term investment decisions.

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

A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. VaR is cal-

culated on a daily basis, taking into consideration the correlations between the individual types of risk. The statistical parameters used in the VaR model are calculated directly from 250-day historical data maintained within the bank. The loss potential is determined applying a 99 % confidence interval and a ten-day holding period. 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.

The quality of forecasts made using this statistical model is checked through a weekly backtesting process. The quality of the statistical procedure used to measure risk is checked using a binomial test, whereby daily profits and losses from market fluctuations are compared with the upper projected loss limit (VaR) forecast on the previous day (known as "clean backtesting"). In line with the selected confidence level of 95 %, only a small number of events are expected to break out of the VaR projection (<5 for a 250-day period). The number of negative outliers was always lower than 1 during 2006, affirming the high forecasting quality of the VaR model we use.

Although VaR has become a standard tool, the concept may fail to adequately project the actual risk in extreme situations – for example, the 1997 crisis in Asia. For this reason, the VaR projection is supplemented by simulating stress scenarios on a weekly basis. Aareal Bank calculates present value fluctuations both on the basis of real ex-

treme market movements over recent years (German reunification, Asian crisis, 11 September 2001, etc.), and also using simulated market movements (parallel shifts, structural changes, steepening of the yield curve). This analysis requires that all positions are revalued fully on the basis of these market scenarios. Within the scope of weekly and monthly reporting, the resulting impact on present value is compared to a special stress limit. No breach of set limits occurred during 2006.

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

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

Being authorised to maintain a trading book, Aareal Bank AG is in a position to assign transactions to the trading portfolio as defined for the purposes of the capital ratio according to the German Banking Act (Grundsatz I). Given the small number of transactions and low volumes concluded during 2006, trading book risks played a negligible role in the overall risk scenario.

During the 2006 financial year, the processes employed proved to be able to quantify the risks arising from market price fluctuations in a timely and accurate manner. In addition, new products were quickly and fully integrated into the monitoring processes.

3. Operational risks

The bank defines operational risks (OR), in accordance with the Basel II accord, as the threat of losses caused by inappropriate internal procedures, human resources and systems (or their failure), or through external events. This definition also includes legal risks. In contrast, strategic, reputation and systematic risks are not included.

It is the objective of the policy pursued by Aareal Bank to achieve a risk-minimising or loss-limiting effect at an early stage by employing a pro-active approach. Within this context, management is therefore supported effectively by appropriately controlling the relevant operational risks, in line

with the type and extent of the legal regulations as well as with the bank's risk profile.

Efforts to comply with the requirements for controlling OR were concluded during 2006: The bank currently uses the following tools to manage operational risks (OR):

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

By means of this control toolkit, decentralised data capture as well as centralised and timely compilation of relevant information are ensured. This information provides the basis on which (among other things) measures for preventing/reducing operational risks are implemented. The responsibility for implementing these measures rests with the respective departments.

Analyses conducted using the instruments employed have shown that the bank is not exposed to disproportionate operational risks; nor did they indicate any material risk concentration. The loss database did not show any losses involving significant mone-

tary damages during the financial year under review.

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

4. Liquidity risks

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

We have developed a cash flow forecast, tracking cash flows from all balance sheet items and derivatives, on a daily basis, over a three-month period forward. This liquidity risk information helps to assess the bank's short-term liquidity position, broken down by currency or product.

Strategic liquidity is taken into account using a ten-year cash flow profile. We use statistical modelling to incorporate the cash flow profile of products without a fixed contractual lifetime.

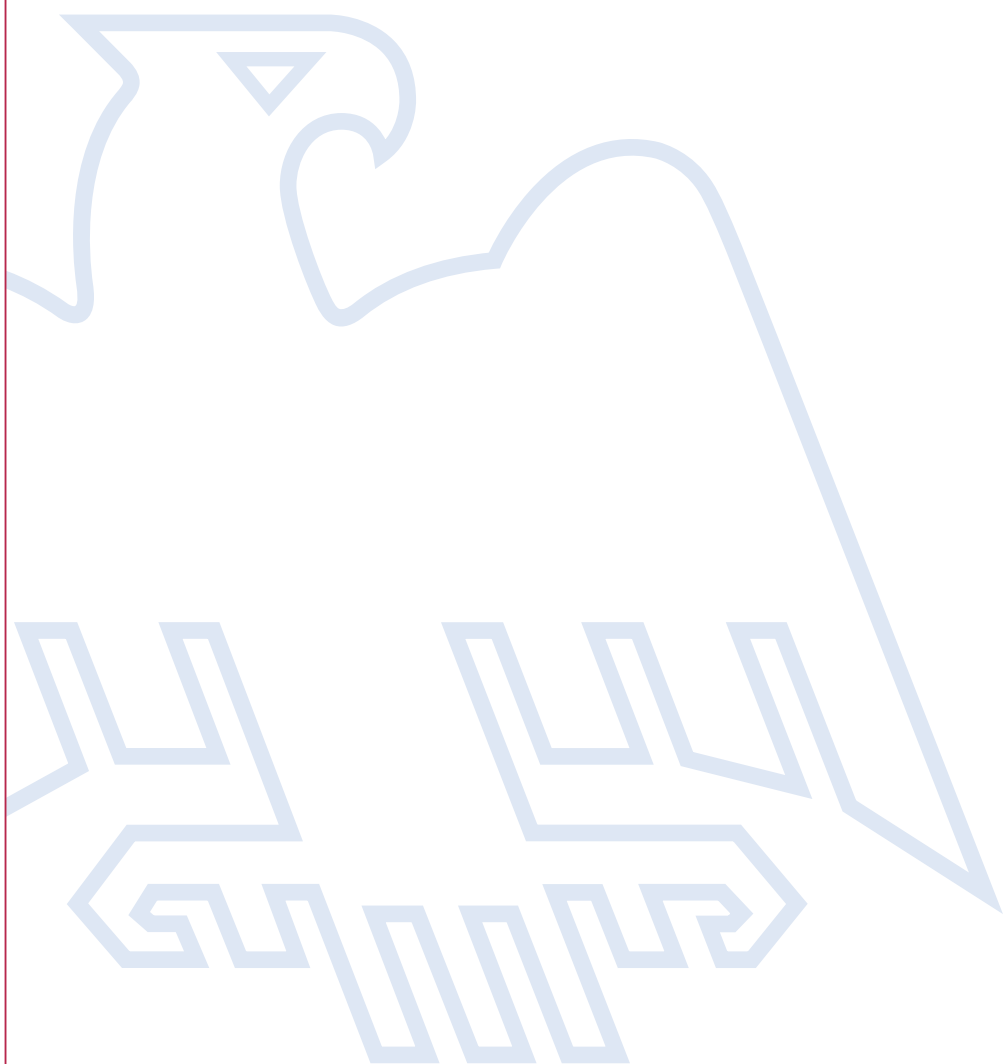
The appropriateness of the bank's liquidity is assessed using a liquidity run-off profile: the aggregate of all potential cash outflows over a three-month period is compared to the liquidity stock (i. e. all assets which can be liquidated at very short notice). The difference of both figures (in absolute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

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

Moreover, we employ stress tests and scenario analyses to assess the impact of sudden stress events onto the bank's liquidity situation. The scenarios used, which are evaluated on the basis of the liquidity run-off profile, include the failure to roll over the full amount of funding resources, a full-sized rollover of loans and advances

to customers, or price mark-downs affecting the liquidity stock.

The requirements of the liquidity ratio in accordance with section 11 of the German Banking Act (Grundsatz II), which is relevant to liquidity management, were always complied with, as were the limits set by reference to the liquidity run-off profile.



CORPORATE GOVERNANCE

AT AAREAL BANK AG

The German Corporate Governance Code was subject again to amendments in 2006. These amendments serve to enhance the management and supervision of exchange-listed companies.

The implementation of the German Corporate Governance Code, as amended on 12 June 2006, within the framework of Aareal Bank AG's Corporate Governance Code

Aareal Bank implemented in full (with the exception of individual points) the changes that were incorporated in the German Corporate Governance Code (the "Code"), as amended on 12 June 2006. These points will be outlined below and the reasons for the exceptions explained. The instances where the company refrains from implementing the changes apply mainly to recommendations that cannot be easily harmonised with the specific structure of the company.

In the section on the cooperation between the Management Board and the Supervisory Board, item 3.8 of the Code recommends that a deductible be agreed where a company takes out D&O insurance cover. Aareal Bank has taken out a D&O liability insurance policy for members of the Management Board and the Supervisory Board that does not provide for a deductible. Responsible action is an integral obligation for all members of a company's executive bodies. For this reason, the members of the company's executive bodies believe that it does not

require a deductible. Item 4.2.2 in the section on the composition and remuneration of the Management Board also recommends that upon proposal by the Board, the plenary meeting of the Supervisory Board deals with the contracts for the members of the Management Board and advises on the structure of the remuneration system for the Management Board as well as reviewing it on a regular basis.

In its meeting on 23 May 2006, Aareal Bank's Supervisory Board passed on all issues related to the remuneration of the Management Board to the Executive Committee for independent assessment and handling. This is due to the abolishment of the separate Human Resources Committee as of this date. The procedure of delegating this duty to a committee has stood the test of time. The Executive Committee advises on a regular basis on the determination and structure of the emoluments paid to the members of the Management Board and reports to the plenary meeting of the Supervisory Board on its deliberations in this respect.

Particular importance was attached – within the scope of reducing the size of the Supervisory Board – to the selection of Supervisory Board members to be appointed to the committees. The banking expertise and international experience of the committee members was important to the selection process. Item 5.4.2 in the section on the composition and remuneration of the Super-



visory Board recommends that the members of the Supervisory Board do not exercise directorships or advisory tasks for important competitors of the company. In view of the due care that was taken by the 2006 Annual General Meeting in selecting the members of the Supervisory Board, this recommendation was complied with in the best possible way. This also applies to the successor to Dr. Nolting, who retired from the Supervisory Board of Aareal Bank after having assumed the position of Chairman of the Management Board of Allgemeine Hypothekenbank Rheinboden AG.

Aareal Bank AG was unable to adhere to the recommendation of the Code to elect Supervisory Board members at varied dates. The reason for this was that historically, all terms of office end on a single termination date. The recommendation could not be adhered to without breaching the principle of equal treatment of all candidates. Furthermore, grading the terms of office would represent an unnecessary increase in the bank's administrative expenditure.

The regulations laid down in item 7.1.3 in the section on accounting practises in the Code refer to the breakdown of the remuneration as of page 70.

Management Board

The Management Board is responsible for managing the company. In doing so, it is obliged to act in the best interests of the

company and undertakes to increase its sustainable enterprise value. The Management Board ensures that all provisions of law are complied with, and endeavours to achieve their compliance throughout Group companies. The Management Board develops company strategy, coordinates it with the Supervisory Board, and ensures its implementation. It ensures appropriate risk management and risk controlling throughout the company. The Management Board cooperates trustfully with Aareal Bank's other executive bodies, and with employee representatives.

There were no conflicts of interest affecting members of the Management Board within the meaning of Aareal Bank's Corporate Governance Code in the 2006 financial year.

The Supervisory Board

The task of the Supervisory Board is to advise regularly, and to supervise the Management Board in the management of the company. It is involved in decision-making that is of fundamental importance to the company, and cooperates closely and on the basis of trust with the Management Board.

The members of the Supervisory Board and their functions in the Supervisory Board's committees are listed on page 34. The Supervisory Board reports on its duties and the events of the 2006 financial year in its report on page 86 of this Annual Report. The members of the Supervisory Board

have stated that there were no conflicts of interest during the financial year under review. As was stated above, Dr. Nolting retired from his office to avoid conflicts of interest. The Supervisory Board reviews the efficiency of its own activities on a regular basis. The following considerations in particular are examined:

- meetings (contents, duration, results);
- information provided to the Supervisory Board by the Management Board;
- composition of the Supervisory Board; and
- specific topics relevant to the committees.

The results serve to further improve the work carried out by the Supervisory Board as well

as enhancing the cooperation between the Supervisory Board and the Management Board. The analysis showed that the Supervisory Board largely works efficiently, and that there is potential for improvement only in certain areas.

The Supervisory Board has created committees for its work. Responsibility for individual duties has been delegated to these committees.

The committees and their duties are outlined in this Annual Report in the Supervisory Board report, and the positions are occupied as set out below.

Remuneration system for the Supervisory Board

A resolution was adopted by the Annual General Meeting in 2006 to reduce the number of members in the Supervisory Board and to adjust its remuneration system accordingly. In the financial year 2006, those members that were re-elected to the Supervisory Board in 2006 will be remunerated on a pro-rata basis in accordance with the old remuneration system for the period until the Annual General Meeting, and pro-rata on the basis of the new remuneration system for the period thereafter.

After the realignment, the total remuneration of the Supervisory Board will comprise a fixed and a variable remuneration component, comparable to the remuneration pack-

D = Chairman
Dpty. C = Deputy Chairman

	Plenary meeting	Executive Committee	Accounts and Audit Committee	Credit and Market Risk Committee	including: Committee for Urgent Decisions
Hans W. Reich	X (C)	X (C)	X	X (C)	X (C)
Erwin Flieger	X (Dpty. C)	X (Dpty. C)		X	X
Christian Graf von Bassewitz	X		X	X	X
Manfred Behrens	X				
Dr. Herbert Lohneiß	X			X (Dpty. C)	X
Joachim Neupel	X		X (C)	X	X
Prof. Dr. Stephan Schüller	X	X	X (Dpty. C)		
Wolf R. Thiel	X	X			
York-Detlef Bülow	X (Dpty. C)	X (Dpty. C)	X		
Tamara Birke	X			X	
Thomas Hawel	X				
Helmut Wagner	X				

	Fixed remuneration Total	Variable remuneration Total	Total remuneration
Hans W. Reich	107,050.60	8,827.49	115,878.09
Christian Graf v. Bassewitz	56,249.69	3,447.69	59,697.38
York-Detlef Bülow	56,525.51	4,344.33	60,869.84
Tamara Birke	29,270.67	3,447.69	32,718.36
Manfred Behrens	22,278.44	3,447.69	25,726.14
Dr. Richard Brantner (until 23 May 2006)	28,605.60	1,654.43	30,260.03
Prof. Dr. Johann Eekhoff (until 23 May 2006)	8,294.00	1,654.43	9,948.43
Wolfgang Fauter (until 23 May 2006)	11,611.60	1,654.43	13,266.03
Erwin Flieger	48,231.51	4,344.33	52,575.84
Lutz Freitag (until 23 May 2006)	8,294.00	1,654.43	9,948.43
Thomas Hawel (since 23 May 2006)	13,984.44	1,793.26	15,777.71
Dr. Friedrich-Adolf Jahn (until 23 May 2006)	8,294.00	1,654.43	9,948.43
Ralf Kupka (until 23 May 2006)	11,611.60	1,654.43	13,266.03
Dr. Peter Lammerskitten (until 23 May 2006)	18,490.40	1,654.43	20,144.83
Jacques Lebhar ¹⁾ (until 23 May 2006)	4,887.03	896.73	5,783.75
Dr. Herbert Lohneiß (since 24 November 2006)	3,351.11	305.76	3,656.88
Joachim Neupel (since 23 May 2006)	34,961.11	3,586.53	38,547.64
Dr. Claus Nolting (since 23 May 2006 until 21 August 2006)	8,506.67	727.22	9,233.89
Kurt Pfeiffelmann (until 23 May 2006)	11,611.60	1,654.43	13,266.03
Prof. Dr. Stephan Schüller (since 23 May 2006)	27,968.89	1,793.26	29,762.15
Klaus-Peter Sell (until 23 May 2006)	11,611.60	1,654.43	13,266.03
Wolf R. Thiel	36,485.87	3,447.69	39,933.56
Prof. Dr. Dr. h. c. mult. Hans Tietmeyer (until 23 May 2006)	8,294.00	1,654.43	9,948.43
Helmut Wagner (since 23 May 2006)	13,984.44	1,793.26	15,777.71
Reiner Wahl (until 23 May 2006)	11,611.60	1,654.43	13,266.03
Dr. Jürgen Westphal (until 23 May 2006)	11,611.60	1,654.43	13,266.03
Anja Wölbert (until 23 May 2006)	8,294.00	1,654.43	9,948.43
	621,971.58	63,710.55	685,682.13

All details on the variable remuneration component assume a dividend payment of € 0.50 per share entitled to dividend payments.

¹⁾ after deduction of 30 % withholding tax for Supervisory Board members (section 50a (1) and 50a (2) of the German Income Tax Act) and 5.5 % solidarity surcharge

age of the Management Board. The variable remuneration is performance-related and comprises a short-term and a long-term component.

The fixed remuneration is € 20,000 p.a. for each Supervisory Board member. The Chairman of the Supervisory Board shall receive twice the amount, while the deputy shall receive one and a half times as much as a normal member. The fixed remuneration is increased by € 10,000 p.a. for any Supervisory Board committee member (with the exception of the Committee for Urgent Decisions, which is a part of the Credit and Market Risk Committee).

The fixed remuneration is increased instead by € 20,000 p.a. for Chairmanship of a Supervisory Board committee (also with the exception of the Committee for Urgent Decisions, being a part of the Credit and Market Risk Committee).

The fixed remuneration component of a Supervisory Board member, including the remuneration for the Chairmanship of a Supervisory Board committee, forms the basis for assessing the performance-related remuneration. The performance-related remuneration only comes into effect if a dividend is paid for the financial year in question that exceeds at least € 0.20 per share.

The short-term performance-related remuneration currently amounts to 12.5 % of the individual assessment basis for each full

€ 50 million of the consolidated net income attributable to shareholders of Aareal Bank AG as reported in the Group income statement. However, it may not exceed 50 % of the individual assessment basis.

The long-term performance-related remuneration of a Supervisory Board member amounts to 12.5 % of the individual assessment basis for each 10 % increase in the consolidated net income attributable to shareholders of Aareal Bank AG (as reported in the consolidated income statement) over the unweighted average of the consolidated net income attributable to shareholders of Aareal Bank AG for the three previous full financial years. The long-term profit-oriented remuneration is not paid if the average value is negative. On this basis, the members of the Supervisory Board are not entitled to a long-term performance-related remuneration for the 2006 financial year. The long-term performance-related remuneration is capped at 50 % of the individual assessment basis, so that the aggregate variable remuneration may amount to maximum 100% of the fixed remuneration component.

Transactions with related parties

The bank also concludes transactions with related parties. These transactions are presented on page 69 of the Notes to the Financial Statements in this Annual Report.

Trade date	Name	Status	Type	Quantity	Price per share	Volume
30 June 2006	Christian Graf von Bassewitz	Supervisory Board	Purchase	1,000	29.50	29,500
29 June 2006	Christian Graf von Bassewitz	Supervisory Board	Purchase	1,000	29.24	29,240
21 June 2006	Christian Graf von Bassewitz	Supervisory Board	Purchase	2,000	29.76	59,520
26 May 2006	Thomas Ortmanns	Management Board	Purchase	300	33.28	9,984
03 April 2006	Christof M. Schörnig	Management Board	Sale	1,798	38.85	69,848
21 March 2006	Christof M. Schörnig	Management Board	Sale	2,308	38.27	88,332
20 March 2006	Christof M. Schörnig	Management Board	Sale	2,000	38.60	77,200

Purchase or sale of the company's shares

The table above indicates the transactions carried out in 2006 by members of the company's executive bodies at the following terms. These transactions were published subject to the reporting requirements of the German Securities Trading Act (WpHG) in the category "Director's Dealings" on Aareal Bank AG's website.

Accounting policies

The Aareal Bank Group accounts are prepared in accordance with International Accounting Standards (IAS) / International Financial Reporting Standards (IFRS). The single-entity financial statements of Aareal Bank AG are prepared in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – HGB). The Management Board prepares the financial statements of Aareal Bank AG and the consolidated financial statements. The Supervisory Board approves them and thus

confirms the financial statements of Aareal Bank AG. The financial statements are audited by PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, which was appointed by the Annual General Meeting as auditors for the financial year 2006.

Relationship to shareholders

The General Meeting of Aareal Bank AG is held once a year. At this Annual General Meeting, the shareholders decide, in particular, on the formal approval for the members of the Supervisory Board and Management Board for the financial year under review, on the appropriation of any net retained profit, amendments to the Memorandum and Articles of Association, and authorisations on capital adjustments. The Annual General Meeting also elects the auditor for the company.

The company's shareholders may submit statements or proposals in writing, by fax or

e-mail, to the company or may request to speak at the Annual General Meeting. The shareholders may also submit counter or supplemental motions to the agenda items at the Annual General Meeting so that they participate in structuring and influencing the meeting. At the Annual General Meeting, the Management Board or Supervisory Board shall comment on or answer the contributions made by shareholders.

Communication

Aareal Bank AG's policy of communication is oriented towards the interests of all stakeholders. It publishes details on the financial position and performance quarterly.

This published information is elaborated on by the Management Board in press conferences and analysts' meetings, and thus communicated to the interested public. The company publishes any information which may impact its share price, in the form of ad-hoc disclosures. This information is also published on the bank's website. Aareal Bank is striving to exploit in a targeted manner the possibilities offered by modern communications channels, particularly the internet.

The company's realignment programme reflects the importance of open and transparent communication to Aareal Bank AG.

Declaration of Compliance with section 161 of the German Stock Corporation Act (AktG)

The Management Board and Supervisory Board of Aareal Bank AG declare, in accordance with section 161 of the AktG, that:

"Aareal Bank AG has complied with the recommendations of the Government Commission "German Corporate Governance Code" (as amended on 02 June 2005 and, with effect from 12 June 2006, as amended on that date) since the last Declaration of Compliance was issued in December 2005; in each case, except for the recommendations mentioned below:

Pursuant to section 3.8 of the German Corporate Governance Code, a suitable deductible shall be agreed if the company takes out a D&O (directors and officers' liability insurance) policy for the Management Board and Supervisory Board.

For the members of the Management Board and Supervisory Board, there is a directors' and officers' liability insurance policy without a deductible. Since it goes without saying that all members of Aareal Bank's Management Board and Supervisory Board have a duty to act responsibly, no deductible is required.

Pursuant to section 4.2.2 of the Code the full Supervisory Board shall discuss and regularly review the structure of the Manage-

ment Board compensation system at the proposal of the committee dealing with Management Board contracts.

The Supervisory Board of Aareal Bank AG has transferred responsibility for matters relating to the remuneration of the Management Board to its Executive Committee, which independently resolves upon and deals with them. This procedure has proven to be successful over many years of practice. The Executive Committee discusses the structure of the system of compensation, regularly examines it and determines the amount of compensation for members of the Management Board. It reports to the full Supervisory Board on the discussion and examination of the system of compensation.

Wiesbaden, December 2006

The Management Board



Dr. Schumacher



Kickum



Merkens



Ortmanns



Schornig

For the Supervisory Board



Hans W. Reich (Chairman)

In the coming fiscal year, Aareal Bank AG will continue to comply with the recommendations of the German Corporate Governance Code (as amended on 12 June 2006) except with respect to sections 3.8 and 4.2.2 as set out above.

Furthermore, Aareal Bank AG adopted its own Corporate Governance Code as early as 1999. The bank's Code has been adapted to incorporate amendments to the German Corporate Governance Code; it goes far beyond the recommendation of the Government Commission."

For further details on the Corporate Governance Principles of Aareal Bank AG, please refer to our website: http://www.aareal-bank.com/servlet/PB/menu/1002243_12/index.html

INCOME STATEMENT

OF AAREAL BANK AG FOR THE PERIOD FROM 01 JANUARY TO 31 DECEMBER 2006

EXPENSES	2006	2005
€ mn		
Interest expenditure	1,275.4	1,037.9
Commission expenditure	47.4	48.3
Net expenditure on financial operations	1.1	1.5
General administrative expenses		
a) Staff costs		
aa) Wages and salaries	98.1	
ab) Social security contributions, pensions and other employee benefits	19.3	117.4
Including: pensions 7,2		
b) Other administrative expenses	99.2	214.5
Depreciation / amortisation of, and writedowns on intangible and fixed assets	8.0	9.2
Other operating expenses	45.3	32.6
Depreciation / amortisation of, and writedowns on claims and certain securities, additions to loan loss provisions	82.3	248.1
Expenditure for assumption of losses	17.9	26.9
Net income taxes	61.9	50.4
Other taxes not reported under "Other operating expenses"	0.0	0.0
Net income	117.4	0.0
Total expenses	1,873.3	1,669.4
Net income / loss	117.4	-33.3
Profit carried forward	0.0	0.0
Withdrawals from retained earnings		
from the reserve for treasury shares	0.0	0.0
from other retained earnings	0.0	33.3
Transfer to retained earnings		
Amounts transferred to the reserve for treasury shares		
Amounts transferred to other retained earnings	58.0	0.0
Net retained profit	59.4	0.0



INCOME		2006	2005
€ mn			
Interest income from			
a) Lending and money market transactions	1,248.2		
b) Fixed-income securities and government ledger bonds	360.4	1,608.6	1,380.4
Current income from			
a) Equities and other non-fixed income securities	21.1		
b) Participating interests	9.4		
c) Interests in affiliated companies	10.3	40.8	53.6
Income from profit pools, profit transfer agreements and partial profit transfer agreements		86.6	47.3
Commission income		106.5	94.4
Income from write-ups to participating interests, shares in affiliated companies and securities held as fixed assets		3.3	43.2
Other operating income		27.5	17.2
Net loss		0.0	33.3
Total income		1,873.3	1,669.4

BALANCE SHEET

OF AAREAL BANK AG AS AT 31 DECEMBER 2006

ASSETS		2006	2005
€ mn			
Cash funds			
a) Cash on hand	0.0		
b) Balances with central banks	1,330.2	1,330.2	1,492.3
Including: with Deutsche Bundesbank	1,174.8		
Loans and advances to banks			
a) Payable on demand	650.3		
b) Other loans and advances	2,766.3	3,416.6	3,359.5
Loans and advances to customers		22,819.9	20,206.6
Including: secured by charges on real property	10,826.2		
Loans to local authorities	2,635.8		
Debt and other fixed-income securities			
a) Money market instruments	0.0		
b) Bonds and notes			
ba) Public-sector issuers	5,629.0		
Including: securities eligible as collateral with Deutsche Bundesbank	4,598.9		
bb) Other issuers	2,609.7	8,238.7	
Including: securities eligible as collateral with Deutsche Bundesbank	2,007.4		
c) Own bonds	903.2	9,141.9	7,626.8
Nominal amount:	892.0		
Equities and other non-fixed income securities		589.2	526.5
Participating interests		61.0	65.1
Including: interests in banks	0.8		
interests in financial services providers	–		
Interests in affiliated companies		438.8	822.2
Including: interests in banks	28.9		
interests in financial services providers	–		

SHAREHOLDERS' EQUITY AND LIABILITIES				2006	2005
€ mn					
Liabilities to banks					
a) Payable on demand	635.6				
b) With an agreed maturity or notice period	4,828.4			5,464.0	8,319.1
Liabilities to customers					
a) Savings deposits					
aa) With a notice period of three months	0.1				
ab) With an agreed notice period of more than three months	0.0	0.1			
b) Other liabilities					
ba) Payable on demand	5,182.0				
bb) With agreed maturity or notice period	16,279.6	21,461.6		21,461.7	15,013.1
Certificated liabilities					
a) Bonds issued	8,026.8				
b) Other certificated liabilities	–			8,026.8	7,864.2
Trust liabilities				1,341.2	2,964.5
Including: trustee loans 1,339.7					
Other liabilities				93.7	85.5
Deferred items				97.3	138.7
Provisions					
a) Provisions for pensions and similar obligations	59.6				
b) Tax provisions	77.8				
Including: provisions for deferred taxes 67.1					
c) Other provisions	133.1			270.5	267.0
Subordinated liabilities				922.5	936.8
Profit-participation certificates				487.9	564.4
Including: maturing within two years 10.2					

ASSETS	2006	2005
€ mn		
Trust assets	1,341.2	2,964.5
Including: trustee loans 1,339.7		
Intangible assets	8.5	13.5
Fixed assets	5.5	9.7
Other assets	235.2	113.3
Deferred items	77.5	95.3
Deferred taxes	47.3	101.1
Total assets	39,512.8	37,396.4

SHAREHOLDERS' EQUITY AND LIABILITIES			2006	2005
€ mn				
Fund for general banking risks			58.0	58.0
Shareholders' equity				
a) Subscribed capital	128.3			
Contributions by silent partners	220.2			
b) Capital reserve	509.5			
c) Retained earnings				
ca) Legal reserve	4.5			
cb) Reserve for treasury shares	–			
cc) Statutory reserves	–			
cd) Other retained earnings	367.3	371.8		
d) Net retained profit		59.4	1,289.2	1,185.1
Total shareholders' equity and liabilities			39,512.8	37,396.4
Contingent liabilities (€ mn)				
a) Contingent liabilities from discounted forwarded bills	–			
b) Liabilities from guarantees and indemnity agreements	1,451.6			
c) Liability from the pledging of collateral for third-party liabilities	–		1,451.6	555.7
Other commitments (€ mn)				
a) Repurchase obligations from securities repurchase agreements	–			
b) Placement and underwriting obligations	–			
c) Irrevocable loan commitments	3,007.1		3,007.1	3,020.5

ACCOUNTING AND VALUATION PRINCIPLES

The financial statements of Aareal Bank AG for the financial year 2006 were prepared in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – "HGB") and the supplementary regulations of the German Stock Corporation Act (Aktiengesetz – "AktG") and the German Accounting Directive for Banks and Financial Services Providers (Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute – "RechKredV").

Merger of Aareal Hyp AG into Aareal Bank AG

Aareal Hyp AG was merged into Aareal Bank AG effective as at 01 January 2006. The extension of the license in accordance with section 32 of the German Banking Act (Kreditwesengesetz – "KWG") to the Pfandbrief (asset-covered bond) business became effective on 03 March 2006 upon the proper registration of the merger with the Commercial Register.

The merger resulted in an increase of total assets of Aareal Bank AG as at the merger date to € 39,012.8 million. The main effects from the merger were an increase in loans and advances to customers (€ +3,627.4 million) and the portfolio of bonds and fixed-income securities (€ +1,642.1 million), while loans and advances to banks declined by € 1,252.4 million.

Liabilities to banks and customers grew by € 3,153.7 million.

Loans and advances

Loans and advances to banks and customers are carried at amortised cost, including

deferred interest. Premiums and discounts are shown under deferred items, in accordance with section 340e (2) of the HGB. Credit risks are accounted for by setting aside provisions in the amount of the expected loss, using prudent estimates. At Aareal Bank, the calculation of general loan loss provisions is based on a procedure using standard risk costs. These costs are determined on the basis of actual risk provisioning expenditure, and recalculated on a regular basis.

Securities

Bonds and other fixed-income securities, as well as equities and other non-fixed income securities, are measured strictly at the lower of cost or market value, as prescribed for current assets, taking into account hedging instruments. Where the reasons for the write-down no longer apply, such securities must be written up in accordance with section 280 of the HGB.

Participating interests, interests in affiliated companies and fixed assets

Participating interests, interests in affiliated companies and fixed assets are stated at the cost of acquisition or manufacture, less scheduled depreciation. Special write-downs are required in the event of impairments in value deemed to be other than temporary. Where the reasons for the write-down no longer apply, such participating interests or interests in affiliated companies must be

written up in accordance with section 280 of the HGB. Where land and buildings were acquired to salvage loans and have been in the possession of the bank for more than five years, these are reported under fixed assets. Low-value commercial goods ("geringwertige Wirtschaftsgüter") are depreciated in full in the year of their acquisition, and shown as additions or disposals in the list of investments. The option to disclose a net amount, pursuant to section 340c (2) of the HGB has been exercised.

Treasury shares

Treasury shares are capitalised at cost, and the appropriate amount transferred to the reserve for treasury shares. Treasury shares are measured at the lower of cost or market.

Liabilities

Liabilities are stated at their repayment amount. The difference between the nominal value and the initial carrying amount of liabilities is recognised under deferred items, and amortised over the term of the liability.

Provisions

Provisions for pensions and similar obligations are determined using an interest rate of 6 % on the basis of the cost method ("Teilwertverfahren") according to section 6 a of the German Income Tax Act (Einkommensteuergesetz – EStG). Provisions for

taxes and other provisions have been set aside in the amount of the expected liability, as required by prudent commercial judgement.

Currency conversion

Aareal Bank has converted balance sheet items and pending transactions in foreign currency, in accordance with section 340h of the HGB and statement 3/1995 issued by the Banking Committee of the German Institute of Auditors (BfA). The bank has classified all foreign exchange transactions as "specific cover" in accordance with section 340h (2) sentence 2. Hence, income and expenses from currency conversion were recognised in the income statement, in accordance with section 340h (2) sentences 1 and 2 of the HGB. As all pending foreign currency exposures at the end of 2006 were related to concurrent business operations, no amounts needed to be disclosed separately under section 340h (2) sentence 4 of the HGB.

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

Currency conversion income and expenses are reported in net profit on financial operations.

Trading portfolio

Aareal Bank AG is authorised to operate a trading book pursuant to section I (12) of the KWG. Transactions in the trading book are subject to institutionalised risk management, with a strict limitation of risk exposure and daily risk reporting. Financial transactions accounted for in the trading book are measured strictly at the lower of cost or market in accordance with section 253 of the HGB. This measurement is carried out on a portfolio basis, whereby positive and negative measurement results within the same portfolio are set off; any net unrealised loss on a portfolio basis is reported, while a net unrealised profit is not. Interest on trading-book securities is recognised in net interest income, while interest on interest-rate based derivatives is recognised in the result of own-account trading. The results of own-account trading are reported in net profit on financial operations.

NOTES TO THE INCOME STATEMENT

Income by geographical segment

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

	2006 € mn	2005 € mn
Germany	1,550.1	1,324.9
Europe / America / Asia	233.2	220.7
Total	1,783.3	1,545.6

Administration and intermediation services rendered to third parties

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

Other operating income and expenses

Other operating income in the amount of € 27.5 million includes € 19.5 million in income attributable to the release of provisions which were no longer needed, and € 3.3 million in income under agency contracts for Group subsidiaries.

Other operating expenses in the amount of € 45.3 million include expenses totalling

€ 16.0 million for external projects, and € 3.2 million for the reimbursement of expenses for the sales activities of a Group subsidiary.

Net income tax expense

Besides income taxes for the current year, this item includes € 70.8 million in net expenses from the recognition of deferred taxes, comprising € 53.8 million from the reversal of deferred tax assets and € 17.0 million from the recognition of deferred tax liabilities.

Due to the passing of the act regarding fiscal measures intended to accompany the introduction of the European Company and the amendment of other fiscal provisions (SEStEG), corporate income tax credits in accordance with section 37 of the German Corporation Tax Act (Körperschaftsteuergesetz, KStG) have to be initially recognised as at 31 December 2006. This capitalisation resulted in income amounting to € 15.1 million.

NOTES TO THE BALANCE SHEET

Securities negotiable at a stock exchange

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

	Listed 31 Dec 2006 € mn	Unlisted 31 Dec 2006 € mn
Debt and other fixed-income securities (excluding pro-rata interest)	7,953.3	1,015.4
Equities and other non-fixed income securities	19.1	108.1
Participating interests	–	–
Interests in affiliated companies	–	–

Valuation units with hedging transactions have been created with respect to negotiable securities in an aggregate amount of € 5,979.7 million. Equities and other non-fixed income securities include € 9.1 million of investment fund units which are exclusively reserved to meet the Aareal Bank AG's pension obligations vis-à-vis its active and retired employees in Germany.

Subordinated assets

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

	31 Dec 2006 € mn	31 Dec 2005 € mn
Loans and advances to banks	38.1	85.2
Loans and advances to customers	114.7	160.2
Debt and other fixed-income securities	14.9	14.9
Equities and other non-fixed income securities	1.0	15.6
Other assets	–	–

Fixed assets development schedule

	Participating interests (Assets 7) € mn	Interests in affi- liated companies (Assets 8) € mn	Intangible assets (Assets 11) € mn	Fixed assets (Assets 12)	
				Office furniture and equipment € mn	Land and buildings € mn
Cost 01 Jan 2006	77.1	898.3	40.4	48.9	7.0
Additions	0.6	31.1	0.5	1.7	–
Disposals	5.1	444.6	0.0	3.1	5.3
Transfers	–	–	–	–	–
Depreciation, amortisation and writedowns (accumulated 31 Dec 2005)	12.0	76.1	26.8	43.5	2.6
Depreciation, amortisation and writedowns in the current year	0.3	7.5	5.6	2.4	0.1
Disposals	0.7	37.6	0.0	2.9	2.0
Transfers	–	–	–	–	–
Book value as at 31 Dec 2006	61.0	438.8	8.5	4.5	1.0
Book value as at 31 Dec 2005	65.1	822.2	13.5	5.3	4.4

The option to aggregate non-trading assets, pursuant to section 34 (3) of the RechKredV, has been exercised. The bank has rented the majority of business land and buildings used for its business operations from one of its subsidiaries. As part of the transfer of some of the business activities from DEPFA Deutsche Pfandbriefbank AG to Aareal Bank AG, good-will has been capitalised and reported under intangible assets.

This will be amortised over the expected useful life of nine or ten years, respectively.

Other assets

Other assets include, in particular, € 27.0 million in assets recognised from currency conversion and € 85.8 million in receivables from assumption of profits.

Deferred taxes

Deferred taxes were reversed in accordance with section 274 (2) of the HGB during the financial year 2006. At 31 December 2005, € 47.3 million in deferred tax assets and € 67.1 million in deferred tax liabilities were reported. Deferrals are made in the amount of the assumed tax burden or relief in coming financial years based on the respective local tax rates.

Other liabilities

Other liabilities include, in particular, € 12.7 million in liabilities from the assumption of losses and € 10.1 million in interest liabilities on silent partnership contributions.

Subordinated liabilities

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

Total interest expenses for subordinated liabilities of € 52.3 million include € 13.1 million in deferred interest not yet due.

In the financial year 2002, Aareal Bank AG raised € 227.0 million in subordinated capital from Aareal Property Services B.V., Amsterdam, due on 31 December 2026, of which € 23 million were provided to Aareal Bank France S.A., Paris, and € 47 million to Aareal Hyp AG, Wiesbaden. The bank had an initial right to terminate on 31 December 2006; the creditors do not have any early termination rights.

Aareal Capital Funding LLC has assumed all obligations of Aareal Property Services B.V. under subordinated capital issues as at 31 December 2005. Upon the merger of Aareal Hyp AG into Aareal Bank AG, effective at 03 March 2006, the share in subordinated capital of Aareal Hyp AG was transferred to Aareal Bank AG. Given the changed transaction structure, the bank now has € 250 million in subordinated equity from Aareal Capital Funding LLC at its disposal, of which it, in turn, made a partial amount available to Aareal Bank France S.A. (€ 23 million). The bank's attributable share of € 227 million exceeds 10 % of the aggregate nominal value of all subordinated liabilities which bear an interest of 7.135 %.

Profit-participation certificates

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

	Nominal amount € mn	Issue currency	Interest rate (% p.a.)	Maturity
Bearer profit- participation certificates				
	150.0	€	6.750	2002 - 2011
	100.0	€	6.375	2002 - 2011
	60.0	€	6.125	2003 - 2013
	310.0			
Registered profit- participation certificates				
	10.2	DM	6.800	1996 - 2007
	5.0	€	7.010	2002 - 2012
	10.0	€	7.010	2002 - 2012
	5.0	€	7.010	2002 - 2012
	10.0	€	7.010	2002 - 2012
	5.0	€	7.100	2002 - 2012
	10.0	€	7.150	2002 - 2012
	5.0	€	7.030	2002 - 2012
	5.0	€	7.220	2002 - 2016
	5.0	€	7.220	2002 - 2016
	5.0	€	6.080	2003 - 2013
	20.0	€	6.120	2003 - 2013
	5.0	€	6.310	2003 - 2017
	10.0	€	5.750	2004 - 2014
	2.0	€	5.470	2004 - 2014
	5.0	€	5.480	2004 - 2014
	5.0	€	5.380	2004 - 2016
	20.0	€	5.950	2004 - 2016
	6.0	€	5.830	2005 - 2017
	148.2			

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

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

€ 35.6 million (2005: € 35.3 million) in interest expenses were incurred in 2006 with respect to profit-participation certificates issued.

The profit-participation certificates evidence creditors' rights; they do not grant any share in the liquidation proceeds. Profit-participation certificates meet the requirements for liable equity capital pursuant to section 10 (5) of the KWG.

Purchase of treasury shares

The Company has been authorised by the Annual General Meeting held on 23 May 2006 to purchase and sell its own shares, pursuant to section 71 (1) no. 7 of the AktG, until 22 November 2007. The volume of shares acquired for this purpose must

not exceed 5 % of the bank's share capital at the end of any day. The lowest price at which a share may be acquired is determined by the closing price of the shares in Xetra (or a comparable successor system) on the trading day prior to such purchase less 10 %. The highest price shall not exceed such average closing price plus 10 %.

The Company was authorised at the same Annual General Meeting to purchase its own shares not exceeding 10 % of the bank's share capital for other purposes than securities trading until 22 November 2007. Shares may be acquired via the stock exchange or by means of a public offer to buy, directed at all shareholders. Neither the purchase price, excluding ancillary costs, (if the acquisition takes place via the stock market) nor the offering price, excluding ancillary costs, (in case of a public offer to buy) may exceed or fall below the average closing price of the Bank's shares in Xetra (or a comparable successor system) during the three trading days prior to the purchase or the public announcement of the purchase offer by more than ten per cent (10 %).

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

Development of shareholders' equity reported on the balance sheet

	€ mn	€ mn
Subscribed capital		
Balance at 01 Jan 2006 (of which: € 233.5 million contributions by silent partners)	361.8	
Repayment of silent partner's interest	-13.3	
Balance at 31 Dec 2006 (of which: € 220.2 million contributions by silent partners)		348.5
Capital reserve		
Balance at 01 Jan 2006	509.5	
Balance at 31 Dec 2006		509.5
Retained earnings		
Legal reserve		
Balance at 01 Jan 2006	4.5	
Balance at 31 Dec 2006		4.5
Other retained earnings		
Balance at 01 Jan 2006	309.3	
Allocation from 2005 balance sheet profit	0.0	
Allocation from net income for the financial year	58.0	
Balance at 31 Dec 2006		367.3
Net retained profit		59.4
Shareholders' equity as at 31 Dec 2006		1,289.2

Subscribed capital is divided into 42,755,159 bearer unit shares (notional no-par value shares).

The regulatory capital in accordance with the German Banking Act (KWG) totalled € 2,205 million. Based on the confirmation of Aareal Bank AG's financial statements 2006, regulatory capital totalled € 2,354 million.

Authorised capital

The Annual General Meeting held on 15 June 2005 resolved to approve a new authorised capital. The Management Board is authorised to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 58,300,000 (Authorised Capital) by issuance of new bearer shares for contribution in cash or in kind (where such contribution in kind may represent the full contribution, or part thereof), subject to the approval of the Supervisory Board; this authority will expire on 14 June 2010. The shareholders shall be granted a subscription right, unless the Management Board exercises its authority to exclude shareholder's pre-emptive subscription rights. The Management Board may exclude shareholders' subscription rights, subject to approval by the Supervisory Board and the conditions set out below:

- in the event of a capital increase against cash contributions, provided that the issue price is not significantly below the prevailing stock exchange price. However, this authorisation shall be subject to the proviso that the aggregate value of shares issued to the exclusion of shareholders' subscription rights, in accordance with section 186 (3) sentence 4 of the AktG, shall not exceed ten per cent (10 %) of the issued share capital at the time of exercising said authorisation. Any shares that were issued or sold during the term

and prior to the exercising of said authorisation, in direct or analogous application of section 186 (3) sentence 4 of the AktG, shall count towards the above threshold of ten per cent (10 %) of the issued capital. Said ten-per-cent threshold shall also include shares which were issued (or the issuance of which is required) under the terms of debt securities with embedded conversion or option rights on shares issued pursuant to section 186 (4) sentence 4 of the AktG, which are outstanding at the time of exercising said authorisation;

- for fractional amounts arising from the determination of the applicable subscription ratio;
- where this is necessary to grant subscription rights to the holders of bonds with warrants or convertible bonds issued (or to be issued) by the Company or its affiliated companies, which subscription rights are required to entitle these holders to the same extent as they would have been entitled upon exercising their conversion or option rights or upon performance of a conversion obligation, if any, thus protecting such holders against dilution;
- for an amount of up to € 4 million, to offer employees (of the Company or its affiliated companies) shares for subscription;
- where the new shares will be issued against contributions in kind.

Exercising said authorisations, and with the approval of the Supervisory Board, the Management Board resolved on 06 November 2005 to increase the Company's issued share capital by € 11,660,496 (equivalent to 10% of the issued share capital prior to the increase) to € 128,265,477, by issuing 3,886,832 no-par value bearer shares against cash contributions, at an issue price of € 25.75. Excluding shareholders' pre-emptive subscription rights, Aareal Holding Verwaltungsgesellschaft mbH, Bayerische Beamtenversicherung and Neue Bayerische Beamten Lebensversicherung AG were admitted to subscribe and acquire the new shares. The capital increase was carried out, and entered in the Commercial Register on 21 November 2005.

Following this increase, the remaining authorised capital amounts to € 46,639,504. This authorisation will expire on 14 June 2010.

Conditional capital

The share capital is subject to a conditional capital increase of up to € 30 million by means of issuing ten million new no-par value bearer shares. Such a conditional capital increase serves to enable the company to service convertible bonds and/or bonds with warrants on the basis of the authorisation resolution of the Annual General Meeting held on 23 May 2006. Said resolution authorised the Management Board, subject to the consent of the Supervisory Board, to issue, on one or more occasions until

22 May 2011, convertible bonds and/or bond come warrants with a limited or an unlimited term in an aggregate nominal amount of € 600 million and to grant option and/or conversion rights to bearers or holders of bonds with regard to no-par value bearer shares of the Company, equivalent to a share in the equity capital of up to € 30 million. The issuance of bonds may be effected against contributions in kind for the purpose of acquiring companies, interests in companies or divisions of companies.

The bonds may be issued in euro as well as in any other currency – with the corresponding equivalent value – which is the legal tender of, for example, an OECD member state. They may also be issued via an indirect or a direct subsidiary of the Company; in this case, the Management Board is authorised, subject to the consent of the Supervisory Board, to issue a guarantee with regard to the bonds on behalf of the Company or to grant to the bondholders conversion or option rights to new no-par value bearer shares of the Company.

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

beginning of the financial year in which they come into existence through the exercise of conversion or option rights or the performance of conversion obligations. No convertible bonds or warrants were in issue as at the balance sheet date.

Contingent liabilities and other commitments

Contingent liabilities as at 31 December 2006 include € 164.7 million in maximum default guarantees extended to DEPFA Deutsche Pfandbriefbank AG (within the scope of splitting the former DEPFA Group), for the purpose of providing cover against risks of default with respect to the property loan portfolio held by DEPFA Deutsche Pfandbriefbank AG.

Irrevocable loan commitments are made up of credit and loan commitments. Of the total amount, € 1,026.3 million relates to domestic borrowers and € 1,980.8 million to foreign borrowers.

Remaining terms

	31 Dec 2006 € mn
Loans and advances to banks	3,416.6
Payable on demand	650.3
Up to 3 months	1,850.4
Between 3 months and 1 year	48.9
Between 1 year and 5 years	228.5
More than 5 years	93.5
Pro rata interest	545.0
Loans and advances to customers	22,819.9
Up to 3 months	2,303.1
Between 3 months and 1 year	1,179.9
Between 1 year and 5 years	9,130.6
More than 5 years	10,055.4
Indefinite maturity	–
Pro rata interest	150.9
Debt securities and other fixed-income securities maturing in the following year (nominal amount)	401.2

	31 Dec 2006 € mn
Liabilities to banks	5,464.0
Payable on demand	635.6
Up to 3 months	1,922.6
Between 3 months and 1 year	355.9
Between 1 year and 5 years	1,264.0
More than 5 years	839.9
Pro rata interest	446.0
Savings deposits with agreed notice period	0.1
Up to 3 months	0.1
Between 3 months and 1 year	0.0
Between 1 year and 5 years	0.0
Pro rata interest	0.0
Other liabilities to customers	21,461.5
Payable on demand	5,182.0
Up to 3 months	4,222.5
Between 3 months and 1 year	606.3
Between 1 year and 5 years	1,423.0
More than 5 years	9,760.1
Pro rata interest	267.6
Bonds issued maturing in the following year (nominal amount)	1,586.8
Other certificated liabilities	–

Deferred items

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

Deferred assets in the amount of € 77.5 million include € 27.8 million in premiums on originated loans, in accordance with section 340e (2) sentence 3 of the HGB, as well as € 26.2 million in discounts on bonds issued and borrowings pursuant to section 250 (3) of the HGB. € 21.6 million of deferred liabilities (total: € 97.3 million) are accounted for by discounts on originated loans, in accordance with section 340e (2) sentence 2 of the HGB.

Trust business

Trust assets	31 Dec 2006 € mn	Trust liabilities	31 Dec 2006 € mn
Loans and advances to banks	–	Liabilities to banks	600.8
Loans and advances to customers	1,339.7	Liabilities to customers	740.4
Equities and other non-fixed-income securities	1.5		
Total	1,341.2	Total	1,341.2

Notes on affiliated companies and enterprises with a participatory interest

	Affiliated companies		Enterprises with a participatory interest	
	Certificated € mn	Not certificated € mn	Certificated € mn	Not certificated € mn
Loans and advances to banks	–	342.8	–	–
Loans and advances to customers	–	293.2	–	0.2
Debt and other non-fixed-income securities	0.0	0.0	–	–
Liabilities to banks	0.0	0.0	–	–
Liabilities to customers	–	131.2	–	0.4
Certificated liabilities	–	–	–	–
Subordinated liabilities	–	250.0	–	–

Interests held in large limited companies

Aareal Bank AG holds more than 5 % of the voting rights in the following large limited companies: Deutsche Structured Finance GmbH.

Shareholdings

The full list of shareholdings has been published in the electronic Federal Gazette and is available to the public.

Assets pledged as collateral

Total assets pledged as collateral:

	31 Dec 2006 € mn	31 Dec 2005 € mn
Loans and advances to banks	166.8	279.3
Loans and advances to customers	516.4	1,294.7
Debt and other fixed-income securities	2,026.4	3,645.1
Total	2,709.6	5,219.1

Repurchase agreements

The book value of bonds pledged under repo agreements totalled € 99.9 million as at 31 December 2006. In addition, outstanding open-market transactions totalled € 900 million.

Assets and liabilities in foreign currencies

The aggregate equivalent amount of assets denominated in foreign currencies, calculated under the capital ratio according to the German Banking Act (Grundsatz I), was € 8,079 million at the balance sheet date, while liabilities totalled € 8,067 million.

Forward transactions

The following forward transactions had been entered into as at 31 December 2006:

- **Transactions based on interest rates**
Caps, floors, futures, swaptions, interest rate swaps
- **Transactions based on exchange rates**
Spot and forward foreign exchange transactions, cross-currency interest rate swaps
- **Other transactions**
Credit default swaps, credit-linked notes

Interest-rate based transactions and cross-currency interest rate swaps are primarily used to hedge against interest rate and exchange rate fluctuations.

Spot and forward foreign exchange transactions are almost exclusively used for refinancing purposes.

Credit derivatives are used both to hedge Aareal Bank AG's existing credit risk ex-

posure and to assume credit risks for the purpose of portfolio diversification.

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

Remaining terms and nominal amounts of derivatives are broken down in the following table:

	Nominal amount by remaining lifetime 31 Dec 2006				Nominal amount	
	up to 3 months € mn	3 months to 1 year € mn	1 to 5 years € mn	more than 5 years € mn	31 Dec 2006 € mn	31 Dec 2005 € mn
Interest rate instruments						
OTC products						
Interest rate swaps	2,047	3,412	17,094	18,051	40,604	31,319
Forward rate agreements					0	0
Swaptions	241	0	144	67	452	208
Caps, floors	43	427	2,565	779	3,814	4,384
Other interest rate instruments				0	0	0
Exchange-listed contracts					0	0
Interest rate futures	90	810	0	0	900	385
Options on interest rate futures	10	0	0	0	10	0
Total interest rate instruments	2,431	4,649	19,803	18,897	45,780	36,296
Currency-related instruments						
OTC products					0	0
Spot and forward foreign exchange transactions	3,192	85	13	0	3,290	4,987
Cross-currency interest rate swaps	650	1,227	1,204	301	3,382	3,864
Currency options					0	0
Other currency-related instruments					0	0
Exchange-listed contracts					0	0
Currency futures					0	0
Currency options					0	0
Total currency-related instruments	3,842	1,312	1,217	301	6,672	8,851
Other forward transactions						
OTC products					0	0
Credit default swaps *	0	0	75	3,321	3,396	4,113
Credit-linked notes *				1,014	1,014	1,014
Equity options				53	53	0
Total other forward transactions	0	0	75	4,388	4,463	5,127
Total	6,273	5,961	21,095	23,586	56,915	50,274

* of which: € 1,715 million financial guarantees

	Market values 31 Dec 2006		Market values 31 Dec 2005	
	positive € mn	negative € mn	positive € mn	negative € mn
Interest rate instruments				
OTC products				
Interest rate swaps	396	648	640	738
Forward rate agreements				
Swaptions	0	1	0	1
Caps, floors	9	9	9	9
Other interest rate instruments	0	0	–	–
Exchange-listed contracts	0	0	–	–
Interest rate futures	1	0	0	0
Options on interest rate futures	0	0	–	–
Total interest rate instruments	406	658	649	748
Currency-related instruments				
OTC products				
Spot and forward foreign exchange transactions	32	13	11	24
Cross-currency interest rate swaps	88	35	89	68
Currency options				
Other currency-related instruments				
Exchange-listed contracts	–	–	–	–
Currency options	–	–	–	–
Total currency-related instruments	120	48	100	92
Other forward transactions				
OTC products				
Credit default swaps *	30	0	41	–
Credit-linked notes *	0	6	–	11
Equity options	2	4		
Total other forward transactions	32	10	41	11
Total	558	716	790	851

* excluding financial guarantees

The table above shows positive and negative market values, aggregated by product level (without taking into account collateral or netting agreements): Unless a quoted market price is available, valuation of derivatives is based on recognised methods such as cash flow analyses, or options pricing models.

Derivatives have been entered into with the following counterparties:

	Market value 31 Dec 2006		Market value 31 Dec 2005	
	positive € mn	negative € mn	positive € mn	negative € mn
OECD public-sector authorities				
OECD banks	548	667	764	832
Non-OECD banks				
Companies and private individuals	10	49	26	19
Total	558	716	790	851

OTHER NOTES

Disclosures in accordance with German Pfandbrief Act (section 28)

Total amount and related cover assets pool for outstanding mortgage bonds and public-sector covered securities:

	Cover assets pool present value € mn	Covered bonds outstanding € mn	Excess cover € mn	Share of derivatives in cover assets pool %	Risk-adjusted net € mn
Mortgage bonds				-0.11	1,125.8
Nominal value	4,271.7	3,119.3	1,152.4		
Present value	4,434.2	3,172.8	1,261.4		
Public-sector covered bonds				0.00	590.2
Nominal value	3,246.8	2,685.2	561.6		
Present value	3,445.7	2,799.3	646.4		

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

	Cover assets pool € mn	Covered bonds outstanding € mn
Mortgage bonds		
Up to 1 year	309.9	171.6
Between 1 year and 5 years	2,331.5	1,782.7
Between 5 years and 10 years	1,444.7	1,165.0
More than 10 years	185.6	0.0
Total	4,271.7	3,119.3
Public-sector covered bonds		
Up to 1 year	276.2	5.0
Between 1 year and 5 years	811.1	445.6
Between 5 years and 10 years	786.5	987.8
More than 10 years	1,373.0	1,246.8
Total	3,246.8	2,685.2

Loans and advances used to cover mortgage bonds:

Distribution of the amounts measured at nominal value by volume:	Cover assets pool € mn
Up to € 300 k	167.0
between € 300 k to € 5 mn	516.2
more than € 5 mn	3,588.5
Total	4,271.7

The loans and advances used for lending against mortgage bonds did not include any items with payment arrears of 90 days or more.

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

	Pure building sites € mn	Buildings not yet yielding returns € mn	Commercial property					Residential property				Total cover assets pool € mn
			Office buildings € mn	Trade € mn	Industrial € mn	Other € mn	Total € mn	Single-family homes € mn	Multi-family homes € mn	Apartments € mn	Total € mn	
Belgium			4.2				4.2				0.0	4.2
Canada			39.3			41.1	80.4				0.0	80.4
Czech Republic			42.9				42.9				0.0	42.9
Denmark			87.2	46.2	4.0	71.0	208.4				0.0	208.4
Germany			155.2	52.8	44.8	134.2	387.1	75.2	30.2	467.5	572.9	960.0
Finland				104.3			104.3				0.0	104.3
France		19.5	68.0	34.3	41.8	40.7	184.8				0.0	204.3
Italy			308.5	160.5		21.7	490.6				0.0	490.6
Netherlands			119.3		127.2	37.9	284.4			16.4	16.4	300.8
Poland			70.9	66.2	22.9		160.0				0.0	160.0
Sweden			52.7	66.0	172.3		290.9			66.0	66.0	356.9
Switzerland			83.9	49.1		26.2	159.2				0.0	159.2
Spain				213.1			213.1				0.0	213.1
United Kingdom			169.2	61.5	27.5	150.3	408.4				0.0	408.4
USA				4.2		38.8	43.0			34.2	34.2	77.2
Total	0.0	19.5	1,201.2	858.2	440.4	561.9	3,061.7	75.2	30.2	584.1	689.5	3,770.7

In the financial year 2006, the bank did not acquire any properties for the purpose of loss prevention.

As at 31 December 2006, 355 foreclosures and 221 compulsory administration proceedings were pending.

As at 31 December 2006, interest payments in the amount of € 3.6 million for commercial property and in the amount of € 0.3 million for residential property were overdue for less than 90 days. In the year under review, there were no interest payments from mortgagors overdue for at least 90 days.

Redemptions in cover assets pool:

	Commercial property € mn	Residential property € mn
Scheduled repayments	41.7	54.2
Extraordinary repayments	753.9	192.0
Total	795.6	246.2

Distribution of the loans and advances measured at nominal value and used to cover public-sector covered bonds by countries in which the debtor or the guaranteeing body is located:

	State € mn	Authorities		Other € mn	Total € mn
		regional € mn	local € mn		
Austria	124.2	0.0	0.0	20.0	144.2
Germany	325.0	1,691.3	0.0	792.6	2,808.9
Italy	210.0	0.0	0.0	0.0	210.0
France	0.0	0.0	0.0	30.2	30.2
Spain	0.0	0.0	35.0	18.5	53.5
Total	659.2	1,691.3	35.0	861.3	3,246.8

Contingencies

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

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

Consolidated financial statements

As the parent company of the Aareal Bank Group, Aareal Bank AG, Wiesbaden, prepares Consolidated Financial Statements incorporating the bank. The consolidated financial statements have been deposited with the Commercial Register at the Wiesbaden District Court (Reg. No. HRB 13 184), and are available from Aareal Bank AG in Wiesbaden, Germany.

Loans to executive bodies of Aareal Bank

Loans granted to members of the Supervisory Board amounted to € 3.5 million as at 31 December 2006 (31 December 2005:

€ 3.1 million). Loans and advances to members of the Management Board totalled € 0.0 million (2005: € 0.0 million). The balance of loans and advances to other related parties was € 2.8 million as at the balance sheet date. Loans extended generally have a term between ten and 15 years, and bear interest at rates between 4.50 % and 5.55 %.

Remuneration of the Management Board and Supervisory Board

The Executive Committee of the Supervisory Board determines the structure and amount of remuneration for members of the Management Board. The Committee sets salaries and other remuneration components for members of the Management Board.

Aareal Bank AG has entered into fixed-term service contracts with the members of its Management Board.

In addition to fixed salary components, which are paid in twelve identical monthly instalments, the members of the Management Board receive a variable remuneration.

The basis for this variable remuneration component is a target system, largely based on net income (of the Group) as reported under International Financial Reporting Standards (IFRS), as well as qualitative and quantitative targets, which are re-defined annually.

The long-term component is paid in the form of phantom shares. The calculation of the number of phantom shares is based on the weighted average price on the basis of five trading days (Xetra) after publication of the annual financial statements adopted by the Supervisory Board. The phantom shares must be held for a period of three years after the date of purchase. Subsequently, the shares may be redeemed, in whole or in part, within a period of a further three years after no more than five working

days after publication of the quarterly report. Upon redemption of the shares, the relevant proportion of phantom shares is converted at the weighted average price as reported by Bloomberg on the redemption date and the resulting amount is paid as taxable income.

On the basis of the agreements made, the total amount of fixed and variable remuneration paid to members of the Management Board in 2006 was € 6,662,691.31 and can be broken down as follows:

	Remuneration 2006 €
Fixed remuneration	1,820,000.00
Variable remuneration	4,710,000.00
Other remuneration	132,691.31
Total remuneration	6,662,691.31

The breakdown of fixed and variable remuneration as stated above amongst the members of the Management Board is shown below:

	Fixed remuneration €	Cash bonus €	Long-term component €	Other ¹⁾ €	Total remuneration €
Dr. Wolf Schumacher	500,000.00	900,000.00	450,000.00	24,144.03	1,874,144.03
Norbert Kickum	300,000.00	435,000.00	435,000.00	22,036.35	1,192,036.35
Hermann Josef Merkens	420,000.00	375,000.00	375,000.00	31,753.05	1,201,753.05
Thomas Ortmanns	300,000.00	435,000.00	435,000.00	22,014.76	1,192,014.76
Christof M. Schörnig	300,000.00	435,000.00	435,000.00	32,743.12	1,202,743.12
					6,662,691.31

¹⁾ Other remuneration includes payments, in particular for company cars in the amount of € 70,402.47 as well as benefits related to social security contributions totalling € 56,915.46. This item also includes payments for theoretical dividends on phantom shares, in case the Company resolves to pay dividends on its shares.

Additional pension provisions were established in an amount of € 242,915.00. The total of pension provisions for active and former members of the Management Board and their surviving dependants amount to € 7,910,647.00. Members of the Management Board who joined the Company before 01 January 2005 are entitled to receive contractual pension payments before they reach the age of 65 when they have served for a period of five years, in case the bank rejects to extend their service contracts. Payments from other employment relationships and other pension plans, if any, are taken into account.

Payments to former Management Board members of Aareal Bank AG and their surviving dependants totalled € 490,151.64.

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

In the case of a change of control and a resulting loss of membership in the Management Board, the members affected receive, in settlement of their total remuneration, their fixed remuneration as well as a contractually agreed compensation for the variable remuneration, paid in monthly instalments during the remaining term of the agreements. In addition, the members of the Management

Board receive a lump-sum payment of up to 75 % of their annual fixed remuneration. If, in case of a change of control, members of the Management Board resign from office or are not willing to extend their office in spite of an offer on the part of the Company, the respective member of the Management Board receives, in settlement of the total remuneration, an amount not exceeding 50 % of the relevant fixed remuneration and the contractually agreed compensation for the variable remuneration. In addition, the relevant member of the Management Board receives a lump-sum payment of up to 50 % of the annual fixed remuneration.

The remuneration of the Supervisory Board members consists of a fixed and a variable remuneration. This applies both to the former remuneration system in effect until the Annual General Meeting 2006 and to the new remuneration system, which came into effect upon resolution of the Annual General Meeting. The fixed remuneration for the financial year 2006 amounts to a total of € 624,234.56, before deducting withholding tax for Supervisory Board members and solidarity surcharge for any member of the Supervisory Board who is non-German resident for tax purposes. The variable remuneration of the Supervisory Board amounted to € 64,204.10 and includes the above mentioned tax components. Accordingly, total remuneration for the Supervisory Board amounts to € 688,438.66. This total was recognised under the assumption that the Annual General Meeting approves the

Management Board's proposal on the distribution of earnings. The individual remuneration paid to members of the Supervisory Board is shown on page 35.

Throughout the financial year 2006, the bank has reported purchases and sales subject to reporting requirements under No. 6.6 of the German Corporate Governance Code, as well as under section 15a of the German Securities Trading Act (WpHG) to BaFin, the German financial services regulatory agency, without delay, and also published such details on its website. Furthermore, Aareal Bank AG has undertaken in its Code to disclose, without delay, each reported purchase or sale by members of the Management Board or the Supervisory Board on its website.

Employees

The average staffing level is shown below:

	2006	2005
Full-time employees	993	1,060
Part-time employees	139	141
Vocational trainees	13	5
Total	1,145	1,206

Auditors' fees

The following auditors' fees were recognised as expenses during the financial year:

Category	T€
Audit	2,023.0
Other audit or valuation services	55.4
Tax advisory services	65.6
Other services	1,845.1
Total	3,989.1

Notice pursuant to section 21 (1) of the WpHG

In June 2006, Aareal Bank AG published that the stake held in the bank by FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, had reached a threshold of 5 %, according to a notification received by the bank on 02 June 2006, and in accordance with section 160 (1) sentence 8 of the AktG in conjunction with section 21 (1) of the WpHG. According to the notification, FMR Corp. held 5.00 % of voting rights in Aareal Bank AG on 01 June 2006.

Also in June 2006, Aareal Bank AG published that the stake held in the bank by FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, had declined below a threshold of 5 %, according to a notification received by the bank on 08 June 2006, and in accordance with section 160 (1) sentence 8 of the AktG in conjunction with section 21 (1) of the WpHG. According to the notification, FMR Corp. held 4.97 % of voting rights in Aareal Bank AG on 07 June 2006.

In July 2006, Aareal Bank AG published that the stake held in the bank by FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, had exceeded a threshold of 5 %, according to a notification received by the bank on 21 July 2006, and in accordance with section 160 (1) sentence 8 of the AktG in conjunction with section 21 (1) of the WpHG. According to the notification, FMR Corp. held 5.41 % of voting rights in Aareal Bank AG on 20 July 2006.

In October 2006, Aareal Bank AG published that the stake held in the bank by FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, had declined below a threshold of 5 %, according to a notification received by the bank on 24 October 2006, and in accordance with section 160 (1) sentence 8 of the AktG in conjunction with section 21 (1) of the WpHG. According to the notification, FMR Corp. held 4.89 % of voting rights in Aareal Bank AG on 23 October 2006.

of € 0.50 per no-par value share, totalling € 21,377,579.50, from net retained earnings of € 59,377,579.50 reported in the financial year 2006.

In addition, it is proposed to transfer the remaining amount of € 38,000,000.00 to other retained earnings.

Corporate Governance Code

The declaration regarding the German Corporate Governance Code, pursuant to section 161 of the AktG, has been published on our website: http://www.aareal-bank.com/servlet/PB/menu/1002243_12/index.html.

Proposal on the distribution of earnings

The Management Board proposes to the Annual General Meeting to pay a dividend

EXECUTIVE BODIES OF AAREAL BANK AG

OFFICES HELD IN ACCORDANCE WITH SECTION 285 No. 10 OF THE GERMAN COMMERCIAL CODE (HGB)
IN CONJUNCTION WITH SECTION 125 (1) SENTENCE 3 OF THE GERMAN STOCK CORPORATION ACT (AktG)

Membership in other statutory Supervisory Boards and similar offices held in other governing bodies

SUPERVISORY BOARD

Hans W. Reich, Chairman of the Supervisory Board

Spokesman of the Management Board of Kreditanstalt für Wiederaufbau (until 30 September 2006)

Aareal Bank AG	Chairman of the Supervisory Board	
DEPFA BANK plc	Non-executive member of the Board of Directors	
Deutsche Post AG	Member of the Supervisory Board	until 30 September 2006
Deutsche Telekom AG	Member of the Supervisory Board	until 03 May 2006
HUK-COBURG Haftpflicht Unterstützungskasse kraftfahrender Beamter Deutschlands a. G. in Coburg	Member of the Supervisory Board	
HUK-COBURG-Holding AG	Member of the Supervisory Board	
IKB Deutsche Industriebank AG	Deputy Chairman of the Supervisory Board	until 31 August 2006
ThyssenKrupp Steel AG	Member of the Supervisory Board	

Erwin Flieger, Deputy Chairman of the Supervisory Board

Chairman of the Management Boards of Bayerische Beamten Lebensversicherung a.G., of BBV Holding AG
and Bayerische Beamten Versicherung AG

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
Aareal Bank AG	Deputy Chairman of the Supervisory Board	since 23 May 2006
BBV Krankenversicherung AG	Chairman of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH	Chairman of the Supervisory Board	
Neue Bayerische Beamten Lebensversicherung AG	Chairman of the Supervisory Board	

York-Detlef Bülow, Deputy Chairman of the Supervisory Board*

Aareal Bank AG

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

Christian Graf von Bassewitz, Deputy Chairman of the Supervisory Board (until 23 May 2006)

Spokesman of the General Partners of Bankhaus Lampe KG (until 28 February 2006),

General Partner of Bankhaus Lampe KG (until 31 March 2006), Banker (ret'd.) (since 01 April 2006)

Aareal Bank AG	Deputy Chairman of the Supervisory Board	until 23 May 2006
Aareal Bank AG	Member of the Supervisory Board	since 23 May 2006
Bank für Sozialwirtschaft Aktiengesellschaft	Member of the Supervisory Board	
Condor / Optima Versicherungen AG	Chairman of the Supervisory Boards	until 11 July 2006
DePfa Holding Verwaltungsgesellschaft mbH	Deputy Chairman of the Supervisory Board	until 28 February 2006
Deutscher Ring Krankenversicherungsverein a. G.	Member of the Supervisory Board	
Lampebank International S. A.	Chairman of the Board of Directors	until 31 March 2006
Optima Pensionskasse AG	Chairman of the Supervisory Board	until 11 July 2006
OVB Holding AG	Member of the Supervisory Board	since 01 August 2006
Societaet CHORUS AG	Member of the Supervisory Board	since 01 May 2006
Universal-Investment-Gesellschaft mbH	Member of the Supervisory Board	until 31 March 2006

Manfred Behrens

Managing Director of Schweizerische Lebensversicherungs- und Rentenanstalt (Swiss Life), German branch office

Aareal Bank AG	Member of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	
Swiss Life Insurance Solutions AG	Chairman of the Supervisory Board	since 04 October 2006
Swiss Life Partner AG	Chairman of the Supervisory Board	

Tamara Birke*

Aareal Bank AG

Aareal Bank AG	Member of the Supervisory Board	
SIRWIN AG	Member of the Supervisory Board	

Dr. Richard Brantner

Retired Bank Management Board member; Chairman of the Accounts and Audit Committee of the Supervisory Board (until 23 May 2006)

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
DEPFA BANK plc	Non-executive member of the Board of Directors	

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

Prof. Dr. Johann Eekhoff

State secretary (ret'd.)

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
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Wolfgang Fauter

Chairman of the Management Boards of Deutsche Ring Versicherungen

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
Atlantic Union Insurance S.A.	Deputy Chairman of the Board of Directors	
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	
Deutscher Ring Bausparkasse AG	Chairman of the Supervisory Board	
MONEYMAXX Lebensversicherungs-AG	Chairman of the Supervisory Board	until 26 September 2006
OVB Holding AG	Chairman of the Supervisory Board	
OVB Vermögensberatung AG	Chairman of the Supervisory Board	
Roland Rechtsschutz-Versicherungs-AG	Member of the Supervisory Board	
ZEUS Service AG	Chairman of the Supervisory Board	
ZEUS Vermittlungsgesellschaft mbH	Chairman of the Supervisory Board	

Lutz Freitag

President of GdW, Bundesverband deutscher Wohnungsunternehmen e.V.

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
Aareon AG	Member of the Supervisory Board	since 31 July 2006
Europäisches Bildungszentrum	Chairman of the Board of Trustees	
Hammonia Verlag GmbH	Member of the Board of Directors	
Norddeutscher Rundfunk	Member of the Board of Directors	

Thomas Hawel*

Aareon Deutschland GmbH

Aareal Bank AG	Member of the Supervisory Board	since 23 May 2006
Aareon Deutschland GmbH	Deputy Chairman of the Supervisory Board	

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

Dr. Friedrich-Adolf Jahn**Parliamentary undersecretary of state (ret'd.)**

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
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Ralf Kupka***Aareal Bank AG**

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
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Dr. Peter Lammerskitten**Former Chairman of Deutsche Bau- und Bodenbank Aktiengesellschaft**

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
Aareon AG	Deputy Chairman of the Supervisory Board	
burgbad AG	Deputy Chairman of the Supervisory Board	
GWE Gesellschaft für Wohnen im Eigentum AG	Member of the Supervisory Board	

Jacques Lebhar**Président de société Jacques Lebhar Finances S.A.S**

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
ESL & Network (France) S.A.S.	Member of the Board of Directors	until 05 April 2006
ESL & Network Holding S.A.	Member of the Supervisory Board	
GFI Informatique	Member of the Board of Directors	
Solving International S.A.	Member of the Supervisory Board	

Dr. Herbert Lohneiß**Chief Executive Officer of Siemens Financial Services GmbH**

Aareal Bank AG	Member of the Supervisory Board	since 24 November 2006
INNOVEST Finanzdienstleistungs AG	Member of the Supervisory Board	
Siemens Financial Services Inc. USA	Chairman of the Supervisory Board	
Siemens Kapitalanlagegesellschaft	Chairman of the Supervisory Board	
Siemens Project Venture GmbH	Member of the Shareholder Representatives Group	
UBS Real Estate Kapitalanlagegesellschaft mbH	Deputy Chairman of the Supervisory Board	

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

Joachim Neupel

**Tax advisor; Member of the Management Board of IKB Deutsche Industriebank AG (until 31 December 2006);
Chairman of the Accounts and Audit Committee (since 23 May 2006)**

Aareal Bank AG	Member of the Supervisory Board	since 23.05.2006
IKB Autoleasing GmbH	Member of the Supervisory Board	until 31.12.2006
IKB Facility-Management GmbH	Chairman of the Supervisory Board	until 31.12.2006
IKB Financial Products S.A.	Deputy Chairman of the Supervisory Board	until 31.08.2006
IKB Immobilien Management GmbH	Chairman of the Supervisory Board	
IKB International S.A.	Deputy Chairman of the Supervisory Board	until 07.06.2006
IKB Leasing Berlin GmbH	Member of the Supervisory Board	until 31.12.2006
IKB Leasing GmbH	Member of the Supervisory Board	until 31.12.2006
IKB Private Equity GmbH	Member of the Supervisory Board	until 31.12.2006
Movesta Lease and Finance GmbH	Chairman of the Supervisory Board	until 31.12.2006

Dr. Claus Nolting

Consultant; Chairman of the Management Board of Allgemeine Hypothekenbank Rheinboden AG (since 01 October 2006)

Aareal Bank AG	Member of the Supervisory Board	23 May until 21 August 2006
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Kurt Pfeiffelmann*

Aareal Bank AG

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
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Prof. Dr. Stephan Schüller

Spokesman of the General Partners of Bankhaus Lampe KG (since 01 March 2006)

Aareal Bank AG	Member of the Supervisory Board	since 23 May 2006
BVT-Equity-Holding	Chairman of the Board of Directors	
BVT-Holding GmbH	Chairman of the Supervisory Board	
Choren Fuel Freiberg GmbH & Co KG,	Chairman of the Supervisory Board	
Choren Industries GmbH	Chairman of the Supervisory Board	
Condor / Optima Versicherungen AG	Deputy Chairman of the Supervisory Board	since 11 July 2006
DePfa Holding Verwaltungsgesellschaft mbH	Member of the Supervisory Board	since 01 April 2006

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

LOYAS Private Finance AG	Chairman of the Supervisory Board	until 05 December 2006
NANORESINS AG	Chairman of the Supervisory Board	
PONAXIS AG	Chairman of the Supervisory Board	
Universal-Investment Gesellschaft mbH	Member of the Supervisory Board	since 01 March 2006

Klaus-Peter Sell*

Investment advisor; Deutsche Vermögensberatung Aktiengesellschaft

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
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Wolf R. Thiel

President and Chairman of the Management Board of Versorgungsanstalt des Bundes und der Länder

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

Prof. Dr. Dr. h.c. mult. Hans Tietmeyer

President of Deutsche Bundesbank (ret'd.)

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
Bank for International Settlements (BIS)	Deputy Chairman of the Board of Directors	
BDO Deutsche Warentreuhand AG	Member of the Supervisory Board	
DEPFA BANK plc	Non-executive member of the Board of Directors	
DWS Investment GmbH	Member of the Supervisory Board	
Hauck & Aufhäuser Privatbankiers KGaA	Chairman of the Supervisory Board	

Helmut Wagner*

Aareon Deutschland GmbH

Aareal Bank AG	Member of the Supervisory Board	since 23 May 2006
Aareon Deutschland GmbH	Member of the Supervisory Board	

Reiner Wahl*

Bank employee (ret'd.)

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
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* Employee representative member of the Supervisory Board of Aareal Bank AG

Dr. Jürgen Westphal

Barrister and solicitor, Judge at the Hamburg Constitutional Court

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
Treugarant AG Treuhand- und Beratungsgesellschaft Steuerberatungsgesellschaft	Chairman of the Supervisory Board	

Anja Wölbert*

Aareal First Financial Solutions AG

Aareal Bank AG	Member of the Supervisory Board	until 23 May 2006
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* Employee representative member of the Supervisory Board of Aareal Bank AG

MANAGEMENT BOARD

Dr. Wolf Schumacher, Chairman of the Management Board

Aareal Asset Management GmbH	Member of the Supervisory Board	
Aareal Estate AG	Deputy Chairman of the Supervisory Board	
Aareal Hypotheken-Management GmbH	Member of the Supervisory Board	until 01 February 2006
Aareal Valuation GmbH	Member of the Supervisory Board	until 01 May 2006
Aareal Valuation GmbH	Chairman of the Supervisory Board	since 01 May 2006
Aareon AG	Chairman of the Supervisory Board	until 04 September 2006
Aareon AG	Member of the Supervisory Board	since 04 September 2006

Norbert Kickum, Member of the Management Board

Aareal Bank France S.A.	Member of the Board of Directors	since 26 April 2006
Aareal Financial Service Polska Sp.z o.o.	Member of the Supervisory Board	since 16 January 2006
Aareal Financial Services (Singapore) Pte. Ltd.	Member of the Board of Directors	since 10 August 2006
Aareal Financial Services (Singapore) Pte. Ltd.	CEO (Chairman)	since 25 February 2006
Aareal Financial Services USA, Inc.	Chairman des Board of Directors	
Aareal-Financial Service spol. s r.o.	Member of the Supervisory Board	
Deutsche Structured Finance GmbH	Member of the Advisory Board	

Hermann Josef Merkens, Member of the Management Board

Aareal Asset Management GmbH	Chairman of the Supervisory Board	
Aareal Estate AG	Chairman of the Supervisory Board	
Aareal Financial Services (Singapore) Pte. Ltd.	Member of the Board of Directors	since 10 August 2006
Aareal First Financial Solutions AG	Member of the Supervisory Board	
Aareal Hyp AG	Deputy Chairman of the Supervisory Board	until 03 March 2006
Aareal Immobilien Kapitalanlagegesellschaft mbH	Chairman of the Supervisory Board	
Aareal Immobilien Management AG	Chairman of the Supervisory Board	until 30 June 2006
Aareal Property Services B.V.	Chairman of the Supervisory Board	
Aareal Valuation GmbH	Member of the Supervisory Board	
Aareon AG	Member of the Supervisory Board	
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Chairman of the Supervisory Board	
Deutsche Interhotel Holding GmbH & Co. KG	Member of the Council of Shareholders	
Deutsche Structured Finance GmbH	Member of the Advisory Board	

Thomas Ortmanns, Member of the Management Board

Aareal First Financial Solutions AG	Member of the Supervisory Board	until 01 April 2006
Aareal First Financial Solutions AG	Chairman of the Supervisory Board	since 01 April 2006
Aareon AG	Member of the Supervisory Board	until 04 September 2006
Aareon AG	Chairman of the Supervisory Board	since 04 September 2006
Innovative Banking Solutions AG	Member of the Supervisory Board	

Christof M. Schörnig, Member of the Management Board

Aareal Asset Management GmbH	Member of the Supervisory Board	
Aareal Bank France S.A.	Member of the Board of Directors	
Aareal Financial Services (Singapore) Pte. Ltd.	Member of the Board of Directors	since 10 August 2006
Aareal Financial Services USA, Inc.	Member of the Board of Directors	
Aareal First Financial Solutions AG	Chairman of the Supervisory Board	until 01 April 2006
Aareal First Financial Solutions AG	Member of the Supervisory Board	since 01 April 2006
Aareal Hyp AG	Chairman of the Supervisory Board	until 03 March 2006
Aareal Hypotheken-Management GmbH	Chairman of the Supervisory Board	until 01 February 2006
Aareon AG	Member of the Supervisory Board	
FPM Frankfurt Performance Management AG	Member of the Supervisory Board	since 08 December 2006
Mansart Conseil S.A.S.	Member of the Supervisory Board	

OFFICES HELD BY EMPLOYEES OF AAREAL BANK AG

PURSUANT TO SECTION 340 a (4) No. 1 OF THE HGB

Dr. Bernd Bach, Bank Director

ICAS Consulting und Anwendungssysteme AG	Member of the Supervisory Board
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Dr. Michael Beckers, Bank Director

Aareal Financial Service Polska Sp.z o.o.	Member of the Supervisory Board
Aareal Financial Service spol. s r.o.	Member of the Supervisory Board

Sven Eisenblätter, Bank Director

Aareal HM Service GmbH	Member of the Supervisory Board	until 07 February 2006
Aareal Hypotheken-Management GmbH	Member of the Supervisory Board	until 01 February 2006
Aareal HM Processing GmbH	Member of the Supervisory Board	until 07 February 2006
Aareal Valuation GmbH	Member of the Supervisory Board	
Immobilien Scout GmbH	Member of the Supervisory Board	

Hartmut Eisermann, Bank Director

Terrain-Aktiengesellschaft Herzogpark	Member of the Supervisory Board
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Dr. Christian Fahrner, Bank Director

Innovative Banking Solutions AG	Deputy Chairman of the Supervisory Board
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Ralf Gandenberger, Bank Director

Deutsche Interhotel Holding GmbH & Co. KG	Member of the Council of Shareholders
Terrain-Aktiengesellschaft Herzogpark	Deputy Chairman of the Supervisory Board

Dagmar Knopek, Bank Director

Aareal Financial Services (Singapore) Pte. Ltd.	Member of the Management Board	since 10 August 2006
Aareal Financial Services USA, Inc.	Member of the Board of Directors	

Dr. Stefan Lange, Bank Director

Aareal Estate AG	Member of the Supervisory Board	
Aareal Hyp AG	Member of the Supervisory Board	until 03 March 2006
Aareal Immobilien Management AG	Deputy Chairman of the Supervisory Board	until 30 June 2006
Deutsche Bau- und Grundstücks-Aktiengesellschaft	Deputy Chairman of the Supervisory Board	
Immobilien Scout GmbH	Member of the Supervisory Board	
Terrain-Aktiengesellschaft Herzogpark	Chairman of the Supervisory Board	
Via Capital Ltd. (in liquidation)	Non-executive Director	

Peter Mehta, Bank Director

Innovative Banking Solutions AG	Member of the Supervisory Board
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Jörg Riepenhausen, Bank Director

Deutsche Bau- und Grundstücks-Aktiengesellschaft	Member of the Supervisory Board	until 07 July 2006
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Dr. Peter Schaffner, Bank Director

Aareal Partecipazioni S.p.A.	Member of the Board of Directors	
IMMO Consulting S.p.A.	Member of the Board of Directors	until 20 April 2006

Markus Schmidt

Deutsche Bau- und Grundstücks-Aktiengesellschaft	Member of the Supervisory Board	since 07 July 2006
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Peter Schott, Bank Director

Via Capital Ltd. (in liquidation)	Non-executive Director
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Christine Schulze Forsthövel, Bank Director

Aareal Bank France S.A.	Chairman of the Board of Directors
Aareal Financial Service Polska Sp.z o.o.	Member of the Supervisory Board
Aareal Partecipazioni S.p.A.	Member of the Board of Directors
Aareal Financial Service spol. s r.o.	Member of the Supervisory Board
Mansart Conseil S.A.S.	Chairman of the Supervisory Board

Martin Vest

Aareal Bank France S.A.	Member of the Board of Directors
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Wiesbaden, 08 February 2007

The Management Board


Dr. Schumacher



Kickum



Merkens



Ortmanns



Schörnig

AUDITORS' REPORT

Following the completion of our audit we have certified the financial statements on 08 February 2007 without qualification:

Auditors' report

We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system, and the management report of the Aareal Bank AG, Wiesbaden, for the business year from 01 January to 31 December 2006. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law are the responsibility of the Company's Board of Managing Directors. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with § (Article) 317 HGB ("Handelsgesetzbuch": "German Commercial Code") and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accor-



dance with (German) principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the Company's Board of Managing Directors, as well as evaluating the overall presentation of the annual financial statements and management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

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

Frankfurt / Main, 08 February 2007

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

	
Rabeling	ppa. Hülsen
Wirtschaftsprüfer	Wirtschaftsprüfer
(German Public Auditor)	(German Public Auditor)

REPORT OF THE SUPERVISORY BOARD OF AAREAL BANK AG, WIESBADEN

Throughout the financial year 2006, the Supervisory Board continually advised, monitored and supervised the management of Aareal Bank AG, in accordance with the law, the Memorandum and Articles of Association, the Internal Rules of Procedure for the Supervisory Board and the bank's Corporate Governance Code. The Management Board informed the Supervisory Board regularly, without delay and comprehensively, both orally and in writing, of all issues important to the Group with regard to its situation, business development, and key financial indicators. The Supervisory Board was also informed about business policy issues (in particular regarding strategic and operative planning), as well as on the current risk exposure and the management and control of risks.

In addition, the Chairman of the Supervisory Board and the Chairman of the Management Board discussed all material issues during numerous contacts between Supervisory Board meetings. The Supervisory Board was involved in all material decisions taken by the company, which were discussed between the Management Board and Supervisory Board in detail, and agreed upon. The approval of the Supervisory Board was granted wherever such approval was required. In particular, the Supervisory Board was involved during 2006 in the disposals of non-performing loan portfolios, and in the sale of participating interests which were no longer part of the company's core area of expertise.

Measures within the scope of the bank's realignment were largely concluded by the end of 2006, significantly ahead of schedule. The Supervisory Board welcomed and supported this positive development.

The Supervisory Board and its Committees

The reduction in the number of Supervisory Board members, which had been prepared for some time, was implemented during the financial year 2006. This involved a restructuring of Supervisory Board Committees. Together with the reduction in the number of committees, the present size of the Supervisory Board allows it to work efficiently.

The Supervisory Board, and the committees formed from amongst its members, met on a total of 15 occasions during the year under review. The number of committees and their functions were amended following the Annual General Meeting 2006, reflecting the reduction in the size of the Supervisory Board. The Executive Committee, Accounts and Audit Committee, Credit and Market Risk Committee, and the Committee for Urgent Decisions continue to exist. Also, the Committee for Urgent Decisions remains to form a part of the Credit and Market Risk Committee.

The duties of the Human Resources Committee and the Capital Adjustment Committee were transferred to the Executive Committee.

The Supervisory Board held four meetings during the year under review. The focus of these meetings was on the realignment of the Aareal Bank Group. The Management Board informed the Supervisory Board of progress made in implementing the six-

point programme. Other topics included business policy issues, corporate planning, the company's risk exposure, and the management and control of risks. At its meeting on 23 May 2006, the Supervisory Board elected its Chairman, discussed the restructuring of committees, passing a corresponding resolution, and elected committee members.

The Executive Committee advises the Management Board and prepares the resolutions of the Supervisory Board; it held three meetings during the year under review. The committee's area of responsibility also includes assessing the internal condition of the Group with regard to its operative strength, efficiency and its potential for achieving set objectives. Furthermore, the committee discussed the remuneration of the Management Board members, the approval for the granting of loans to members of the company's executive bodies and other transactions between members of the company's executive bodies and the company or its Group subsidiaries. The Executive Committee assumed these duties from the Human Resources Committee, within the framework of the restructuring of the Supervisory Board; the latter had held one meeting during which the variable remuneration for members of the Management Board for the past financial year was discussed. In keeping with its duties, the Executive Committee also discussed and actively supported the implementation of measures for the realignment of Aareal Bank AG.

The Credit and Market Risk Committee convened three times and dealt with the granting of loans requiring approval. The Committee also noted any transactions subject to reporting requirements, and any other issues requiring the Supervisory Board's approval pursuant to the company's Memorandum and Articles of Association, or the Managing Board's internal rules of procedure. This also included the decision regarding the update of the bank's credit risk strategy: within the scope permitted under the Minimum Requirements for Risk Management issued by BaFin, the plenary meeting of the Supervisory Board had assigned the relevant authority to the Credit and Market Risk Committee. The committee discussed reports on the bank's risk situation, which were submitted and explained, in great detail.

The Committee for Urgent Decisions, as a sub-committee of the Credit and Market Risk Committee, did not convene during the year under review; loans requiring approval were approved in writing.

The Accounts and Audit Committee held four meetings during the year under review. In keeping with its duties under the bank's Memorandum and Articles of Association, the committee appointed the external auditors, following their election by the Annual General Meeting, discussed the focal points of the audit and passed a corresponding resolution. The committee also received and duly noted the report submitted by Internal

Audit, and the Compliance Report. The Management Board presented and explained the Group planning for the years 2007 to 2009 to the committee. The Accounts and Audit Committee concerned itself with the single-entity financial statements and the consolidated financial statements, as well as with the Management Report and the Group Management Report. Following the presentation of the results of the audit conducted by PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt / Main, the committee members discussed the results with the external auditors.

Fulfilling their duties as commissioned by the Supervisory Board, PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft audited the financial statements prepared in accordance with the German Commercial Code (HGB) and the consolidated financial statements prepared in accordance with IFRS (both as at 31 December 2006), including the accounting records, the Management Report, the Group Management Report and the Report of the Supervisory Board, and certified the financial statements without qualification.

All members of the Supervisory Board received the audit reports regarding the financial statements and the consolidated financial statements, including all annexes thereto, in good time before the meeting during which the audit results were discussed. The representatives of the external auditors took part

in that meeting, explaining the audit results and answering any further questions.

In its meeting on 21 March 2007, the Supervisory Board approved the results of the audit carried out by PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft. No objections were raised following the detailed examination of the financial statements and Management Report of Aareal Bank AG, prepared in accordance with the HGB; the consolidated financial statements prepared in accordance with IAS / IFRS; the Group Management Report; the proposal of the Management Board regarding the appropriation of profit; and of the audit report. The Supervisory Board approved the financial statements and Management Report of Aareal Bank AG, prepared in accordance with the HGB, which are thus confirmed, together with the consolidated financial statements prepared in accordance with IAS / IFRS and the Group Management Report. The Supervisory Board has endorsed the proposal for the appropriation of profit submitted by the Management Board.

The Chairmen of Supervisory Board committees regularly gave account of the work in the committees to the plenary meeting.

Focus of Supervisory Board activities

As in the previous year, the work performed by the Supervisory Board during the year under review focused on supporting the

operative implementation of the six-point programme devised by the Management Board for the bank's realignment. This programme comprised the expansion of new business in line with the bank's strategy, reducing the non-performing loan portfolio, leveraging the bank's mid-sized corporate structure, strengthening its organisational structure, enhancing the transparency of entrepreneurial actions, and establishing a modern corporate culture.

The Supervisory Board discussed the positive development of new business in great detail, together with a review of the bank's opportunities for growth in various domestic and international markets.

The Supervisory Board was closely involved in the successful marketing of non-performing loan portfolios, and was constantly kept informed by the Management Board.

Excellent progress was made in leveraging the bank's mid-sized structure. Specific measures included the disposal of various participating interests, such as the Aareal Asset Management sub-group, the reintegration of Aareal Hyp AG into the parent company, and the sale of Aareal Immobilien Management AG. The Supervisory Board was always kept informed of the measures planned and initiated, and granted its approval where necessary. The disposals carried out during the last quarter of 2006 in particular represented major milestones within the framework of the Aareal Bank's realignment.

Furthermore, the Management Board presented all measures required within the scope of the six-point programme to the Supervisory Board, who duly approved them and passed resolutions as required.

The Management Board regularly informed the Supervisory Board regarding the implementation of the regulatory regime under the Basel II Accord, the Minimum Requirements for Risk Management ("MARisk"), and other changes to the regulatory environment. Discussions focused on a variety of issues and implications of current developments.

Corporate Governance

The implementation of, and compliance with the provisions of the German Corporate Governance Code was particularly evident in the reduction in the number of Supervisory Board members during the year under review. Please refer to the Corporate Governance Report – which forms part of this Annual Report – for details regarding the committees formed after the Annual General Meeting on 23 May 2006, and their elected members. In parallel to these changes, the Annual General Meeting 2006 passed a resolution to implement a new remuneration system for the Supervisory Board, which is also described in detail in the Corporate Governance Report.

The regular examination of efficiency regarding the Supervisory Board, as provided for

in the Corporate Governance Code, was carried out after conclusion of the structural changes to the Supervisory Board. This was designed to ensure that proposals and suggestions of new members be implemented in the new framework as swiftly as possible.

The Management Board and Supervisory Board issued a Declaration of Compliance in accordance with the bank's Corporate Governance Code on 01 December 2006, and published it on the bank's website. The wording of said Declaration of Compliance is contained in this Annual Report.

Amendment of section 289 of the German Commercial Code (HGB)

Following an amendment of the provisions of the German Commercial Code governing the contents of a company's management report, the Supervisory Board must obtain information as to whether there are contractual arrangements within the company which would present an obstacle (to a bidder for shares in the company) to the full takeover of the enterprise. In this context, the Supervisory Board is obliged to include an assessment of such contractual arrangements within the scope of this report.

The Supervisory Board complied with this obligation. As outlined in the Management Report for the financial year 2006, change-of-control clauses which might present an obstacle to a takeover exist within Aareal Bank AG, but exclusively in the contracts

entered into with members of the Management Board. These arrangements were resolved by the Human Resources Committee of the Supervisory Board.

Personnel matters

The term of office of the following Supervisory Board members ended with the Annual General Meeting on 23 May 2006, at which point they retired from the Supervisory Board: Dr. Richard Brantner, Prof. Dr. Johann Eekhoff, Messrs. Wolfgang Fauter, Lutz Freitag, Dr. Friedrich-Adolf Jahn, Mr. Ralf Kupka, Dr. Peter Lammerskitten, Messrs. Jacques Lebhar, Kurt Pfeiffelmann, Klaus Peter Sell, Prof. Dr. Dr. h.c. mult. Hans Tietmeyer, Mr. Reiner Wahl, Dr. Jürgen Westphal and Ms. Anja Wölbart. The Supervisory Board would like to thank those members who retired from the Supervisory Board for the many years of trusting cooperation, and for their valuable and constructive contribution.

The Annual General Meeting elected Mr. Joachim Neupel, Prof. Dr. Stephan Schüller and Dr. Claus Nolting to the Supervisory Board, as shareholder representatives. Messrs. Thomas Hawel and Helmut Wagner were appointed to the Supervisory Board as employee representatives.

Following his appointment as Chairman of the Management Board of AHBR Allgemeine Hypothekenbank Rheinboden AG, Dr. Claus Nolting resigned from his office with effect

from 21 August 2006; he took up his new office as of 01 October 2006. Dr. Nolting considered his new appointment to constitute a conflict of interest as defined in No. 5.5.3 of Aareal Bank AG's Corporate Governance Code, as a result of which he took the said step without delay. We would like to thank Dr. Nolting for the trusting cooperation, and wish him every success in his new office.

Dr. Herbert Lohneiß, a renowned expert in international financial markets, agreed to succeed Dr. Nolting as a member of the Supervisory Board. Dr. Lohneiß, who is currently holding an executive position at Siemens Financial Services GmbH, has many years of experience, including a tenure at J.P. Morgan.

To expedite the completion of the Supervisory Board, Dr. Lohneiß was appointed as a member by the Wiesbaden local court

on 24 November 2006. He will be nominated as a candidate at the Annual General Meeting in 2007.

No conflicts of interest of members of the Management Board or the Supervisory Board, as defined in No. 5.5.3 of Aareal Bank AG's Corporate Governance Code, arose during the financial year 2006.

The Supervisory Board would like to thank all staff members of Aareal Bank AG and its affiliated companies for their achievements. It was their strong commitment and contributions which permitted the implementation of the six-point programme and hence, the swift and successful realignment of Aareal Bank.

Wiesbaden, March 2007

The Supervisory Board



Hans W. Reich (Chairman)

OUR OFFICES

Wiesbaden Head Office

Aareal Bank AG

Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3480
Fax: +49 611 3482549

Structured Property Finance

Amsterdam

Byzantium Building
Stadhouderskade 14e
1054 ES Amsterdam, The Netherlands
Phone: +31 20 5898660
Fax: +31 20 5898666

Berlin

Kurfürstendamm 33
10719 Berlin, Germany
Phone: +49 30 880990
Fax: +49 30 88099470

Brussels

7, rue Guimard
1040 Brussels, Belgium
Phone: +32 2 5144090
Fax: +32 2 5144092

Copenhagen

Frederiksgade 7
1265 Copenhagen, Denmark
Phone: +45 70 109090
Fax: +45 70 109091

Hamburg

Pelzerstrasse 7
20095 Hamburg, Germany
Phone: +49 40 33316546
Fax: +49 40 33316599

Istanbul

Ebulula Mardin Caddesi
Maya Meridyen İş Merkezi
D:2 Blok · Kat. 11
34335 Akatlar-Istanbul, Turkey
Phone: +90 212 3490200
Fax: +90 212 3490299

London

38 Lombard Street
London EC3V 9BS, United Kingdom
Phone: +44 20 74569200
Fax: +44 20 79295055

Madrid

Paseo de la Castellana, 60 - 4D
28046 Madrid, Spain
Phone: +34 917 454160
Fax: +34 917 450775

Milan

Via Paolo Andreani, 6
20122 Milan, Italy
Phone: +39 02 76419001
Fax: +39 02 764190211

Munich

Richard-Strauss-Strasse 24
81677 Munich, Germany
Phone: +49 89 51270
Fax: +49 89 5127211

New York

Aareal Financial Services USA, Inc.
410 Park Avenue
Suite 910
New York, NY 10022 · USA
Phone: +1 212 5084080
Fax: +1 917 3220285

Paris

Aareal Bank France S.A.
5, rue Scribe
75009 Paris, France
Phone: +33 1 44516630
Fax: +33 1 42669794

Prague

Aareal Financial Service spol. s r.o.
FORUM Building
Václavské náměstí 19
11000 Prague 1, Czech Republic
Phone: +420 234656000
Fax: +420 234656011

Rhine-Main-Ruhr

Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3483166
Fax: +49 611 3482833

Rome

Via Mercadante, 12/14
00198 Rome, Italy
Phone: +39 06 83004200
Fax: +39 06 83004250

Singapore

Aareal Financial Services
(Singapore) Pte. Ltd.
3 Church Street
17-03 Samsung Hub
Singapore 049483
Phone: +65 6372 9750
Fax: +65 6536 8162

Stockholm

Hamngatan 11
11147 Stockholm, Sweden
Phone: +46 8 54642000
Fax: +46 8 54642001

**Warsaw**

Aareal Financial Service Polska Sp. z o.o.
RONDO I
Rondo ONZ I
00-124 Warsaw, Poland
Phone: +48 22 5449060
Fax: +48 22 5449069

Zurich

Rennweg 52
8001 Zurich, Switzerland
Phone: +41 43 8887575
Fax: +41 43 8887576

Aareal Estate AG

Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3482025
Fax: +49 611 3482775

Aareal Valuation GmbH

Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3482134
Fax: +49 611 3482640

Deutsche Structured Finance GmbH

Westendstrasse 24
60325 Frankfurt/Main, Germany
Phone: +49 69 9714970
Fax: +49 69 97149715

Consulting / Services**Aareal Bank AG****Institutional Housing unit**

Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone: +49 611 3482967
Fax: +49 611 3482559

Institutional Housing unit**Berlin Branch**

Kurfürstendamm 33
10719 Berlin, Germany
Phone: +49 30 88099438
Fax: +49 30 88099470

Institutional Housing unit**Essen Branch**

Huyssenallee 48
45128 Essen, Germany
Phone: +49 201 81008100
Fax: +49 201 81008200

Institutional Housing unit**Hamburg Branch**

Pelzerstrasse 7
20095 Hamburg, Germany
Phone: +49 40 33316810
Fax: +49 40 33316399

Institutional Housing unit**Leipzig Branch**

Neumarkt 2-4
04109 Leipzig, Germany
Phone: +49 341 2272160
Fax: +49 341 2272101

Institutional Housing unit**Munich Branch**

Richard-Strauss-Strasse 24
81677 Munich, Germany
Phone: +49 89 5127265
Fax: +49 89 51271264

Institutional Housing unit**Rhine-Main-Ruhr Branch**

Paulinenstrasse 15
65189 Wiesbaden, Germany
Phone-Hotline: +49 611 3482000
Fax: +49 611 3483002

Institutional Housing unit**Stuttgart Branch**

Kriegerstrasse 3
70191 Stuttgart, Germany
Phone: +49 711 2236116
Fax: +49 711 2236160

Aareon AG

Im Münchfeld 1-5
55122 Mainz, Germany
Phone: +49 6131 3010
Fax: +49 6131 301419

Aareal First Financial Solutions AG

Peter-Sander-Strasse 30
55252 Mainz-Kastel, Germany
Phone: +49 6134 560201
Fax: +49 6134 560401

**Deutsche Bau- und
Grundstücks-Aktiengesellschaft**

Chlodwigplatz 1
53119 Bonn, Germany
Phone: +49 228 5180
Fax: +49 228 518298

Deposit-taking**Dublin**

Dublin Exchange Facility
Mayor Street · IFSC
Dublin 1, Ireland
Phone: +353 1 6369220
Fax: +353 1 6702785

FINANCIAL CALENDAR

11 May 2007	Presentation of interim report as at 31 March 2007
30 May 2007	Annual General Meeting – Kurhaus, Wiesbaden
August 2007	Presentation of interim report as at 30 June 2007
November 2007	Presentation of interim report as at 30 September 2007

Imprint

Contents:

Aareal Bank AG

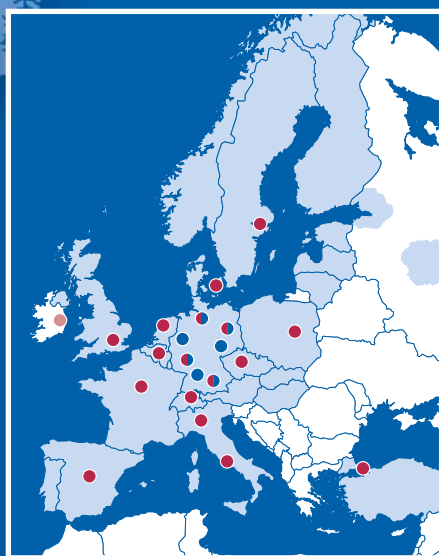
Corporate Communications

Design/Layout:

s/company, Fulda-Künzell

Production:


Druckerei Chmielorz GmbH, Wiesbaden-Nordenstadt



 *Locations Real Estate Structured Finance*

 *Locations Institutional Housing unit*

 *Treasury activities*

 *Countries with lending operations*

AMSTERDAM
BERLIN
BRUSSELS
COPENHAGEN
DUBLIN
HAMBURG
ISTANBUL
LONDON
MADRID
MILAN
MUNICH
NEW YORK
PARIS
PRAGUE
ROME
SINGAPORE
STOCKHOLM
WARSAW
WIESBADEN
ZURICH



Aareal Bank

Aareal Bank AG · Corporate Communications
Paulinenstrasse 15 · 65189 Wiesbaden, Germany
Phone: +49 611 348 3009 · Fax: +49 611 348 2637
E-mail: aareal@aareal-bank.com · www.aareal-bank.com