Interim Report Aareal Bank Group

1 January to
30 June 2023

Aareal

YOUR COMPETITIVE ADVANTAGE.

Key Indicators

	1 Jan – 30 Jun 2023	1 Jan – 30 Jun 2022
Results		
Operating profit (€ mn)	87	91
Consolidated net income (€ mn)	58	58
Consolidated net income allocated to ordinary shareholders (€ mn)[1]	58	50
Cost/income ratio (%)[2]	32.3	40.8
Earnings per ordinary share (€)[1]	0.97	0.84
RoE before taxes (%)[1)3]	5.7	5.8
RoE after taxes (%)[1)3]	4.0	3.7

	30 Jun 2023	31 Dec 2022
Statement of Financial Position		
Property finance (€ mn)	32,145	30,901
Equity (€ mn)	3,288	3,258
Total assets (€ mn)	49,029	47,331
Regulatory Indicators[4]		
Basel IV (phase-in)		
Risk-weighted assets (€ mn)	13,330	12,782
Common Equity Tier 1 ratio (CET1 ratio) (%)	19.4	19.3
Tier 1 ratio (T1 ratio) (%)	21.7	21.7
Total capital ratio (TC ratio) (%)	23.5	24.0
Employees	3,313	3,316

	30 Jun 2023	31 Dec 2022
Moody's		
Issuer rating	A3	A3
Senior Preferred	A3	A3
Senior Non Preferred	Baa2	–
Bank deposit rating	A3	A3
Outlook	negative	negative
Mortgage Pfandbrief Rating	Aaa	Aaa
Fitch Ratings		
Issuer default rating	BBB+	BBB+
Senior Preferred	A-	A-
Senior Non Preferred	BBB+	BBB+
Deposit ratings	A-	A-
Outlook	negative	negative
Sustainability Ratings[5]		
MSCI	AA	AA
ISS-ESG	prime (C+)	prime (C+)
CDP	Management Level B	Management Level B
Aktienkurs		
XETRA® closing price (€)	33.70	33.06

1) The allocation of earnings is based on the assumption that net interest payable on the AT1 bond is recognised on an accrual basis.
2) Structured Property Financing and Banking & Digital Solutions segments: in line with common practice in the banking sector, bank levy and contributions to the deposit guarantee scheme are not included.
3) On an annualised basis
4) 31 December 2022: including originally proposed dividend of € 1.60 per share in 2022 and pro rata temporis accrual of the net interest on the AT1 bond, excluding profits for 2022 under commercial law. There are no plans to distribute any dividends, in line with the strategy for 2023. The appropriation of profits is subject to approval by the Annual General Meeting.
30 June 2023 (preliminary): including interim results for 2023 (assuming ECB approval of inclusion) and pro rata temporis accrual of net interest on the AT1 bond. The SREP recommendations concerning the NPL inventory and the ECB's NPL guidelines for the regulatory capital of new NPLs and an additional voluntary and preventive capital deduction for regulatory uncertainties from ECB tests were taken into account.
Adjusted total risk exposure amount (as defined in Article 92 (3) CRR – RWAs), in accordance with applicable law as at 31 December 2022 (CRR II) and applying the partial regulation for the "output floor" in connection with commercial property lending and equity exposures, based on the European Commission's proposal dated 27 October 2021 for implementation of Basel IV (CRR III). The adjusted risk-weighted exposure amount for commercial property lending and equity exposures is determined using the higher of (i) total RWAs calculated in accordance with CRR II currently in force, and (ii) the figure calculated in accordance with the revised CRSA (pursuant to CRR III), applying the transitional provisions for 2025 (50 % output floor).
5) Please refer to our website (www.aareal-bank.com/en/responsibility/reporting-on-our-progress/) for more details.

This report contains rounded numbers, which may result in slight differences when aggregating figures and calculating percentages.

Contents

Interim Group Management Report

Report on the Economic Position

Macro-economic environment

In light of a challenging environment and with monetary policy becoming increasingly tighter, the global economy experienced sluggish development overall during the first half of 2023. In this context, growth in the euro zone was very weak indeed – despite a palpable easing of energy prices, whereas the US benefited from slightly stronger growth, driven by private consumer spending. The exception was China, where real gross domestic product was able to post more pronounced growth following the end of the zero-Covid policy. Geopolitical tensions caused by the war in Ukraine and the mutual sanctions imposed by Western countries and Russia remained at the forefront. Even though inflation cooled in many economies, thanks to falling energy prices and basis effects, underlying inflationary pressure remained strong, with price pressures still high especially in the services sector where costs are strongly driven by salary trends. Major central banks continued to tighten their monetary policy in an effort to contain inflation. Moreover, international financial markets were subject to temporary tensions on account of turbulence facing banks in the US. The collapse of several US regional banks, together with the troubles at Credit Suisse, triggered concerns regarding the stability of the financial system from mid-March onwards. However, these concerns proved to be short-lived.

Economy

In the euro zone, real gross domestic product declined by 0.1 % in the first quarter of 2023 compared to the previous quarter, followed by a 0.3 % increase during the second quarter. All in all, economic output in the first half of 2023 was up 0.7 % on the same period of the previous year. Among the largest euro zone countries, Spain recorded the greatest year-on-year increase in economic output in the first half of 2023 with 3.1 %, followed by Italy with 1.3 % and France with 0.6 %. In contrast, economic output in Germany was down 0.5 % year-on-year.

Economic growth in selected countries within the European Union that are not members of the euro zone was less pronounced than the average for euro zone member states. Specifically, Sweden and Poland reported year-on-year economic growth of 0.4 % and 0.3 %, respectively, in the first half of 2023, whilst Czechia saw a 0.7 % decline.

The UK recorded weaker economic output in the first half of the year than most EU countries. At the end of the first six months, gross domestic product was 0.2 % higher than in the same period of the previous year. Economic activity at the start of the year was weak – especially in the services sector, attributable to large-scale industrial action in the public sector and the healthcare industry, among other factors.

Economic output in the US rose by 2.1 % year-on-year by the middle of the year, mainly driven by strong growth in private consumption, as private households took advantage of the scope for spending afforded by the increase in disposable income. Government-driven demand – which once again rose considerably – also contributed to growth. Despite a weakening industrial economy and progressive tightening of monetary policy, investment rose during the second quarter in particular. In Canada, gross domestic product at the end of the first half of the year was up by 1.8 % on the same period of the previous year.

The Chinese economy received a strong boost from the end of zero-Covid policy, benefiting the services sector in particular. All in all, economic output grew by 5.9 % year-on-year in the first six months. Australia was able to benefit from stable export demand, despite waning global momentum: this helped offset weakening consumption growth following exhaustion of catch-up effects after Covid-19-induced lockdowns. Overall, economic output in the first six months of the year was up by 2.0 % on the same period of the previous year.

Despite the challenging overall environment, and given the expectation of impending recessions, labour markets in many economies were characterised by low unemployment rates and strong labour demand. The unemployment rate in the euro zone was 6.5 % at the end of the first half of 2023, and 3.6 % in the US.

Financial and capital markets, monetary policy and inflation

Attention on the financial markets focused on persistently high inflation rates, continued monetary policy tightening, temporary stress affecting US regional banks in particular, as well as on the forced takeover of Credit Suisse. Leading central banks continued to tighten their monetary policy in response to the inflationary outlook. In contrast to the previous year, the first half of 2023 was characterised by relatively stable bond yields overall; a flight into investments considered a safe haven was only a temporary phenomenon. However, with better-then-expected economic data, a growing appetite for risk and further rate hikes, yields stabilised. The turbulence in the banking sector had only a temporary and relatively mild impact on equity markets.

As inflationary pressures remained elevated, the European Central Bank (ECB) continued its course set in the previous year of raising key interest rates to ensure that inflation will return to the mid-term target of 2 % in due course. In the first six months of 2023, the ECB raised its key interest rates in four steps, reaching 4.00 % on main refinancing operations, 4.25 % on the marginal lending facility and 3.50 % on the deposit facility. The ECB's Governing Council indicated that future policy rate decisions would continue to be data-dependent and that key interest rates would either increase further or remain at restrictive levels. It also stated that holdings of securities under the asset purchase programme (APP) would continue to be reduced at a measured pace, and that principal payments from maturing securities purchased under the APP would not be reinvested starting July 2023. Accordingly, principal payments for maturing assets bought under the pandemic emergency purchase programme (PEPP) will continue to be reinvested at maturity until at least the end of 2024. In order to counter potential market fragmentation, the Governing Council reserves the right to apply flexibility in reinvesting redemptions over time, across asset classes and jurisdictions at any time. Furthermore, the Transmission Protection Instrument is available to counter unwarranted, disorderly market dynamics.

Addressing a tight labour market and inflation rates that – while abating – were still above 2 %, the US Federal Reserve (Fed) revised its federal funds rate upwards three times in the first six months of 2023, to a corridor between 5.00 % and 5.25 %. The Fed also reduced its holdings of bonds and mortgage-backed securities it had taken on during the pandemic. As with the ECB, the Fed announced potential further interest rate increases, depending on economic data and the effects of the interest rate hikes made so far. In particular, it said that interest rates would rise further if provoked by core inflation.

A tight labour market and high inflation also convinced the Bank of England (BoE) to raise its base rate in four steps in the course of the first half of 2023, reaching 5.00 %. The BoE also highlighted the possibility of further interest hikes as a function of the economy, the labour market and inflation.

Other major central banks lifted their key rates, too: the Bank of Canada raised its key interest rate in the first six months to 4.75 %, the Swedish Riksbank to 3.50%, and the Reserve Bank of Australia to 4.10 %.

Short-term interest rates[1)] in the euro area at the end of the first half of 2023 were higher than at the end of 2022. The same applied to the pound sterling, the Swedish krona, and the Australian dollar. While short-term interests also rose in US dollar and Canadian dollar, these increases were less pronounced. As for long-term interest rates[2)], the picture was mixed across the currency areas relevant to Aareal Bank: decreases in the euro area, the Swedish krona, and the Australian dollar were met with slight increases for the US dollar and the Canadian dollar, whilst sterling rates posted a strong increase. Ten-year government bonds painted a mixed picture as well, but for the most part yields declined.

As expectations regarding inflation, the economy and the future monetary policy in different regions had less of an influence on currency markets during the first six months of 2023 than they had had during the previous year: exchange rates were relatively stable and less volatile. In the course of the first half year, the euro appreciated slightly against the US dollar, even though some volatility was observed at times. At the end of the first six months, the exchange rate was USD 1.09 per euro and therefore above the rate prevailing on 30 December 2022 (USD 1.07 per euro). Vis-a-vis the Canadian dollar, the euro remained stable over the same period at CAD 1.44 per euro. On average, it remained stable vis-a-vis the pound sterling in the first quarter, but depreciated slightly in the second quarter. The exchange rate fell from GBP 0.89 per euro at the start of the year to GBP 0.86. The euro was relatively stable

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

against the Swedish krona until April, before gaining value in the second quarter. By the end of June, the exchange rate had risen from SEK 11.12 per euro at the beginning of the year, to SEK 11.81. The euro appreciated against the Australian dollar, from AUD 1.57 at the beginning of the year to reach AUD 1.64 per euro.

Even though inflation subsided in many economies since the beginning of 2023, it clearly exceeded the target rates defined by the central banks for their respective currency area. Inflation fell as the costs of energy and food declined. Lower freight and commodity prices also provided some relief, in particular to businesses. However, core inflation remains high as labour market tightness prevails and wages in the services sector rise. In areas that had been particularly hit by the Covid-19 crisis, such as the hospitality industry, high demand continued to meet limited supply and labour shortage strains. In the euro zone, inflation reached 5.5 % at the end of June compared to the same month of the previous year: in the US it was 3.0 % and 7.9 % in the UK.

Regulatory environment

The environment in which banks are operating continues to be defined by highly dynamic regulatory requirements, as well as by changes in banking supervision. This includes, in particular, implementation of the final draft of the Basel III framework into EU law (known as "Basel IV"), which was resolved by the Basel Committee (BCBS). The EU Commission submitted proposals on this on 27 October 2021, which are now to be finalised as part of the trilogue procedure. The proposed first-time application of the new regulation is 1 January 2025 – two years later than initially planned by the BCBS.

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

Moreover, both national and European regulators are imposing various new requirements – including in connection with IT/information security risks, or regarding the prevention of money laundering/terrorist financing and tax evasion. Furthermore, politicians and banking supervisors deem it necessary to establish sustainability more strongly with society, and as a regulatory requirement within the economy. To this end, a standard taxonomy was introduced in the EU, which provides the basis for the classification of economic activities with regard to sustainability targets. The taxonomy forms the basis for a large number of disclosure requirements for financial and non-financial entities. Initial minor disclosure requirements for environmental, social and governance ("ESG") matters were applicable as of 31 December 2021, with the scope increasing over time. Furthermore, the ECB conducted its first climate stress test in 2022. The requirement – first introduced under CRR II for large listed institutions to include qualitative and quantitative information on ESG risks in the regulatory disclosure report on a half-yearly basis – entered into effect on 31 December 2022.

The ECB's Supervisory Review and Evaluation Process (SREP) ensures a common approach on the supervisory review of banks, within the framework of Pillar 2. The SREP is built around a business model analysis, an assessment of governance, as well as of the capital and liquidity risks. Results from the individual areas are aggregated in a score value, from which the ECB derives supervisory measures on holding additional capital and/or additional liquidity buffers.

Sector-specific and business developments

Structured Property Financing segment

Driven by high interest rates and stricter lending standards, financing costs for commercial property remained elevated in the first six months of 2023 and – as a consequence – transaction activity subsided compared with the previous year. The macro-economic downturn and risks, coupled with differences in price expectations between buyers and sellers of commercial property, further depressed transaction markets. A general liquidity decline in the property markets and the fact that it has become harder for buyers to secure financing further contributed to muted transaction activity. However, such a correction had been likely given that liquidity had been abundant for a prolonged period of time.

Global transaction volumes were down by around 54 % in the first half of 2023 compared with the same period in 2022. Regional differences were less pronounced than in past reporting periods, with North America, Europe and Asia/Pacific recording declines of

54 %, 59 % and 45 %, respectively. Broken down by property type[1], transaction volumes decreased in all three regions compared to the same period last year.

The general picture was one of reticence on the part of investors, more complicated pricing, and overall falling property valuations. Lenders focused their interest on residential and logistics properties, food stores, as well as on high-quality office properties in preferred locations. Properties with good re-lettability, which satisfy sustainability criteria such as energy-efficient use continued to enjoy demand. Financing costs for newly financed commercial property have risen for several quarters in a row as a result of higher interest rates and stricter lending standards. Building costs have increased, as have uncertainties surrounding property valuations at the time of disposal. In this context, the number of new project developments has fallen off. Transaction yields have also moved higher, depending on the market and type of property. At the same time, most loan-to-value ratios on the financing markets fell.

Aareal Bank generated new business of € 4.1 billion[2] in the first half of 2023 (H1 2022: € 5.2 billion). Following a slow start into the year, new business picked up. Newly-originated loans accounted for € 2.4 billion over the same period (H1 2022: € 3.5 billion), falling slightly short of the prior-year period. Green financings of approximately € 860 million were closed by the end of June. The portfolio volume of green financings increased by € 0.8 billion, to a total of around € 3.0 billion; in this context, some existing clients also submitted the required undertaking and the related certificates for the first time. Green financings meet the high energy efficiency requirements of the “Aareal Green Finance Framework” and the client undertakes to meet these requirements throughout the term of the loan. The criteria for classification as a green building comprise the EU taxonomy criteria, an above-average sustainability rating by recognised rating agencies or compliance with conservative energy efficiency criteria.

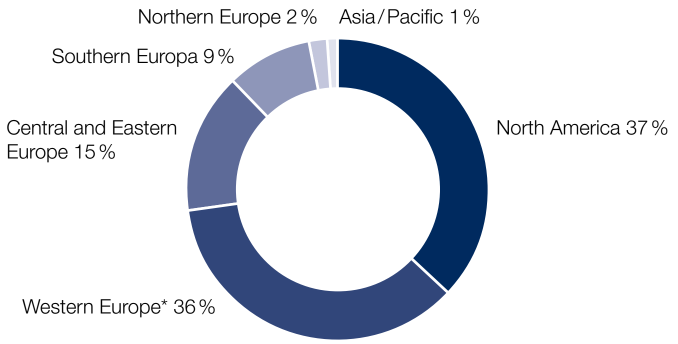
At around 62 %, the highest proportion of the new business volume was generated in Europe (H1 2022: 70 %), followed by North America at 37 % (H1 2022: 24 %). The Asia/Pacific region accounted for a share of 1 % (H1 2022: 6 %).[3]

In terms of property type, around 34 % of new business was attributable to hotels. Office properties accounted for 27 %, followed by retail properties with 16 % and office residential with a share of 14 %. Logistics properties accounted for a share of 8 %, while other properties made up 1 % of total new business. Newly-originated loans centred around office properties (34 %) and hotels (31 %), followed by residential properties (16 %). Logistics properties accounted for a share of 14 %, while retail properties made up 5 % of business.

New business[1] 1 Jan – 30 Jun 2023

by region, (%)

Total volume: € 4.1 bn



* Incl. Germany

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

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

[2] New business, excluding private client business and former WestImmo’s local authority lending business

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

Europe

Transaction volumes in Europe decreased by around 59 % during the first half of 2023 compared with the same period in 2022. Declining activity was observed in all European countries, being particularly pronounced in Italy, Poland and the Netherlands, while Spain and France recorded the smallest decline. Looking at property types, the strongest decline was found in logistics properties, followed by office and retail properties. Whilst hotel properties saw the lowest decline, they were nonetheless down by approximately 15 % year-on-year. The majority of cross-border investors were on the buy side, whilst REIT structures tended to be sellers. Institutional and private investors assumed a balanced position overall.

Average rents in the prime office property segment remained stable during the first half of 2023, while certain sub-markets, e.g. Brussels and London, also saw rent increases. Retail property rents remained stable in the vast majority of markets, but shopping centre rents in Barcelona and Madrid rose markedly, as did high-street rents in Rome. Rents for logistics properties benefited from persistent strong demand and historically low vacancy rates in the entire segment, continuing the positive development of the last few years.

In line with the increased interest rate levels seen since 2022, prime yields for office properties climbed further in most major European cities during the first six months of 2023, recording particularly strong increases in many French and Dutch cities. Yields in secondary locations developed similarly. With the trend of falling yields for logistics properties having reversed last year, yields rose further almost across the board during the first six months of 2023 – with the exception of the Swedish and UK sub-markets, where yields have remained stable since the beginning of the year. Looking at retail properties, prime yields for both shopping centres and high-street properties rose on a European average, which was essentially reflected in secondary locations as well. The Spanish and French sub-markets saw more pronounced increases.

Even though real wages have declined and economic uncertainty persists, global travel continued to recover during the first six months of 2023. The major travel destinations of Europe are no exception as the return of international travellers resulted in an increase in overnight visits. The hotel sector largely defied the unfavourable macro-economic conditions, benefiting from post-pandemic catch-up effects: occupancy rates and revenues per available room in European hotel properties increased considerably during the first half of 2023 versus the same period last year. In some countries, the recovery was so strong that they recorded more overnight visits in the first six months of 2023 than during [the same period] in 2019, i.e. before the pandemic.

In Europe, the Bank generated new business of € 2.6 billion in the first half of 2023 (H1 2022: € 3.7 billion). The majority was transacted in Western Europe, followed by – in descending order – Central and Eastern, Southern, and Northern Europe.

North America

Transaction volumes in North America were down by around 54 % in the first half of 2023 compared with the corresponding period of the previous year. Volumes had already decreased significantly year-on-year in the first quarter and continued to decline in the second quarter. In fact, volumes as low as those in the second quarter had not been seen since 2020. The number of transferred properties, however, remained significantly above the lows seen during the pandemic. Cross-border and private investors were on the buy side for the most part, while institutional investors and REIT structures were mostly sellers.

Rents offered for prime and secondary office properties in US metropolitan areas remained stable in the first six months of 2023, which was also true for relevant sub-markets such as New York or Chicago. In San Francisco, rents fell slightly compared with the start of the year. The fact that average shopping mall rents in the US remained stable across the country in the first six months was basically also evident in the metropolitan areas relevant to Aareal Bank. Rents for logistics properties increased markedly across the country and in all important sub-markets by around 4 %.

Yields for office properties in prime and secondary markets were up in the first six months of 2023, both on a national average and in relevant sub-markets. Increases were similar in premium and secondary markets, but different across sub-markets, with Chicago and – again – San Francisco registering the strongest growth. To a major extent, the general rise in yields was driven by the fast, very abrupt rise in US interest rates, which already commenced in 2022 and has been more pronounced than in the euro zone. This led to higher debt servicing payments for many borrowers (unless they had entered into interest rate hedges). Moreover, valuations of office properties came under increasing pressure during the half-year period. Yields for retail properties remained largely stable, with only minor changes vis-a-vis the start of the year. A slight decrease was recorded in New York. With interest rates increasing, the long-standing trend of falling yields for logistics properties has reversed since the beginning of the year. Yields increased both on a national average and in all relevant sub-markets.

Hotels in North America saw occupancy rates and earnings rise during the first half of the year. Occupancy ratios and revenues per available room in the luxury and upper upscale category, and in the US market overall, increased continuously between January and June, and also over the same period last year. This increase was driven not only by strong national tourism, but also by international visitors. International tourism, however, is not expected to fully recover before 2024. As at 30 June, average occupancy rates fell only slightly short of the pre-pandemic levels of 2019. In Canada, key hotel indicators developed even better in the first six months of 2023.

In North America, the Bank originated new business of € 1.5 billion (H1 2022: € 1.2 billion), all of which was attributable to the US.

Asia/Pacific

Transaction volumes for commercial property in the Asia/Pacific region were roughly 45 % lower in the first half of 2023 than in the comparable period of the previous year, with significant declines seen in Australia (-66 %) and China (-47 %). All property types weakened in this context, the only exception being hotels in Australia, where transaction volumes were up on a low comparison base, and retail properties in China. Across the region, cross-border and institutional investors were on the buy side for the most part, whilst REIT structures were predominantly sellers. Private investors assumed a balanced position overall.

Prime rents for logistics properties in Australia's metropolitan areas of Sydney, Perth and Melbourne continued to increase during the first half of 2023, whilst rents for retail properties stagnated in the major Chinese metropolitan areas.

Yields for Australian logistics properties continued along the growth path begun last year, with yields for properties in relevant metropolitan areas increasing by 15 to 50 basis points. In contrast, Chinese retail property yields remained stable.

Buoyed by the final lifting of travel restrictions, hotels in the Asia/Pacific region developed favourably during the first half of the year. Occupancy rates and earnings alike mostly improved, reflecting the ongoing recovery in international tourism. The main driver for success, however, remained short-haul visits and domestic travellers. It will take until around 2025 for long-haul tourism to reach the levels seen before the pandemic. Another positive factor is the gradual return of Chinese tourists. But as the year progressed, high inflation and negative real wage growth increasingly hampered the recovery. In this context, the Maldives again recorded a significant increase in visitors. Overall, around 900,000 tourists had visited the Maldives by the middle of the year, after about 800,000 in the same period of 2022.

The Bank originated new business of € 35 million in the Asia/Pacific region during the first half of 2023 (H1 2022: € 0.3 billion).

Banking & Digital Solutions segment

The housing and commercial property sectors continued to prove stable market segments in the first half of 2023, even though the period was shaped by rising costs of energy and materials, as well as inflation – as in the previous year. Rental prices continued to increase year-on-year in the first quarter, reaching a national level of 5.8 %. Supply chains – which have been problematic until recently – as well as high energy costs are showing some signs of normalisation. But now it is rising interest rates that keep construction prices high, thwarting realisation of new construction projects. Accordingly, the number of new building permits has fallen to 21,200 residential units, down 31.9% compared to April 2022.

The scope of BK01 functionality was extended during the period under review, to account for our clients' special needs in terms of receivables management – also incorporating functionality from our platform offers as well as the expertise of Collect Artificial Intelligence GmbH ("Collect AI"), the payment solutions provider acquired in 2022 whose product range also includes AI-supported end-customer communications.

Favourable interest rate developments mean that we are once again in a position to offer interest terms enabling us to attract clients for fixed-term deposits and deposits at notice.

At present, more than 4,000 corporate clients throughout Germany are using our process-optimising products and banking services. The segment's volume of deposits averaged € 13.5 billion in the first half of 2023 (H1 2022: € 13.2 billion). All in all, this reflects the strong trust our clients continue to place in Aareal Bank. Net commission income of € 16 million increased as planned (H1 2022: € 15 million). Higher interest rate levels, combined with the persistently high volume of deposits, made a notable contribution to stronger operating profit in the BDS segment.

Aareon segment

Aareon is a provider of software as a service (SaaS). It is helping the European property management industry go digital by offering user-oriented software that simplifies and automates processes, supports sustainable and energy-efficient operations, and interconnects all process participants. Aareon pursues an international growth strategy with the aim of transforming the company into a "Rule of 40" SaaS company, with its combined EBITDA margin and revenue growth set to exceed 40 % by 2025.

Aareon launched a new partner programme – "Aareon Connect" – during the first half of 2023 to make it even easier to integrate software solutions and services of third-party providers. More than ten partners were already on board when this open ecosystem went live. Aareon Connect was developed using the low-code technology by Locoia GmbH, which was fully acquired by Aareon in December 2022. This approach enables a simpler and faster technical integration of third-party solutions. Aareon also acquired German UTS innovative Softwaresysteme GmbH in February 2023, a provider of software solutions specialising in the administrative needs of residential owners' associations and external property management companies. In March 2023, Aareon added Embrace – The Human Cloud, the Dutch market leader for SaaS solutions in the areas of digital workspace and customer engagement, to its portfolio. Embrace's CRM solutions enlarge the product portfolio for Dutch clients.

An additional focal point during the first half of the year for Aareon was the introduction of Salesforce customer relationship management software, and Workday, an HR management software, to further professionalise the software systems used at Aareon and to optimise costs. Further measures to future-proof Aareon included the acquisition of new talent, in particular in the UK and including employees for product portfolio optimisation.

Aareon Group's sales revenues increased by 15 % in the first six months to reach € 168 million (H1 2022: € 147 million), with almost all countries posting higher revenues than in the same period of the previous year. The only exception was the UK, where revenues fell following the product strategy adjustment for social housing software and the transition to SaaS products that resulted in lower service and licence and higher recurring revenues. In Germany and the Netherlands, the UTS and Embrace acquisitions made their first contributions to sales revenues. While licence revenues declined in line with the SaaS strategy, recurring revenues enjoyed a strong increase (+21 %) and now account for 76 % of total revenues (H1 2022: 73 %) – mainly driven by Aareon's ERP systems (Wodis Yuneo and the SAP® solutions including Blue Eagle, Tobias, Twinq and REMS). Mareon and Archiv kompakt, combined with Aareon's solution for occupant change management, also made a positive contribution to sales revenues.

Aareon's adjusted EBITDA[1)] amounted to € 39 million in the first half of the year (H1 2022: € 32 million). The improved cost structure is already starting to filter through to the bottom line.

Succeeding Christian M. Schmahl, Dirk Schilling was appointed CFO of Aareon AG on 1 April 2023.

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

Financial Position and Financial Performance

Financial performance

Group

Consolidated net income of Aareal Bank Group

€ mn	1 Jan-30 Jun 2023	1 Jan-30 Jun 2022
Net interest income	462	330
Loss allowance	160	107
Net commission income	149	132
Net derecognition gain or loss	12	22
Net gain or loss from financial instruments (fvpl)	-41	18
Net gain or loss from hedge accounting	0	-7
Net gain or loss from investments accounted for using the equity method	–	-2
Administrative expenses	342	295
Net other operating income/expenses	7	0
Operating profit	**87**	**91**
Income taxes	29	33
Consolidated net income	**58**	**58**
Consolidated net income attributable to non-controlling interests	-9	1
Consolidated net income attributable to shareholders of Aareal Bank AG	67	57

Consolidated operating profit of € 87 million for the first half of the financial year was in line with the previous year's figure of € 91 million, and within the expected range – thanks to strong income growth and despite the announcement of Aareon's efficiency enhancement measures and charges as a result of the swift NPL reduction.

Due to a year-on-year increase in the credit portfolio, solid margins, and the impact of rising interest rates on the continued high volume of deposits, net interest income of € 462 million was significantly higher than in the previous year (€ 330 million), and above expectations.

Loss allowance totalled € 160 million (H1 2022: € 107 million). It mainly results from individual new loan defaults of US office properties, for which the management overlay recognised in the first quarter was reversed in the second quarter. This also includes the announced addition to loss allowance of around € 60 million for a swift NPL reduction. The remaining (NPL-classified) exposure to Russia of € 217 million has meanwhile been disposed of.

Net commission income from the Banking & Digital Solutions segment and at Aareon increased as planned, to reach a total of € 149 million (H1 2022: € 132 million).

Net derecognition gain of € 12 million (H1 2022: € 22 million) was mainly attributable to income from the Treasury portfolio, whilst positive market-driven effects from early loan repayments had been the main driver in the previous year.

Net gain or loss from financial instruments (fvpl) and from hedge accounting in the aggregate amount of € -41 million (H1 2022: € 11 million) was largely due to credit risk-induced valuation losses on defaulted property loans, especially in the US – in contrast to positive valuation effects resulting from market developments for currency and interest rate hedging derivatives due to strong market dynamics in the previous year.

Administrative expenses increased from € 295 million in the previous year to € 342 million, reflecting both strong growth and the efficiency enhancement measures of approximately € 55 million at Aareon. Costs at the Bank remained largely stable: at 32%

(excluding bank levy and contributions to the deposit guarantee scheme, as is customary in the banking sector), the cost/income ratio was at a very low – and thus very good – level during the quarter under review, even in an international comparison.

Net other operating income/expenses amounted to € 7 million (H1 2022: € 0 million); the figure included reversals of provisions.

Overall, this resulted in consolidated operating profit of € 87 million (H1 2022: € 91 million). Taking into consideration tax expenses of € 29 million and non-controlling interest income of € -9 million, consolidated net income attributable to shareholders of Aareal Bank AG amounted to € 67 million (H1 2022: € 57 million). Earnings per ordinary share amounted to € 0.97 (H1 2022: € 0.84), and RoE after taxes to 4.0 % (H1 2022: 3.7 %).

Structured Property Financing segment

Structured Property Financing segment result

€ mn	1 Jan-30 Jun 2023	1 Jan-30 Jun 2022
Net interest income	365	313
Loss allowance	160	107
Net commission income	1	4
Net derecognition gain or loss	12	22
Net gain or loss from financial instruments (fvpl)	-41	18
Net gain or loss from hedge accounting	0	-7
Administrative expenses	120	146
Net other operating income/expenses	7	-2
Operating profit	**64**	**95**
Income taxes	25	34
Segment result	**39**	**61**

Operating profit in the Structured Property Financing segment amounted to € 64 million in the first half of 2023 (H1 2022: € 95 million).

Net interest income of € 365 million in the segment was significantly higher than in the previous year (€ 313 million) due to a year-on-year increase in the credit portfolio and solid margins.

Loss allowance totalled € 160 million (H1 2022: € 107 million). It mainly results from individual new loan defaults of US office properties, for which the management overlay recognised in the first quarter was reversed in the second quarter. This also includes the announced addition to loss allowance of around € 60 million for a swift NPL reduction. The remaining (NPL-classified) exposure to Russia of € 217 million has meanwhile been disposed of.

Net derecognition gain of € 12 million (H1 2022: € 22 million) was mainly attributable to income from the Treasury portfolio, whilst positive market-driven effects from early loan repayments had been the main driver in the previous year.

Net gain or loss from financial instruments (fvpl) and from hedge accounting in the aggregate amount of €- 41 million (H1 2022: € 11 million) was largely due to credit risk-induced valuation losses on defaulted property loans, especially in the US – in contrast to positive valuation effects resulting from market developments for currency and interest rate hedging derivatives due to strong market dynamics in the previous year.

Administrative expenses in the segment remained largely stable; the decrease to € 120 million (H1 2022: € 146 million) resulted from the regular review and revision of intra-Group cost allocation between the SPF and BDS segments in 2023.

Net other operating income/expenses amounted to € 7 million (H1 2022: € -2 million); the figure included reversals of provisions.

Overall, operating profit for the Structured Property Financing segment was € 64 million (H1 2022: € 95 million). After income taxes of € 25 million (H1 2022: € 34 million), the segment result amounted to € 39 million (H1 2022: € 61 million).

Banking & Digital Solutions segment

Banking & Digital Solutions segment result

€ mn	1 Jan - 30 Jun 2023	1 Jan - 30 Jun 2022
Net interest income	111	23
Net commission income	16	15
Net gain or loss from financial instruments (fvpl)	0	0
Net gain or loss from investments accounted for using the equity method	–	-1
Administrative expenses	52	37
Net other operating income/expenses	-1	-1
Operating profit	**74**	**-1**
Income taxes	23	0
Segment result	**51**	**-1**

Due to the impact of rising interest rates on the continued high volume of deposits, net interest income in the Banking & Digital Solutions segment of € 111 million surpassed the previous year's figure of € 23 million.

Net commission income of € 16 million increased slightly, as planned (H1 2022: € 15 million).

Administrative expenses in the segment remained largely stable; the increase to € 52 million (H1 2022: € 37 million) resulted from the regular review and revision of intra-Group cost allocation between the SPF and BDS segments in 2023.

Overall, segment operating profit in the first half of 2023 was € 74 million (H1 2022: € -1 million). After income taxes, the segment result for the first half of the year amounted to € 51 million (H1 2022: € -1 million).

Aareon segment

Aareon segment result

€ mn	1 Jan - 30 Jun 2023	1 Jan - 30 Jun 2022
Net interest income	-14	-6
Loss allowance	0	0
Net commission income	137	119
Net gain or loss from financial instruments (fvpl)	0	0
Net gain or loss from investments accounted for using the equity method	–	-1
Administrative expenses	175	118
Net other operating income/expenses	1	3
Operating profit	**-51**	**-3**
Income taxes	-19	-1
Segment result	**-32**	**-2**

Net interest income in the Aareon segment amounted to € -14 million, reflecting debt-financed M&A activities (H1 2022: € -6 million).

Net commission income increased as planned to € 137 million (H1 2022: € 119 million); M&A transactions closed in the previous year also contributed to this rise.

Aareon reported increased administrative expenses of € 175 million – vis-à-vis € 118 million in the previous year – reflecting both strong growth and efficiency enhancement measures accounting for approximately € 55 million.

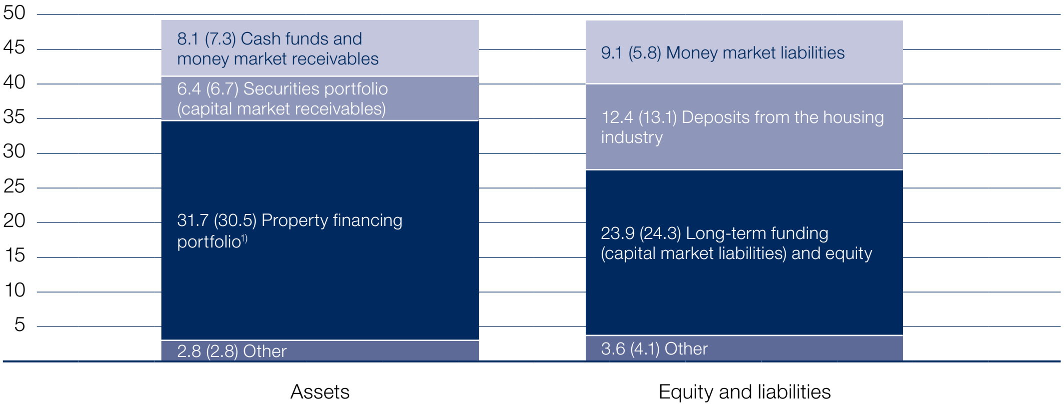
Overall, segment operating profit in the first half of 2023 was € -51 million (H1 2022: € -3 million). Taking income taxes into consideration, the segment result for the first half of the year amounted to € -32 million (H1 2022: € -2 million).

Financial position – assets and liabilities

Consolidated total assets of Aareal Bank Group increased to € 49.0 billion as at 30 June 2023 (31 December 2022: € 47.3 billion), reflecting the increase in the property financing portfolio.

Balance sheet structure as at 30 June 2023 (31 December 2022)

€ bn



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

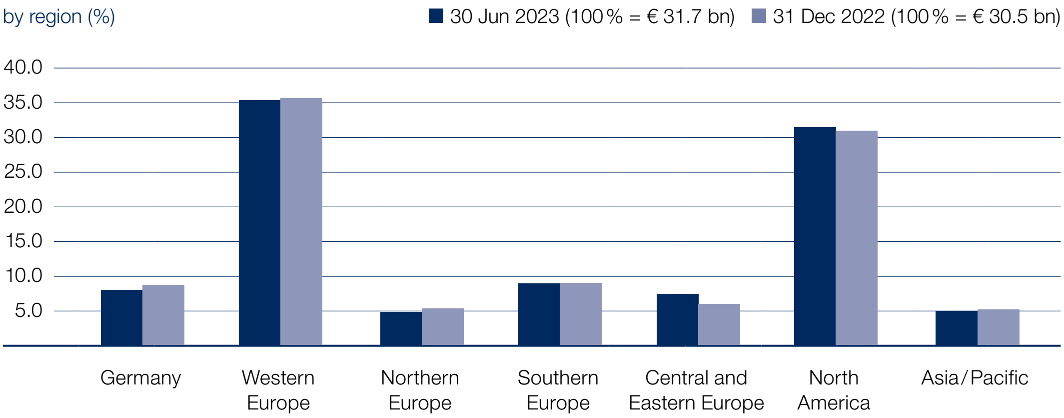
Property financing portfolio

The volume of Aareal Bank Group's property financing portfolio[1] stood at € 31.7 billion as at 30 June 2023 (31 December 2022: € 30.5 billion). Including private client business (which is being run down) and former WestImmo's local authority lending business, it amounted to € 32.1 billion (31 December 2022: € 30.9 billion), showing that Aareal Bank is on track to achieve the target portfolio size of around € 32 billion to € 33 billion by year-end.

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

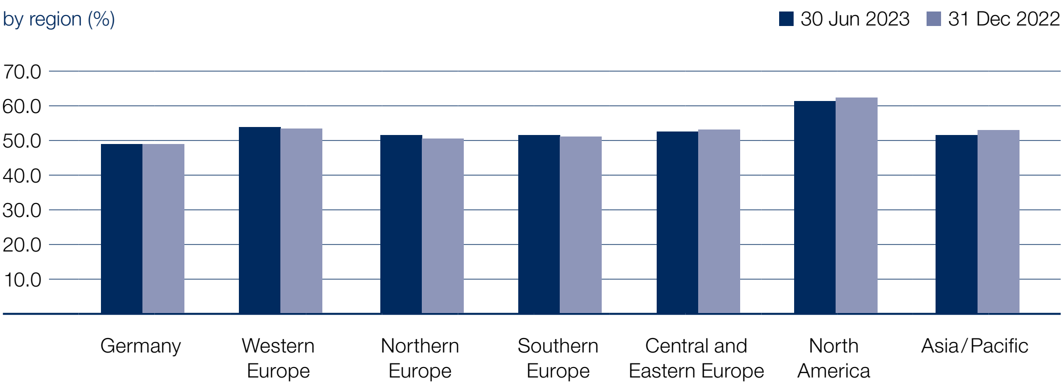
At the reporting date (30 June 2023), Aareal Bank Group's property financing portfolio was composed as shown below, compared to year-end 2022:

Property financing volume[1] (amounts drawn)
by region (%)



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

Average LTV of property financing[1]
by region (%)



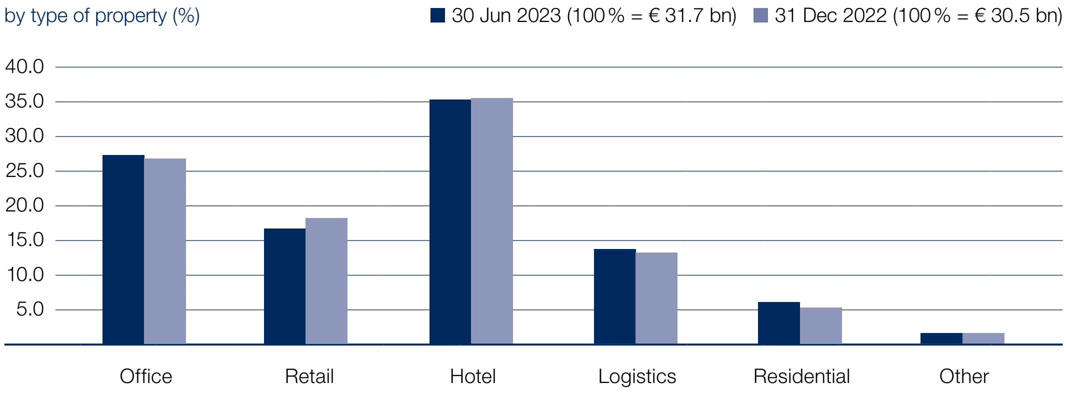
[1] Excluding private client business and former WestImmo's local authority lending business

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

Portfolio allocation by region and continent also did not change significantly during the period under review. The portfolio share in Central and Eastern Europe increased by approximately 0.9 percentage points, whilst remaining relatively stable for all other regions.

Property financing volume[1] (amounts drawn)

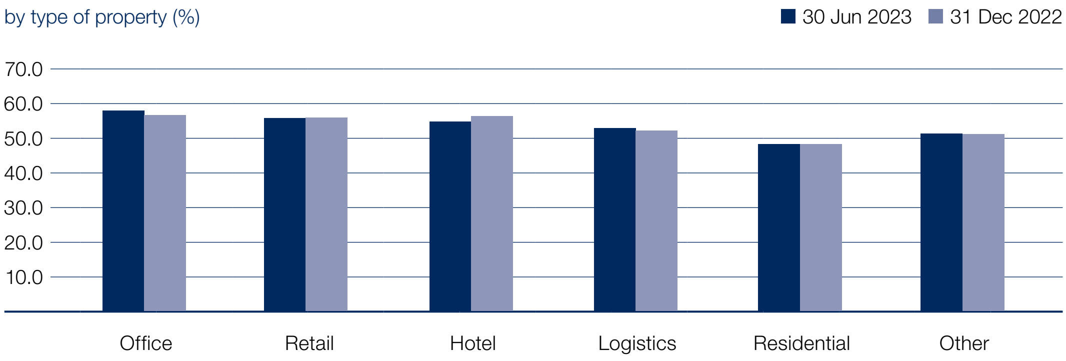
by type of property (%)



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

Average LTV of property financing[1]

by type of property (%)



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

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

The breakdown of the portfolio by property type did not change significantly either during the period under review. The share of retail properties decreased by around 1.6 percentage points compared to year-end 2022. The share of all other property types remained almost unchanged compared to the year-end 2022.

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

Treasury portfolio

In terms of its ratings structure, Aareal Bank's Treasury portfolio enjoys a very high credit quality and liquidity.

As at 30 June 2023, the total nominal volume of the Treasury portfolio[2] was € 6.5 billion (31 December 2022: € 6.7 billion).

[2] As at 30 June 2023, the securities portfolio was carried at € 6.4 billion (31 December 2022: € 6.7 billion).

In terms of asset classes, the portfolio comprises public-sector borrowers, covered bonds and bank bonds (financials), with the public-sector asset class accounting for the largest share of the portfolio (currently at around 78 %).

The high credit quality requirements are also reflected in the portfolio's rating breakdown. 99.8 % of the portfolio has an investment grade rating[1], with 86.8 % having an AAA to AA- rating.

The portfolio currently comprises almost exclusively (94 %) securities denominated in euros, and its average remaining term as at the reporting date was 6.3 years.

Financial position – liquidity

Funding and equity

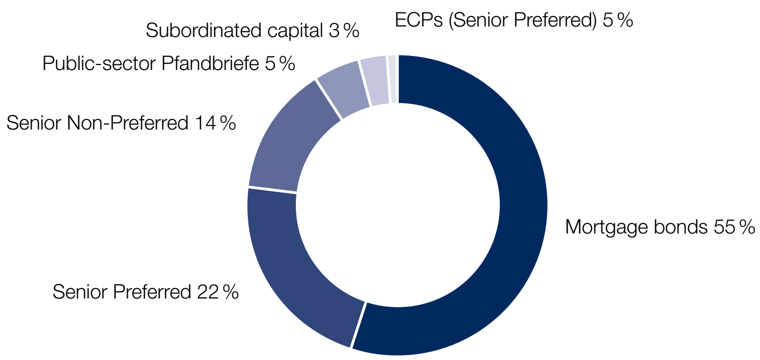
Funding

Aareal Bank Group has remained very solidly funded throughout the first half of the 2023 financial year, evidenced by its major share of long-term funding. This encompasses registered and bearer Pfandbriefe, promissory note loans, medium-term notes, other bonds and subordinated issues. According to its legal characteristics, we recognise European Commercial Paper (ECP) as debt even though its maturity is usually less than one year. Subordinated capital includes subordinated liabilities and the Additional Tier I (AT I) bond.

As at 30 June 2023, the notional volume of the long-term refinancing portfolio was € 22.4 billion. Book values of the long-term refinancing portfolio totalled € 20.9 billion.

Capital market funding mix as at 30 June 2023

% Total volume (nominal): € 22.4 bn



As at the reporting date, Aareal Bank also had € 12.4 billion at its disposal in deposits generated from the business with the housing industry (31 December 2022: € 13.1 billion). Money market liabilities, including targeted longer-term refinancing operations (TLTROs) of Deutsche Bundesbank, amounted to € 9.1 billion (31 December 2022: € 5.8 billion), including € 3.0 billion in deposits from institutional investors and € 1.7 billion in retail deposits.

Aareal Bank Group raised € 1.8 billion on the capital market during the first half of 2023, including two benchmark Pfandbrief issues of € 750 million each.

[1] The rating details are based on the composite ratings.

Since we conduct our business activities in a range of foreign currencies, we have adopted appropriate measures to secure foreign currency liquidity over the longer term.

Equity

Aareal Bank Group's total equity as disclosed in the statement of financial position amounted to € 3,288 million as at 30 June 2023 (31 December 2022: € 3,258 million); the increase was due, in particular, to the consolidated net income for 2023.

Please also refer to the statement of changes in equity, and to the explanations provided in Note 22 of the consolidated interim financial statements for the first half of 2023.

Regulatory indicators[1)]

	30 Jun 2023	31 Dec 2022
€ mn		
Basel IV (phase-in)		
Common Equity Tier 1 (CET1) capital	2,590	2,468
Tier 1 (T1) capital	2,890	2,768
Total capital (TC)	3,133	3,065
%		
Common Equity Tier 1 ratio (CET1 ratio)	19.4	19.3
Tier 1 ratio (T1 ratio)	21.7	21.7
Common Equity Tier 1 ratio (CET1 ratio)	23.5	24.0

[1)] Aareal Bank AG utilises the rules set out in section 2a of the KWG in conjunction with Article 7 of the CRR, pursuant to which regulatory indicators may only be determined at Group level. In this respect, the following disclosures relate to Aareal Bank Group.
31 December 2022: including the originally proposed dividend of € 1.60 per share in 2022 and pro rata temporis accrual of the net interest on the AT1 bond, excluding profits for 2022 under commercial law. There are no plans to distribute any dividends, in line with the strategy for 2023. The appropriation of profits is subject to approval by the Annual General Meeting.
30 June 2023 (preliminary): including interim results for 2023 (assuming ECB approval of inclusion) and pro rata temporis accrual of net interest on the AT1 bond. The SREP recommendations concerning the NPL inventory and the ECB's NPL guidelines for the regulatory capital of new NPLs and an additional voluntary and preventive capital deduction for regulatory uncertainties from ECB tests were taken into account.
Adjusted total risk exposure amount (as defined in Article 92 (3) CRR – RWAs), in accordance with applicable law as at 31 December 2022 (CRR II) and applying the partial regulation for the "output floor" in connection with commercial property lending and equity exposures, based on the European Commission's proposal dated 27 October 2021 for implementation of Basel IV (CRR III). The adjusted risk-weighted exposure amount for commercial property lending and equity exposures is determined using the higher of (i) total RWAs calculated in accordance with CRR II currently in force, and (ii) the figure calculated in accordance with the revised CRSA (pursuant to CRR III), applying the transitional provisions for 2025 (50% output floor).

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

	RWA amounts 30 Jun 2023	Minimum capital requirements Total 30 Jun 2023	RWA amounts 31 Dec 2022	Minimum capital requirements Total 31 Dec 2022
€ mn				
Credit risk (excluding counterparty credit risk)	10,827	866	10,063	805
Counterparty credit risk	335	27	384	31
Market risk	130	10	136	11
Operational risk	1,283	103	1,142	91
Additional RWA pursuant to Article 3 of the CRR	755	60	1,057	85
Total	**13,330**	**1,066**	**12,782**	**1,023**

[1)] Adjusted (preliminary) risk exposure amount (as defined in Article 92 (3) CRR – RWAs), in accordance with applicable law as at 31 December 2022 (CRR II) and applying the partial regulation for the "output floor" in connection with commercial property lending and equity exposures, based on the European Commission's proposal dated 27 October 2021 for implementation of Basel IV (CRR III). The adjusted risk-weighted exposure amount for commercial property lending and equity exposures is determined using the higher of (i) total RWAs calculated in accordance with CRR II currently in force, and (ii) the figure calculated in accordance with the revised CRSA (pursuant to CRR III), applying the transitional provisions for 2025 (50% output floor).

Risk Report

Aareal Bank Group Risk Management

The Group Management Report 2022 contains a comprehensive description of Aareal Bank Group's risk management approach, including the corresponding organisational structure and workflows in the lending and trading businesses, as well as the methods and procedures used for measuring and monitoring risk exposure. Within the scope of the present Interim Report, we briefly reiterate the key elements of our risk management, also outlining material developments during the period under review.

The business policy set by the Management Board, and duly acknowledged by the Supervisory Board, provides the conceptual framework for Aareal Bank Group's risk management. Taking this as a basis, and strictly considering the Bank's defined risk appetite, we have formulated detailed strategies for managing the various types of risk. These risk strategies, as well as the Bank's business strategy, are adapted to the changed environment at least once a year, adopted by the Management Board, and duly acknowledged by the Supervisory Board. Appropriate risk management and risk control processes are deployed to implement the risk strategies and to ascertain the Bank's ability to bear risk. An internal risk report regularly informs Management Board and Supervisory Board about all material risks.

Aareal Bank regularly reviews the appropriateness and effectiveness of its corporate governance systems (including risk governance systems).

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

Risk-bearing capacity and risk limits

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

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

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

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

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

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

Moreover, the value-oriented approach adopted under the economic perspective requires suitable adjustments to be made to regulatory Tier 1 capital, in order to bring aggregate risk cover into line with the economic assessment. Specifically, this may entail adjustments regarding conservative valuation, hidden encumbrances, or a management buffer. The management buffer also includes adjustments for potential climate-related risks as determined within the scope of our Group-wide ESG strategy.

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

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

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

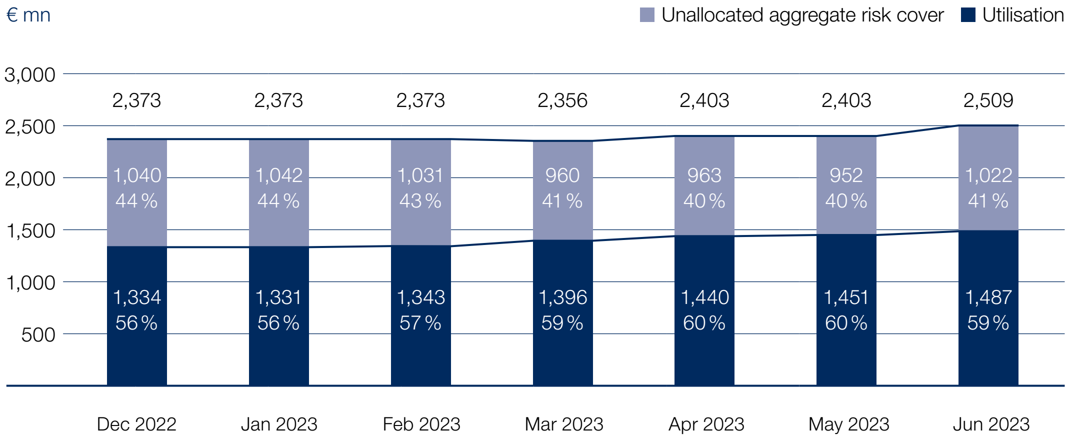
A detailed monthly report provides information regarding the utilisation of individual limits for the material types of risk, as well as on the overall limit utilisation. These are being monitored as part of daily reporting. No limit breaches at the aggregate risk level were detected during the period under review. The observed increase in market volatility in connection with the war in Ukraine led to "amber" thresholds (early warning triggers) for individual risk categories being exceeded. These could be resolved through risk-mitigating measures without undue delay.

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

€ mn	30 Jun 2023	31 Dec 2022
Common Equity Tier 1 capital (CET1 in accordance with Basel III)	2,590	2,468
Economic adjustments	-81	-95
Aggregate risk cover	**2,509**	**2,373**
Utilisation of aggregate risk cover		
Loan loss risks	601	467
Interest rate risk in the banking book (IRRBB)	74	86
Pension risks	84	72
Market risks	414	406
Operational risks	103	91
Investment risks	69	75
Property risks	77	71
Business and strategic risks	65	66
Total utilisation	**1,487**	**1,334**
Utilisation (% of aggregate risk cover)	**59 %**	**56 %**

Utilisation of aggregate risk cover during the course of 2023

€ mn



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

Loan loss risks

Definition

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

Risk measurement and monitoring

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

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

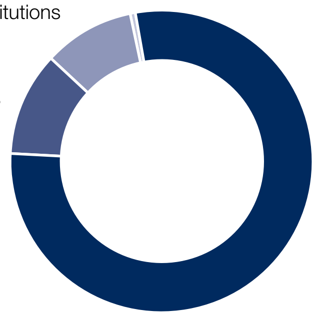
Aareal Bank employs different risk classification procedures tailored to the requirements of the respective type of business for the initial, regular, or event-driven assessment of counterparty credit risk. Forward-looking as well as macro-economic information is taken into consideration for risk classification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

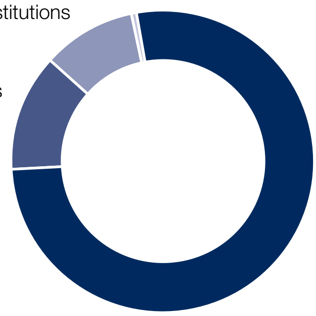
In light of geopolitical and macro-economic uncertainty, special attention is currently paid to economic forecasts. In the context of this ongoing review, we also rely on projections published by the ECB, apart from those issued by our usual data providers. Yet estimation uncertainties are currently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

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

by rating procedure, € bn

30 Jun 2023 | 31 Dec 2022





* Including the private client business of former WestImmo

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

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

The following tables provide a breakdown of gross carrying amounts of on-balance sheet as well as off-balance sheet credit business, money-market business, and capital markets business, by rating classes and loss allowance stages, in line with credit risk management at Group level. The ongoing interest rate increases on the international markets burdened debt service requirements, resulting in continued high levels of Stage 2 loss allowance compared to historical levels. Figures are based on Aareal Bank Group's internal default risk rating classes. The default definition follows the definition pursuant to Article 178 of the CRR, which is decisive for management purposes.

On-balance sheet commercial property finance business with mandatory rating

	30 Jun 2023					31 Dec 2022				
	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
€ mn										
Class 1	–	–	–	–	**–**	–	–	–	–	**–**
Class 2	82	–	–	–	**82**	158	–	–	–	**158**
Class 3	75	–	–	–	**75**	258	–	–	–	**258**
Class 4	838	–	–	–	**838**	775	24	–	–	**799**
Class 5	3,784	19	–	19	**3,822**	4,367	19	–	18	**4,404**
Class 6	3,501	149	–	64	**3,714**	4,296	52	–	112	**4,460**
Class 7	5,950	277	–	5	**6,232**	4,534	772	–	37	**5,343**
Class 8	3,059	1,466	–	32	**4,557**	2,610	1,352	–	52	**4,014**
Class 9	5,297	1,448	–	23	**6,768**	3,649	2,623	–	33	**6,305**
Class 10	746	1,554	–	41	**2,341**	962	1,519	–	42	**2,523**
Class 11	261	485	–	–	**746**	157	116	–	–	**273**
Class 12	–	152	0	–	**152**	–	97	–	–	**97**
Classes 13-15	–	227	–	–	**227**	–	–	–	–	**–**
Defaulted	–	–	1,218	99	**1,317**	–	–	983	133	**1,116**
Total	**23,593**	**5,777**	**1,218**	**283**	**30,871**	**21,766**	**6,574**	**983**	**427**	**29,750**

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

Off-balance sheet commercial property finance business with mandatory rating

	30 Jun 2023					31 Dec 2022				
	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
€ mn										
Classes 1-3	–	–	–	–	**–**	–	–	–	–	**–**
Class 4	10	–	–	–	**10**	5	–	–	–	**5**
Class 5	65	–	–	–	**65**	52	–	–	–	**52**
Class 6	28	8	–	–	**36**	72	–	–	0	**72**
Class 7	91	–	–	–	**91**	62	19	–	–	**81**
Class 8	68	40	–	–	**108**	211	33	–	–	**244**
Class 9	168	124	–	5	**297**	84	18	–	–	**102**
Class 10	20	22	–	–	**42**	211	20	–	–	**231**
Class 11	119	59	–	–	**178**	19	–	–	–	**19**
Classes 12-15	–	4	–	–	**4**	–	–	–	–	**–**
Defaulted	–	–	7	–	**7**	–	–	2	–	**2**
Total	**569**	**257**	**7**	**5**	**838**	**716**	**90**	**2**	**0**	**808**

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

On-balance sheet loans and advances to financial institutions

	30 Jun 2023					31 Dec 2022				
€ mn	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
Class 1	286	–	–	–	**286**	322	–	–	–	**322**
Class 2	405	–	–	–	**405**	157	–	–	–	**157**
Class 3	256	–	–	–	**256**	476	–	–	–	**476**
Class 4	1,103	–	–	–	**1,103**	1,102	–	–	–	**1,102**
Class 5	70	–	–	–	**70**	302	–	–	–	**302**
Class 6	247	–	–	–	**247**	7	–	–	–	**7**
Class 7	790	–	–	–	**790**	655	–	–	–	**655**
Class 8	495	–	–	–	**495**	422	–	–	–	**422**
Class 9	183	–	–	–	**183**	396	–	–	–	**396**
Class 10	91	11	–	–	**102**	18	–	–	–	**18**
Classes 11-18	–	–	–	–	**–**	–	–	–	–	**–**
Defaulted	–	–	–	–	**–**	–	–	–	–	**–**
Total	**3,926**	**11**	**–**	**–**	**3,937**	**3,857**	**–**	**–**	**–**	**3,857**

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

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

	30 Jun 2023					31 Dec 2022				
€ mn	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
Class 1	1,359	–	–	–	**1,359**	1,687	–	–	–	**1,687**
Class 2	1,760	–	–	–	**1,760**	1,802	–	–	–	**1,802**
Class 3	390	–	–	–	**390**	495	–	–	–	**495**
Class 4	28	–	–	–	**28**	30	–	–	–	**30**
Class 5	16	–	–	–	**16**	21	–	–	–	**21**
Class 6	246	–	–	–	**246**	273	–	–	–	**273**
Class 7	41	–	–	–	**41**	120	–	–	–	**120**
Class 8	530	–	–	–	**530**	526	–	–	–	**526**
Class 9	–	–	–	–	**–**	–	–	–	–	**–**
Classes 10-20	–	–	–	–	**–**	–	–	–	–	**–**
Defaulted	–	–	–	–	**–**	–	–	–	–	**–**
Total	**4,370**	**–**	**–**	**–**	**4,370**	**4,954**	**–**	**–**	**–**	**4,954**

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

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

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

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

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

Country risks

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

Interest rate risk in the banking book

Definition

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

Specifically, for Aareal Bank this includes:

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

Risk measurement and monitoring

Risk Controlling informs the members of the Management Board responsible for Treasury and risk monitoring about the risk position and the present-value exposure to interest rate risk in the banking book on a daily basis (the "economic value of equity" perspective). This is supplemented, on a monthly basis, by an analysis of possible deviations of planned income in the event of adverse interest rate scenarios (the earnings perspective). The interest rate scenarios used for the measurement of potential plan deviations comprise interest rate shocks (both increases and reductions) as well as time-based increases or reductions of the interest rate projection used to determine planned interest income.

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

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

By their very nature, VaR calculations are based on numerous assumptions regarding the future development of the business, and the related cash flows. Key assumptions used include current account balances and deposits at notice which are factored into calculations for a period of up to ten years (2.24 years on average), using the average residual amount of deposits observed in the past. Loans are taken into account using their fixed-interest period (for fixed-rate exposures), or using their expected maturity (variable-rate exposures). Aareal Bank Group's consolidated equity is not taken into account as a risk-mitigating item. This tends to overstate VaR, demonstrating our goal to pursue a conservative approach adopted in our risk measurement processes.

Pension risks

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

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

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

Market risks

Definition

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

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

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

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

Additional elements of market risk are:

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

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

Risk measurement and monitoring

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

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

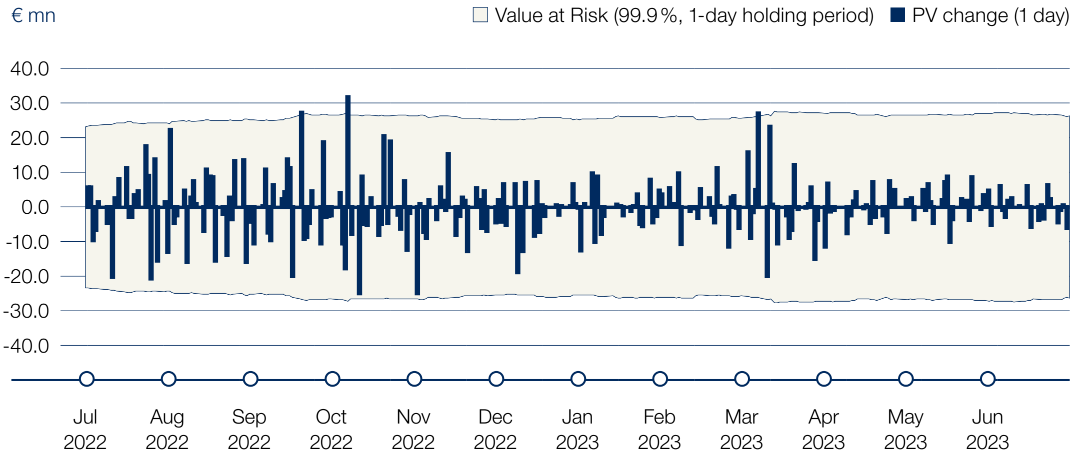
A variance-covariance approach (delta-normal method) is used to determine the aggregated VaR indicator for market risk. Determined on a daily basis for the Group, the VaR figure takes into account the correlation between individual risk types. Statistical parameters used in the VaR model are calculated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

Backtesting

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

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

Present values and 1-day VaR during the course of 2022/2023



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

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

Operational risks

Definition

The Bank defines operational risk as the threat of losses caused by inappropriate internal procedures, human resources and systems (or their failure), or through external events. This definition also includes legal risks. To the extent that they are caused by operational risks, ESG risk factors as well as model and reputational risks are also taken into consideration within this type of risk.

It is the objective of the policy pursued by Aareal Bank to achieve a risk-minimising or loss-limiting effect at an early stage by employing a pro-active approach. The Bank resorts to various risk control tools to manage operational risk. Data is collected on a decentralised basis and all material operational risks of the Group compiled centrally. The tools described above are used to prepare the regular risk reporting to the Bank's senior management. Taken together, these tools for managing operational risks result in an integrated control circuit which leads to risk identification, evaluation, and management – through to risk control.

The responsibility for implementing operative risk-reducing measures rests with those responsible for the Bank's risk management. The utilisation of freely available funds for operational risks – as part of the Bank's risk-bearing capacity – is determined using the regulatory standardised approach under Pillar I.

Investment risks

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

The investment risk model breaks down investments outside the regulatory scope of consolidation into two groups, whereby risk-equivalent exposures are determined for material investments using the regulatory IRB formula. For non-material investments, equity coverage is determined using the simple risk weight function for investments in accordance with the CRR. Risk exposure for investments within the regulatory scope of consolidation is measured using the look-through principle, based on the assets of the respective investment.

Property risks

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

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

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

Business and strategic risks

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

Allocation risk is already covered by various planning scenarios, and is thus incorporated in aggregate risk cover.

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

Liquidity risks

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

Treasury is responsible for managing liquidity risks, whilst Risk Controlling ensures the continuous monitoring, including preparation of a daily liquidity report, and a contribution to the monthly risk report to the entire Management Board.

Report on Expected Developments and Opportunities

Macro-economic environment

The economy, financial markets, and commercial property are all exposed to a number of risks; some downside risks, however, have lost relevance in the first half of 2023 or proven to be only temporary. The Russian invasion of Ukraine, which has caused enormous humanitarian and economic distress, remains an extraordinary concern. Other risks that could have a negative impact are the repercussions of persistently high inflation, an excessive monetary tightening by central banks, increased public and private debt, doubts about the cohesion of the European project, geopolitical risks as well as the consequences of the transformation of the economy towards more climate neutrality.

The consequences of the Russian invasion of Ukraine and mutual sanctions between the West and Russia continue to have a serious negative impact on many economies, which may persist or be exacerbated if the conflict continues. Direct economic effects of this war include supply chain disruptions and higher commodity prices, alongside increased uncertainty and heightening risk aversion amongst market participants, which pose a threat to economic growth. The high rates of inflation fuelled by the war are lowering real incomes and – in conjunction with the increased cost of production – burdening aggregate demand. In this context, it is fair to expect that the economic relationship between Russia and the West will not normalise completely in the near term, even if the war ends.

While energy and commodity prices were the main drivers of inflation in the first half of 2022, price pressures subsequently became increasingly broad-based, pushing inflation in many economies to its highest level in several decades. Although energy-related price pressures subsided in the first half of 2023, persistently high core inflation suggests that companies are passing through higher prices to their customers. One explanation is wage increases that companies are passing on to consumers through higher prices for goods and services, aiming to protect their profit margins. To the extent that demand in the future continues to be met by supply shortages, prices of some goods and services may continue to rise, contributing to high inflation rates and possibly to persistently higher inflation expectations.

Central bankers are faced with the difficult task of steering inflation from its current high levels towards the target rate in the medium term, without jeopardising financial stability. At the same time, excessive or prolonged monetary tightening is an enormous threat for financial and property markets, which could materialise after another significant raise in key interest rates or a faster-than-expected reduction in balance sheets. Such monetary tightening could have serious consequences and may trigger another substantial rise in bond yields and further negative corrections on the equity and property markets. The resulting liquidity shortages on the funding markets – combined with unrealised losses from bond portfolios – could put significant pressure on financial institutions. The turmoil in the US banking sector at the beginning of 2023 was a case in point, showing that sudden, large outflows of deposits, together with a drying-up of liquidity following a loss of trust among market participants, constitute a serious downside risk for financial institutions.

Another risk is rising government indebtedness as a consequence of massive fiscal stimulus alongside slower economic growth. With bond purchase programmes expiring and continuing monetary tightening, risk premiums for highly indebted countries could rise. Non-financial corporate debt has expanded in many advanced economies, mainly reflecting bond issuance. Reduced macro-economic activities or other risks could be a reason for downgrading the rating of these bonds.

The political shift away from European cohesion poses a significant threat not only to the EU, but also to Europe as a whole, in the longer term. This refers especially to governments in Central and Eastern Europe with nationalist attitudes/tendencies. Insufficient coordination and cooperation in the refugee crisis, slowing economic growth, and recessionary fears have all fuelled the risk of rising populism in several countries. The reform backlog and structural economic problems in some euro zone countries present further uncertainties, risk and stress factors. Whilst the EU's investment package is aimed at supporting these countries in particular, there is still a risk that the measures will not be quite enough to address structural problems.

The risk of disruption to free trade is still present and could intensify again in the future. In addition, further geopolitical risks such as cyberattacks, terrorism and political or military conflicts may have a significant impact on markets and their participants. The effects of potential decoupling, e.g. between China and Western economies, could also dampen growth prospects.

The efforts of many countries and companies to limit global warming require a radical transformation of the entire economy. The macro-economic impact of this transition is uncertain, and the actual effects depend on a number of factors. Similarly, this change entails costs that will likely be borne by companies and end-consumers alike. Decarbonisation, for instance, not only involves energy supply, but also requires significant changes in industry, transport, construction and agriculture. In addition to the transition costs incurred in decarbonising the global economy, the costs directly attributable to climate change will also increase over the medium term. Extreme weather events, temperature fluctuations and more frequent extreme heat events are causing physical damage that will increase over time. The extent of the increase will depend on how well the global community succeeds in reducing greenhouse gas emissions.

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

Economy

A variety of stress factors support the assumption that global economic activity will continue to be hampered in the second half of 2023. The path of economic development will depend on the extent to which monetary tightening and more restrictive financing conditions will dampen consumption, inflation and investments. A mild recession is forecast for some economies, with unemployment rebounding but still remaining at a low level. We expect a marked decline in overall inflation in most economies, whilst core inflation is expected to decline more slowly and remain elevated. The major central banks will maintain a restrictive monetary policy stance until the end of the year, and might even lift interest rates again if further inflation data makes this necessary.

Real gross domestic product in the euro zone is likely to only pick up marginally during the course of the year, and to a materially lesser extent than in 2022. Looking at the second half of the year, we expect more restrictive financing conditions and tighter fiscal policies to slow overall demand and prevent the economy from gaining momentum. Diverging economic trends between European regions should persist for the time being: in particular those economies with a large industrial sector (such as Germany) should see slower growth than the euro zone as a whole.

Positive real economic growth is also expected for the UK in the full year 2023, but to a lower extent than in the euro zone. With continued high inflation at the end of the first six months and more restrictive financing conditions, private consumption and investments should remain subdued in the second half of 2023. Adding to this, fiscal policy will see some tightening as Covid-19- and energy-related economic stimulus programmes expire and announced tax increases enter into force, while government spending will be reduced.

We expect the US to generate positive real growth in 2023 – similar to the euro zone and the UK, however, at a markedly lower level than in the previous year. After relatively robust growth – given the circumstances – in the first half of the year, we anticipate the start of a recession during the second half of 2023, since the delayed impact of interest rate hikes, tighter financing conditions and persistently high core inflation should lead to reduced rates of consumption, less new hiring, and lower levels of investment. However, due to the general financial soundness of households and companies, we expect this recession to be rather mild.

Although China has reached a phase of slower recovery from the Covid-19 pandemic, we forecast significantly positive growth for 2023. We also expect positive real growth for Australia in 2023, surpassing the US, the UK, and the euro zone.

Financial and capital markets, monetary policy and inflation

The risks and uncertainty factors referred to above are also significant for the financial and capital markets, and could once again cause disruption. Steeper funding costs are a reflection of monetary policy tightening induced by rising inflation, along with higher levels of uncertainty. This development is likely to persist in the short term, depending on the macro-economic and political environment, before economic prospects improve and monetary policy is eased – in 2024 at the earliest.

We expect the funding markets relevant for Aareal Bank to remain accessible in the second half of the year.

We assume that inflationary pressure will continue to recede in most economies until the end of the year, with a positive impact on pricing coming from weaker demand for raw materials, a slowdown in global growth, and easing supply chain issues. However, the speed and exact development of the decline will vary from country to country, depending on how relevant individual supply and demand factors were for the rise in inflation. Whilst lower food and energy prices should significantly reduce overall inflation, we expect core inflation to remain at a higher level until the end of the year.

Central banks will continue to focus on reducing inflation rates to their target levels in the second half of 2023. In light of previous interest rate hikes and general disinflation, key interest rates are expected to peak, or to be on the verge of peaking, in most economies towards the end of the first half-year. Central banks are likely to act with caution, maintaining their tight monetary policy for the time being, and are thus unlikely to decide on interest rate cuts this year – barring any major economic downturn or massive problems in the financial sector.

Regulatory environment

While the Covid-19 pandemic had a temporary impact on the regulatory environment, as various regulatory initiatives were postponed and temporary relief for institutions was adopted as an immediate reaction to the outbreak of the pandemic, the trend towards stricter regulatory frameworks is nevertheless expected to continue in the coming years. For example, finalisation of the Basel III framework, adopted by the Basel Committee's Group of Governors and Heads of Supervision (GHOS), will bring about extensive changes to the approaches used for determining risk-weighted capital requirements (the regime known as "Basel IV"). The EU Commission submitted a proposal on this in October 2021, which will now be finalised as part of the trilogue procedure that is expected to take place during 2023 according to the EU timetable. Based on the current status of negotiations, the proposed date for first-time application of the new regulation is 1 January 2025 – two years later than initially planned by the BCBS.

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

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

In addition, requirements for sustainable business and ESG risk management will increasingly define the regulatory landscape in the years to come. One of the main foundations here is the introduction and further expansion of the EU taxonomy for the classification of economic activities. Initial minor disclosure requirements for ESG matters were applicable as of 31 December 2021, with the scope increasing over time. Furthermore, the ECB conducted its first climate stress test in 2022. The requirement – introduced for the first time under CRR II – for large listed institutions to include qualitative and quantitative information on ESG risks in the regulatory disclosure report, entered into effect on 31 December 2022.

ESG risk management will also play an increasingly important role within the context of risk management and the SREP going forward, and supervisory authorities are considering taking ESG factors into account when determining regulatory capital requirements. In addition, several countries have already announced plans to (re-)introduce the countercyclical capital buffer previously suspended in almost all countries due to the Covid-19 pandemic. As such, markets saw the reinstatement of the countercyclical capital buffer for risk exposures located in Germany, and first-time introduction of a sector-specific systemic risk buffer for loans collateralised by residential properties in February 2023, based on the package of macro-prudential measures as resolved by the German Federal Financial Supervisory Authority (BaFin) in January 2022. This will result in increasing capital buffer requirements for the Bank.

Sector-specific and business developments

Structured Property Financing segment

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

Demand for commercial property will vary in the second half of 2023, depending on the region and property type. In the context of the current economic slowdown and the recessions forecast for some national economies, we see challenging times ahead for the property markets. Whilst higher interest rates are expected to influence investment decisions amongst buyers and sellers alike for now, as well as weighing on transaction volumes, the substantial accumulation of uninvested capital from investors around the world and an increasingly attractive yield level should mitigate excessive downward pressure on demand. For the financing markets, the Bank anticipates that competition will persist, especially in regions and for property types that have already experienced high demand in recent years. Higher financing costs and more restrictive lending policies should counteract an increase in loan-to-value ratios; we thus assume stable to slightly declining LTV ratios for new business. However, improvements in the market environment could put direct pressure on margins, or result in moderately higher loan-to-value ratios.

Uncertainty remains for the commercial property sector, particularly in light of monetary tightening. The elevated cost of capital associated with rising interest rates, for example, will result in a lower valuation of commercial properties if these costs are not offset by rent increases. This is a particular risk for investors with variable interest payments or with a pending refinancing, and it intensifies as loan-to-value ratios rise. Moreover, further significant interest rate increases, for example due to excessive monetary tightening by central banks or very high inflation rates in the medium term, could dampen aggregate demand, putting pressure on commercial property rents and cash flows.

Other uncertainty factors and risks in the macro-economic environment are also relevant for commercial property markets, and various factors are expected to have an impact on how commercial property values develop. Increasing political uncertainty, economic downturns or investor restraint all might negatively affect property values. Even though Covid-19 is now considered an endemic disease, any high new infection and hospitalisation rates continue to pose a risk for commercial property – and in particular for hotels and retail properties, should new infection control measures be adopted. This risk, however, is assessed to be significantly lower than in previous years. It should be noted that new, as of yet unknown, pandemics cannot be ruled out. Should the trend towards increased remote working continue or even intensify, more and more companies may decide to rent less office space. The transition to such a new way of working could exert pressure on rental prices for office properties and on the demand for office space. It can be assumed that the impact varies depending on the market, the country, and a property's quality. On the other hand, communal and flexible working space will be increasingly sought after in a changing world of work, halting or even reversing the pre-pandemic trend of decreasing office space per employee.

Aareal Bank anticipates an interest rate-driven revaluation of commercial properties in the current year; increased financing costs might have an additional negative effect in the medium term and could incur further downward pressure.[1] However, market value developments will be influenced not only by the quality and location of properties, but also increasingly by compliance with sustainability criteria (ESG).

With a view to retail properties, we expect that the structural change in shopping habits will have a weakening effect on the outlook for value-driving rental revenues, depending on location and segment. Cyclical factors are burdening developments in the current year, with consumers reducing their discretionary spending due to high inflation rates. Even though weaker consumption is likely to weigh on rental growth before the macro-economic environment lightens up again, sustained low unemployment rates should continue to alleviate negative effects on the retail segment. It should be noted that the retail market had already seen valuations decline in recent years. Also subject to location and segment, we see hotel properties continuing to perform well in terms of occupancy rates and income, driven by increasing travel activity. However, the increase in yields will have a slightly negative initial impact on market values on average, before a recovery follows later on. We have a positive outlook for student housing, where demand from international students has already recovered significantly as a result of the return to face-to-face teaching. In addition, this property type is considered to possess a certain resilience, especially in times of economic uncertainty, so we anticipate investor interest remaining high in this segment. For the current year, we expect average market values of office properties to fall more than those of other property types, as office property yields are increasing due to aggravated financing conditions, and rental growth is expected to slow down or remain stable. This is due to potential changes in the demand for space and the increasing impact of sustainability requirements. We expect underperformance from properties that fail to comply with corporate environmental and sustainability goals, and with government climate targets. Our assessment of logistics properties remains positive overall, as structural demand drivers remain in place, which should lead to rising rental income in the near future. Overall demand will continue to be supported by a shift from just-in-time to just-in-case production. Companies are undertaking this shift in an attempt to counter supply chain challenges and prevent delays, leading to greater demand for warehouse space. The low level of availability is supported by additional demand from retail companies and logistics service providers. However, this property type is also set to face declining market values on average in 2023, again due to increasing yields.

As a matter of principle, it is worth noting that estimation uncertainty – concerning the economy, markets and the impact on Aareal Bank – is currently still at a high level. Therefore, we are simulating further potential macro-economic scenarios in addition to our “baseline” scenario.

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

in %	2022	2023	2024	2025
“Baseline” scenario				
Gross domestic product (year-on-year change in %)				
Euro zone	3.5	0.6	1.2	1.7
US	2.1	1.3	0.4	1.9
UK	4.1	0.4	0.9	1.5
Unemployment (%)				
Euro zone	6.7	6.6	6.7	6.7
US	3.6	3.9	5.2	4.9
UK	4.1	4.0	4.2	4.1
Long-term interest rates (10-year government bonds) (%)				
Euro zone	1.9	3.0	2.6	2.5
US	3.0	3.5	3.1	2.8
UK	2.4	4.0	4.2	3.7
Portfolio-weighted property price development (2022 basis = 100%)	100%	97%	95%	95%

[1] It should be noted in this context that commercial property is a highly diverse asset class whose performance can differ significantly, depending on market, location, amenities, degree of modernisation, and other factors. Information provided here must be understood as a general statement, with individual markets, sub-markets and single properties potentially diverging from the developments mentioned.

In the Structured Property Financing segment, we aim to originate new business of between € 9 billion and € 10 billion for the 2023 financial year, so that Aareal Bank Group's property financing portfolio will amount to approximately € 32 billion to € 33 billion, subject to exchange rate fluctuations. To manage our portfolio and risk exposure, we also use syndications.

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

Banking & Digital Solutions segment

The German housing and commercial property industries should remain solid in 2023, despite geopolitical and macro-economic uncertainty, and we anticipate rents to remain largely steady overall. The need for housing will continue to exceed supply, given that inflation and the turnaround in interest rates will impact the ability of financing new construction projects – despite a possible easing of construction costs and materials shortages.

Overall, therefore, it is fair to expect further rent increases, on account of increasing pressure on the housing market – firstly, due to moves to metropolitan areas and university cities (expected to prevail at least until 2035) and secondly, given the impact of war refugees. The existing trend towards smaller households might exacerbate these developments.

Even though the Bank's market share in the institutional housing industry is already high based on the number of residential units, we see excellent opportunities for acquiring new clients and enhancing our existing client relationships in 2023. We plan to achieve this in particular by continuing to invest in the expansion of the "Housing Industry Ecosystem", the cross-sector development of interface products, and the expansion into related ecosystems, such as companies from the utilities and waste disposal industries. In our view, the range of services that connect alternative digital payment solutions to existing systems – thus helping to overcome process gaps (even across industry sectors) – are particularly attractive. Leveraging the AI-supported intelligent invoicing and dunning system of our new subsidiary Collect Artificial Intelligence GmbH (CollectAI), we see opportunities to support our clients in the housing and energy industries in establishing standards for digital receivables management in the context of integrating various payment routes.

Further growth is anticipated from the integrated tenant deposit guarantee product Aareal Aval – and from Aareal Meter, a solution that uses mobile meter reading and subsequent data capture without disrupting traffic to provide a digital solution to a labour-intensive analogue process gap.

Against this background, we are aiming for renewed net commission income growth over the previous year (2022: € 33 million) and expect the average deposit volume from the housing industry to remain around € 13 billion, with significant contributions to net interest income.

Aareon segment

Aareon will continue its growth strategy in the 2023 financial year, with the declared objective of becoming a "Rule of 40" SaaS company.

Aareon's consolidated sales revenues for the 2023 financial year are expected to increase to between € 325 million and € 345 million (2022: € 308 million). The main revenue driver is recurring business with SaaS, subscription, and maintenance contracts. Especially when using software as a service, clients benefit from the added value of a cloud solution. The continued expansion of new client business and further cross-selling of digital products to existing clients is also contributing to revenue growth.

Unabated client demand for digital processes is driving growth at Aareon. The products Wodis Yuneo in the Germany/Austria/Switzerland (DACH) region, Tobias 365 in the Netherlands, Arthur Online in the UK, and Momentum in Sweden are all growing strongly; in the meantime, roll-outs of new product generations for Wodis Yuneo and Tobias 365 are ongoing. Swedish Momentum Software Group, acquired in June 2022, will be consolidated for the full twelve months in the 2023 financial statements. Furthermore, the migration of Xpand clients to the technologically cutting-edge Momentum solution will contribute to its revenue growth.

Accordingly, revenues from Xpand will gradually decline. Revenue from CRM products will soar, due to demand for the solutions of the acquired companies Cubic Eyes B.V., OSRE B.V. and wohnungshelden GmbH, as well as further penetration within the existing client base. Further acquisitions in the first quarter of 2023 included UTS innovative Softwaresysteme GmbH in Germany and Embrace – The Human Cloud B.V. with its subsidiaries in the Netherlands, both of which will also contribute to growth.

With SaaS solutions trending, licence business will continue to decline in 2023. Organic growth will be complemented by inorganic growth through mergers & acquisitions in line with the corporate strategy. As part of a sharper focus on our core business, the subsidiary phi-Consulting GmbH, which specialises in consulting for the utilities industry, was sold at the end of the first quarter of 2023, based on the contract signed in December 2022, impacting Professional Service revenues compared to 2022.

The optimised cost structure and its scalability are set to yield only a slight increase in current costs during 2023. Adjusted EBITDA[1] is expected to be significantly higher than in the previous year, coming in at between € 90 million and € 100 million (2022: € 75 million). Adjustments will amount to approximately € 50 million and thus be above the previous year's level (2022: € 22 million); they include M&A-related costs and an investment budget for efficiency enhancement of around € 45 million. In the second quarter of 2023, various measures aimed at optimising the product portfolio, locations, and capacity adjustments were resolved in the UK, leading to an increase in adjustments of around € 10 million compared to previous planning.

Strategic focus

Aareal Bank Group's strategy focuses on sustainable business success, and as such, environmental, social and governance aspects are key elements of the business strategy. Short- and medium-term targets are allocated to all of these aspects, and the medium-term strategic development is being pursued under the guiding principle of "Aareal Next Level". The general strategic orientation will continue – with international commercial property financing on the one hand, and consulting services and digital solutions for the institutional housing sector in Europe and related industries on the other.

Based on the "Aareal Next Level" strategy, individual business activities will be developed in a targeted manner in order to sharpen their own independent profiles, accelerate the Group's overall growth, and create value for shareholders and other stakeholders. Specifically, the Bank wants to carry on exploiting opportunities for profitable growth.

The Structured Property Financing segment continues to focus on the controlled, risk-conscious expansion of its portfolio volume within its target range, considering ESG criteria and taking advantage of its flexible approach with regard to countries, property types and financing structures. We will continue to use syndications as one of the tools for active portfolio management. In addition, we intend to actively reduce non-performing loans (NPL) and sustainably lower the NPL ratio.

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

Aareon's position as a provider of ERP Software and digital solutions for the European property industry and its partners is set to be expanded further – with the clear objective of developing Aareon into a "Rule of 40" company. Together with its partner Advent International, the Group aims to maintain the pace of Aareon's growth and further increase its profitability through organic growth initiatives as part of the Value Creation Programme, as well as initiatives to enhance the existing product portfolio's efficiency and improve the cost/income mix for Aareon Group. An institutionalised M&A pipeline and a credit facility from Aareal Bank are in place to support inorganic growth.

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

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

Atlantic BidCo GmbH's ("Atlantic BidCo") voluntary public takeover offer for Aareal Bank AG was closed in June 2023. Atlantic BidCo had secured around 84 % of Aareal Bank shares at an offer price of € 33.00 per share in the course of a voluntary public takeover offer last year. After completion of the takeover bid, the Bidder owns approximately 90 % of the shares.

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

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

Group targets

Thanks to strong income growth in the first half of the year, Aareal Bank Group maintains its forecast for consolidated operating profit in the communicated range between € 240 million and € 280 million (2022: € 239 million), despite higher loss allowance. Given additional investments in efficiency-enhancement measures at Aareon, which have largely already been booked, the figure is anticipated at the lower end of this range. The same applies to earnings per share (EpS), forecast in a range between € 2.40 and € 2.80 (2022: € 2.32) and RoE after taxes (5 % to 6.5 %; 2022: 5.0 %).

Yet the environment remains challenging, and the effects of geopolitical conflicts and macro-economic uncertainty remain difficult to estimate.[1]

Aareal Bank Group anticipates another marked increase in income due to growth, an improved funding mix, and positive effects from higher market interest rates. The latter is likely to boost net interest income, which is now expected in a range of between € 850 million and € 890 million (previous forecast: € 730 million to € 770 million; 2022: € 702 million). Net commission income will also improve year-on-year, to between € 315 million and € 335 million (2022: € 277 million), mainly due to growth at Aareon.

Loss allowance is likely to be higher than initially forecast as a result of expected headwinds in the US office property market. The Bank now anticipates loss allowance of between € 270 million and € 310 million (original forecast range: € 170 million to € 210 million; 2022: € 192 million), including the additional loss allowance of around € 60 million scheduled for a swift NPL reduction. This also comprises credit risk-induced measurement losses of defaulted property loans, which are reflected in net gain or loss from financial instruments (fvpl).

Growth, along with an investment budget (originally € 35 million) earmarked for efficiency enhancement measures at Aareon, is set to result in higher administrative expenses than in the previous year. Now that additional efficiency enhancement measures have been identified, the investment budget has been projected at € 60 million, resulting in expected administrative expenses at the upper end of the range between € 590 million and € 630 million (2022: € 571 million).

In the Structured Property Financing segment, we plan to achieve a portfolio size of around € 32 billion to € 33 billion by the end of the year, market conditions permitting and subject to exchange rate fluctuations. Aareal Bank is planning for new business volume of € 9 billion to € 10 billion on this basis.

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

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

Aareon's sales revenues are expected to increase to between € 325 million and € 345 million in the current year (2022: € 308 million). Adjusted EBITDA[1] is also likely to see a marked increase to between € 90 million and € 100 million (2022: € 75 million).

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

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

Consolidated Interim Financial Statements

Statement of Comprehensive Income

Income Statement

	Note	1 Jan-30 Jun 2023	1 Jan-30 Jun 2022
€ mn			
Interest income from financial instruments (ac and fvoci)		1,084	473
Interest income from financial instruments (fvpl)		20	11
Market-driven modification gains		1	2
Interest expenses for financial instruments (ac and fvoci)		487	58
Interest expenses for financial instruments (fvpl)		155	94
Market-driven modification losses		1	4
Net interest income	1	**462**	**330**
Loss allowance excluding credit-driven net modification gain or loss		155	107
Credit-driven net modification gain or loss		5	0
Loss allowance	2	**160**	**107**
Commission income		184	161
Commission expenses		35	29
Net commission income	3	**149**	**132**
Net gain or loss on the derecognition of financial assets (ac)		4	11
Net gain or loss on the derecognition of financial liabilities (ac)		3	3
Net gain or loss on the derecognition of financial assets (fvoci)		5	8
Net derecognition gain or loss	4	**12**	**22**
Net gain or loss from financial instruments (fvpl)	5	-41	18
Net gain or loss from hedge accounting	6	0	-7
Net gain or loss from investments accounted for using the equity method		–	-2
Administrative expenses	7	342	295
Net other operating income/expenses	8	7	0
Operating profit		**87**	**91**
Income taxes		29	33
Consolidated net income		**58**	**58**
Consolidated net income attributable to non-controlling interests		-9	1
Consolidated net income attributable to shareholders of Aareal Bank AG		67	57
Earnings per share (EpS)			
Consolidated net income attributable to shareholders of Aareal Bank AG[1]		67	57
of which: allocated to ordinary shareholders		58	50
of which: allocated to AT1 investors		9	7
Earnings per ordinary share (€)[2]	9	0.97	0.84
Earnings per AT1 unit (€)[3]	9	0.09	0.07

[1] The allocation of earnings is based on the assumption that net interest payable on the AT1 bond is recognised on an accrual basis.
[2] Earnings per ordinary share are determined by dividing the earnings allocated to ordinary shareholders of Aareal Bank AG by the weighted average of ordinary shares outstanding during the financial year (59,857,221 shares). Basic earnings per ordinary share correspond to diluted earnings per ordinary share.
[3] Earnings per AT1 unit (based on 100,000,000 AT1 units with a notional amount of € 3 each) are determined by dividing the earnings allocated to AT1 investors by the weighted average of AT1 units outstanding during the financial year. Basic earnings per AT1 unit correspond to diluted earnings per AT1 unit.

Reconciliation from Consolidated Net Income to Total Comprehensive Income

€ mn	1 Jan - 30 Jun 2023	1 Jan - 30 Jun 2022
Consolidated net income	**58**	**58**
Items that will not be reclassified subsequently to profit or loss		
Changes in the reserve from remeasurements of defined benefit plans	**-6**	**70**
Remeasurements of defined benefit plans	-9	102
Taxes on remeasurements of defined benefit plans	3	-32
Changes in the reserve from the measurement of equity instruments (fvoci)	**0**	**0**
Gains and losses from equity instruments (fvoci)	–	0
Reclassifications to retained earnings from equity instruments (fvoci)	0	–
Taxes on gains and losses from equity instruments (fvoci)	–	–
Items that are reclassified subsequently to profit or loss		
Changes in the reserve from the measurement of debt instruments (fvoci)	**-10**	**-4**
Gains and losses from debt instruments (fvoci)	-9	2
Reclassifications to the income statement from debt instruments (fvoci)	-5	-7
Taxes on gains and losses from debt instruments (fvoci)	4	1
Changes in the reserve from foreign currency basis spreads	**9**	**29**
Gains and losses from foreign currency basis spreads	13	43
Reclassifications to the income statement from foreign currency basis spreads	–	–
Taxes on gains and losses from foreign currency basis spreads	-4	-14
Changes in currency translation reserves	**-6**	**7**
Gains and losses from translating foreign operations' financial statements	-7	-1
Reclassifications to the income statement from translating foreign operations’ financial statements	–	–
Taxes on gains and losses arising from translating foreign operations’ financial statements	1	8
Other comprehensive income	**-13**	**102**
Total comprehensive income	**45**	**160**
Total comprehensive income attributable to non-controlling interests	-11	1
Total comprehensive income attributable to shareholders of Aareal Bank AG	56	159

Statement of Financial Position

€ mn	Note	30 Jun 2023	31 Dec 2022
Assets			
Financial assets (ac)	10	**42,031**	**40,490**
Cash funds (ac)		6,248	5,424
Loan receivables (ac)		31,051	29,948
Money market and capital market receivables (ac)		4,636	5,017
Receivables from other transactions (ac)		96	101
Loss allowance (ac)	11	-365	-490
Financial assets (fvoci)	12	**3,575**	**3,552**
Money market and capital market receivables (fvoci)		3,573	3,550
Equity instruments (fvoci)		2	2
Financial assets (fvpl)	13	**2,151**	**2,258**
Loan receivables (fvpl)		283	427
Money market and capital market receivables (fvpl)		5	5
Positive market value of designated hedging derivatives (fvpl)		1,081	1,104
Positive market value of other derivatives (fvpl)		782	722
Non-current assets held for sale	14	68	7
Investments accounted for using the equity method		16	14
Intangible assets	15	600	566
Property and equipment	16	229	235
Income tax assets		50	46
Deferred tax assets		201	179
Other assets	17	473	474
Total		**49,029**	**47,331**
Equity and liabilities			
Financial liabilities (ac)	18	**42,097**	**40,022**
Money market and capital market liabilities (ac)		29,249	26,425
Deposits from the housing industry (ac)		12,361	13,115
Liabilities from other transactions (ac)		105	96
Subordinated liabilities (ac)		382	386
Financial liabilities (fvpl)	19	**3,214**	**3,514**
Negative market value of designated hedging derivatives (fvpl)		1,616	2,183
Negative market value of other derivatives (fvpl)		1,598	1,331
Non-current liabilities held for sale		–	1
Provisions	20	223	292
Income tax liabilities		63	76
Deferred tax liabilities		32	57
Other liabilities	21	112	111
Equity	22	**3,288**	**3,258**
Subscribed capital		180	180
Capital reserves		721	721
Retained earnings		2,129	2,076
AT1 bond		300	300
Other reserves		-99	-88
Non-controlling interests		57	69
Total		**49,029**	**47,331**

Statement of Changes in Equity

€ mn	Subscribed capital	Capital reserves	Retained earnings	AT1 bond	Other reserves: Reserve from remeasurements of defined benefit plans	Other reserves: Reserve from the measurement of equity instruments (fvoci)	Other reserves: Reserve from the measurement of debt instruments (fvoci)	Other reserves: Reserve from changes in the value of foreign currency basis spreads	Other reserves: Currency translation reserve	Total	Non-controlling interests	Equity
Equity as at 1 January 2023	**180**	**721**	**2,076**	**300**	**-73**	**-4**	**4**	**-8**	**-7**	**3,189**	**69**	**3,258**
Total comprehensive income for the period	–	–	67	–	-6	0	-10	9	-4	**56**	-11	**45**
Consolidated net income	–	–	67	–	–	–	–	–	–	**67**	-9	**58**
Other comprehensive income	–	–	–	–	-6	0	-10	9	-4	**-11**	-2	**-13**
Payments to non-controlling interests	–	–	–	–	–	–	–	–	–	**–**	-2	**-2**
AT1 coupon	–	–	-17	–	–	–	–	–	–	**-17**	–	**-17**
Changes in ownership interests in subsidiaries	–	–	3	–	–	–	–	–	–	**3**	1	**4**
Equity as at 30 June 2023	180	721	2,129	300	-79	-4	-6	1	-11	3,231	57	3,288

€ mn	Subscribed capital	Capital reserves	Retained earnings	AT1 bond	Other reserves: Reserve from remeasurements of defined benefit plans	Other reserves: Reserve from the measurement of equity instruments (fvoci)	Other reserves: Reserve from the measurement of debt instruments (fvoci)	Other reserves: Reserve from changes in the value of foreign currency basis spreads	Other reserves: Currency translation reserve	Total	Non-controlling interests	Equity
Equity as at 1 January 2022	**180**	**721**	**1,937**	**300**	**-133**	**-3**	**16**	**-23**	**0**	**2,995**	**66**	**3,061**
Total comprehensive income for the period	–	–	57	–	69	0	-4	29	8	**159**	1	**160**
Consolidated net income	–	–	57	–	–	–	–	–	–	**57**	1	**58**
Other comprehensive income	–	–	–	–	69	0	-4	29	8	**102**	0	**102**
Payments to non-controlling interests	–	–	–	–	–	–	–	–	–	**–**	-2	**-2**
AT1 coupon	–	–	-14	–	–	–	–	–	–	**-14**	–	**-14**
Changes in ownership interests in subsidiaries	–	–	–	–	–	–	–	–	–	**–**	1	**1**
Equity as at 30 June 2022	180	721	1,980	300	-64	-3	12	6	8	3,140	66	3,206

Statement of Cash Flows (condensed)

€ mn	2023	2022
Cash and cash equivalents as at 1 January	**5,424**	**6,942**
Cash flow from operating activities	878	941
Cash flow from investing activities	-22	-8
Cash flow from financing activities	-32	-138
Total cash flow	**824**	**795**
Cash and cash equivalents as at 30 June	**6,248**	**7,737**

Notes (condensed)

Basis of Accounting

Legal framework

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

This half-yearly financial report for the period ended 30 June 2023 was prepared pursuant to the provisions of section 115 of the German Securities Trading Act (Wertpapierhandelsgesetz – "WpHG") in conjunction with section 117 no. 2 of the WpHG and was approved for publication by the Management Board on 1 August 2023. It comprises the present condensed consolidated interim financial statements, as well as an interim group management report.

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

Reporting entity structure

Subsidiaries of Aareal Bank AG are included in the consolidated financial statements by way of full consolidation. Companies over which Aareal Bank AG may exercise a significant influence ("associates") are included in the consolidated financial statements, using the equity method. The present interim report is based on the same consolidation methods as were applied in the consolidated financial statements 2022.

Two companies constituted the material additions to the reporting entity structure during the period under review.

In March 2023, Aareon acquired 100% of shares in Embrace the Human Cloud B.V., via its Dutch subsidiary Aareon Nederland B.V. The purchase price amounted to approximately € 40 million, with € 31 million as a fixed price and € 9 million as a contingent purchase price which depends upon performance indicators (EBITDA and the level of recurring revenues), to be reached by 2024. The preliminary fair value of assets and liabilities amounts to approximately € 11 million, largely comprising € 1 million in software, € 7 million related to client relationships; and € 1 million in brand rights. The company generated € 1 million in profits on sales revenues of € 7 million in the first half of 2023. From the date of acquisition until 30 June 2023, the company generated € 1 million in profits on sales revenues of € 3 million. The acquisition results in a preliminary goodwill of € 29 million, including potential market value effects and synergies. With Embrace, Aareon has acquired the Dutch market leader for SaaS solutions in the areas of digital workspace and customer engagement. Embrace's CRM solutions enlarge the product portfolio for Dutch clients.

In February 2023, Aareon also acquired 100% of shares in UTS innovative Softwaresysteme GmbH. The purchase price amounted to approximately € 8 million. The preliminary fair value of assets and liabilities amounts to approximately € 6 million, largely comprising € 2 million in software and € 2 million related to client relationships. The company generated € 1 million in profits on sales revenues of € 2 million in the first half of 2023. From the date of acquisition until 30 June 2023, the company generated € 1 million in profits on sales revenues of € 1 million. The acquisition results in a preliminary goodwill of approximately € 2 million, including potential market value effects and synergies. With the acquisition, Aareon has gained access to the property management software segment in Europe's biggest market.

There were no other material changes to the reporting entity structure.

Accounting Policies

Unless specifically indicated otherwise, the accounting policies applied in preparation of the consolidated financial statements 2022 were also applied in preparation of these condensed consolidated interim financial statements, including the calculation of comparative figures.

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

- **IFRS 17 Insurance Contracts**
  The standard governs the accounting for insurance contracts. IFRS 17 replaces the previously applicable interim standard IFRS 4. The new standard applies to insurance contracts, reinsurance contracts as well as investment contracts with discretionary participation features. In accordance with IFRS 17, insurance contracts are generally measured using the general measurement model. Under this model, the fulfilment cash flows and the contractual service margin are determined upon initial recognition for a group of insurance contracts. Depending on what any changes in underlying parameters refer to, subsequent measurement affects either insurance revenue or insurance finance income or expenses, or the contractual service margin may have to be adjusted which will affect the income statement only in later periods.

- **IAS 1 Disclosure of Accounting Policies**
  The amendments to IAS 1 are intended to support preparers in their decision as to which accounting policies are required to be disclosed in the financial statements. Entities are now required to disclose material accounting policy information rather than their significant accounting policies.

- **IAS 8 Definition of Accounting Estimates**
  The amendments to IAS 8 are intended to provide support to make a distinction between accounting policies and accounting estimates. In this context, the definition of a change in accounting estimates is replaced by a definition of accounting estimates. According to the new definition, accounting estimates are "monetary amounts in financial statements that are subject to measurement uncertainty". Entities develop accounting estimates when the accounting policies require items in financial statements to be measured in a way that involves measurement uncertainty. Changes in accounting estimates that result from new information or new developments do not represent a correction of an error.

- **IAS 12 Deferred Tax related to Assets and Liabilities arising from a Single Transaction**
  The amendment to IAS 12 narrows the scope of the initial recognition exemption pursuant to which no deferred tax assets or liabilities are recognised upon initial recognition of an asset or a liability. If the transaction gives rise simultaneously to equal taxable and deductible temporary differences, such differences no longer fall under the scope of the exemption; accordingly, deferred tax assets and liabilities have to be recognised.

The revised standards did not have any material consequences for the consolidated financial statements of Aareal Bank Group.

Notes to the Statement of Comprehensive Income

(1) Net interest income

€ mn	1 Jan-30 Jun 2023	1 Jan-30 Jun 2022
Interest income from financial assets (ac and fvoci)	1,084	425
Loan receivables	983	423
Money market and capital market receivables	101	2
Interest income from financial liabilities (ac)	0	48
Money market and capital market liabilities	0	36
Deposits from the housing industry	0	12
Interest income from financial instruments (fvpl)	20	11
Loan receivables	10	6
Other derivatives	10	5
Market-driven modification gains	1	2
Total interest and similar income	**1,105**	**486**
Interest expenses from financial liabilities (ac)	486	11
Money market and capital market liabilities	455	5
Deposits from the housing industry	21	0
Liabilities from other transactions	1	0
Subordinated liabilities	9	6
Interest expenses for financial assets (ac and fvoci)	1	47
Cash funds	–	30
Money market and capital market receivables	1	17
Interest expenses for financial instruments (fvpl)	155	94
Other derivatives	155	94
Market-driven modification losses	1	4
Total interest and similar expenses	**643**	**156**
Total	**462**	**330**

Net interest income of € 462 million was significantly higher than in the previous year (€ 330 million), due to a year-on-year increase in the credit portfolio, good margins as well as the impact of higher interest rates in connection with the continued high volume of deposits.

(2) Loss allowance

€ mn	1 Jan-30 Jun 2023	1 Jan-30 Jun 2022
Additions	217	163
Reversals	61	56
Recoveries on loans and advances previously written off	1	0
Credit-driven net modification gain or loss	5	0
Total	**160**	**107**

Loss allowance totalled € 160 million (H1 2022: € 107 million). It mainly results from individual new loan defaults of US office properties, for which the management overlay recognised in the first quarter was reversed in the second quarter. This also includes the announced addition to loss allowance of around € 60 million for a swift NPL reduction. The remaining (NPL-classified) exposure to Russia of € 217 million has meanwhile been disposed of.

Please also refer to Note (11).

(3) Net commission income

€ mn	1 Jan-30 Jun 2023	1 Jan-30 Jun 2022
Commission income from[1]		
Recurring services	132	107
Non-recurring services	34	37
Banking business and other activities	18	17
Total commission income	**184**	**161**
Commission expenses for		
Purchased services	31	27
Banking business and other activities	4	2
Total commission expenses	**35**	**29**
Total	**149**	**132**

[1] The breakdown of the previous year's figure was adjusted. Aareon's net commission income from ERP products (€ 99 million) and from digital solutions (€ 40 million) comprises € 102 million from recurring services and € 37 million from non-recurring services. Furthermore, commission income in the BDS segment was reclassified from other activities to recurring services.

Net commission income increased as planned to € 149 million (H1 2022: € 132 million) as a result of higher commission income both in the Banking & Digital Solutions segment and at Aareon.

(4) Net derecognition gain or loss

€ mn	1 Jan-30 Jun 2023	1 Jan-30 Jun 2022
Net gain or loss on the derecognition of financial assets (ac)		
Loan receivables	2	11
Money market and capital market receivables	2	0
Net gain or loss on the derecognition of financial liabilities (ac)		
Money market and capital market liabilities	3	3
Net gain or loss on the derecognition of financial assets (fvoci)		
Money market and capital market receivables	5	8
Total	**12**	**22**

Net derecognition gain of € 12 million (H1 2022: € 22 million) was mainly attributable to income from the Treasury portfolio, whilst positive market-driven effects from early loan repayments had been the main driver in the previous year.

(5) Net gain or loss from financial instruments (fvpl)

€ mn	1 Jan-30 Jun 2023	1 Jan-30 Jun 2022
Net gain or loss from loan receivables	-36	-16
Net gain or loss from money market and capital market receivables	0	0
Net gain or loss from other derivatives	-5	36
Currency translation	0	-2
Total	**-41**	**18**

The net gain or loss from financial instruments (fvpl) primarily resulted from credit-risk induced measurement losses of defaulted property loans, especially in the US – in contrast to positive valuation effects resulting from market developments for currency and interest rate hedging derivatives due to strong market dynamics in the previous year.

(6) Net gain or loss from hedge accounting

€ mn	1 Jan-30 Jun 2023	1 Jan-30 Jun 2022
Ineffective portion of fair value hedges	0	-7
Ineffective portion of net investment hedges	0	0
Total	**0**	**-7**

(7) Administrative expenses

€ mn	1 Jan-30 Jun 2023	1 Jan-30 Jun 2022
Staff expenses	196	167
Wages and salaries	166	134
Social security contributions	22	22
Pensions	8	11
Other administrative expenses	102	102
Depreciation, amortisation and impairment of property and equipment and intangible assets	44	26
Total	**342**	**295**

Administrative expenses increased from € 295 million in the previous year to € 342 million, reflecting both strong growth and the efficiency enhancement measures of approximately € 55 million implemented at Aareon.

(8) Net other operating income/expenses

€ mn	1 Jan–30 Jun 2023	1 Jan–30 Jun 2022
Income from properties	17	17
Income from the reversal of provisions	11	0
Income from goods and services	0	–
Miscellaneous other operating income	9	10
Total other operating income	**37**	**27**
Expenses for properties	24	21
Expenses for other taxes	3	5
Miscellaneous other operating expenses	3	1
Total other operating expenses	**30**	**27**
Total	**7**	**0**

Net other operating income/expenses amounted to € 7 million (H1 2022: € 0 million); the figure included reversals of provisions.

(9) Earnings per share

Earnings per ordinary share are determined by dividing the earnings attributable to ordinary shareholders of Aareal Bank AG by the weighted average of ordinary shares outstanding during the financial year (59,857,221 shares). Basic earnings per ordinary share correspond to diluted earnings per ordinary share.

Earnings per AT1 unit (based on 100,000,000 AT1 units with a notional amount of € 3 each) are determined by dividing the earnings allocated to AT1 investors by the weighted average of AT1 units outstanding during the financial year. Basic earnings per AT1 unit correspond to diluted earnings per AT1 unit.

Notes to the Statement of Financial Position

(10) Financial assets (ac)

€ mn	30 Jun 2023	31 Dec 2022
Cash funds (ac)	**6,248**	**5,424**
Cash on hand	0	0
Balances with central banks	6,248	5,424
Loan receivables (ac)	**31,051**	**29,948**
Property loans	30,784	29,662
Public-sector loans	249	268
Other loan receivables	18	18
Money market and capital market receivables (ac)	**4,636**	**5,017**
Money market receivables	1,825	1,914
Promissory note loans	1,182	1,345
Bonds	1,629	1,758
Receivables from other transactions (ac)	**96**	**101**
Trade receivables	39	44
Other financial receivables	57	57
Total	**42,031**	**40,490**

(11) Loss allowance (ac)

€ mn	Stage 1	Stage 2	Stage 3	Receivables from other transactions (ac)	Total loss allowance (ac)
Position as at 1 January 2023	**42**	**59**	**386**	**3**	**490**
Additions	11	40	162	0	**213**
Utilisation	–	–	238	0	**238**
Reversals	16	30	13	0	**59**
Transfer to Stage 1	5	-5	–	–	**–**
Transfer to Stage 2	-4	4	–	–	**–**
Transfer to Stage 3	–	-4	4	–	**–**
Interest rate effect	–	–	10	–	**10**
Currency adjustments	0	-1	0	0	**-1**
Transfers	–	–	-50	–	**-50**
Position as at 30 June 2023	**38**	**63**	**261**	**3**	**365**

The loss allowance for financial assets measured at amortised cost refers to loan receivables, money and capital market receivables as well as receivables from other transactions (largely trade receivables) that are measured at amortised cost. A large part of draw-downs was attributable to our € 217 million exposure to Russia, which is being run down.

€ mn	Stage 1	Stage 2	Stage 3	Receivables from other transactions (ac)	Total loss allowance(ac)
Position as at 1 January 2022	**9**	**77**	**403**	**3**	**492**
Additions	19	30	111	1	**161**
Utilisation	–	–	46	–	**46**
Reversals	3	27	24	0	**54**
Transfer to Stage 1	2	-2	–	–	**–**
Transfer to Stage 2	0	2	-2	–	**–**
Transfer to Stage 3	–	-2	2	–	**–**
Interest rate effect	–	–	13	–	**13**
Currency adjustments	0	4	-2	0	**2**
Transfers	–	–	–	–	**–**
Position as at 30 June 2022	**27**	**82**	**455**	**4**	**568**

(12) Financial assets (fvoci)

€ mn	30 Jun 2023	31 Dec 2022
Money market and capital market receivables (fvoci)	**3,573**	**3,550**
Bonds	3,573	3,550
Equity instruments (fvoci)	**2**	**2**
Equities and other non-fixed income securities	0	0
Other investments	2	2
Total	**3,575**	**3,552**

(13) Financial assets (fvpl)

€ mn	30 Jun 2023	31 Dec 2022
Loan receivables (fvpl)	**283**	**427**
Property loans	283	427
Money market and capital market receivables (fvpl)	**5**	**5**
Fund units	5	5
Positive market value of designated hedging derivatives (fvpl)	**1,081**	**1,104**
Positive market value of fair value hedges	1,079	1,102
Positive market value of net investment hedges	2	2
Positive market value of other derivatives (fvpl)	**782**	**722**
Positive market value of economic hedging derivatives	297	251
Positive market value of other derivatives	485	471
Total	**2,151**	**2,258**

(14) Non-current assets held for sale

Our € 217 million exposure to Russia, which is being run down, fulfilled the criteria for being classified as “held for sale” as at 30 June 2023. This includes an addition to loss allowance of around € 35 million. The property loan has meanwhile been disposed of. Furthermore, the relevant criteria were met in connection with two Italian property loans totalling € 73 million and an aggregate addition to loss allowance of € 8 million.

(15) Intangible assets

€ mn	30 Jun 2023	31 Dec 2022
Goodwill	401	378
Proprietary software	85	84
Other intangible assets	114	104
Total	**600**	**566**

The increase in goodwill is mainly attributable to the acquisition of Embrace, which was allocated to the CGU Aareon Netherlands. Following a realignment of Aareon’s product portfolio in the UK, the CGU SMB UK has been absorbed by the CGU Aareon UK, requiring a goodwill impairment of € 5 million. No further impairments were required.

(16) Property and equipment

€ mn	30 Jun 2023	31 Dec 2022
Land and buildings and construction in progress	204	210
Office furniture and equipment	25	25
Total	**229**	**235**

(17) Other assets

€ mn	30 Jun 2023	31 Dec 2022
Properties	360	360
Contract assets	23	19
Miscellaneous	90	95
Total	**473**	**474**

(18) Financial liabilities (ac)

€ mn	30 Jun 2023	31 Dec 2022
Money market and capital market liabilities (ac)	**29,249**	**26,425**
Money market liabilities	9,059	5,761
Promissory note loans	2,572	2,573
Mortgage Pfandbriefe	11,532	10,823
Public-sector Pfandbriefe	1,189	1,296
Other debt securities	4,897	5,972
Other financial liabilities	0	0
Deposits from the housing industry (ac)	**12,361**	**13,115**
Payable on demand	9,007	10,180
Term deposits	3,354	2,935
Liabilities from other transactions (ac)	**105**	**96**
Trade payables	15	20
Other liabilities	90	76
Subordinated liabilities (ac)	**382**	**386**
Total	**42,097**	**40,022**

(19) Financial liabilities (fvpl)

€ mn	30 Jun 2023	31 Dec 2022
Negative market value of designated hedging derivatives (fvpl)	**1,616**	**2,183**
Negative market value of fair value hedges	1,589	2,141
Negative market value of net investment hedges	27	42
Negative market value of other derivatives (fvpl)	**1,598**	**1,331**
Negative market value of economic hedging derivatives	468	639
Negative market value of other derivatives	1,130	692
Total	**3,214**	**3,514**

(20) Provisions

€ mn	30 Jun 2023	31 Dec 2022
Provisions for pensions and similar obligations	94	158
Provisions for unrecognised lending business	6	4
Other provisions	123	130
Total	**223**	**292**

Changes in the discount rate applicable to pensions require a revaluation of the amount of obligations. This is recognised directly in other comprehensive income, under changes in the reserve from defined benefit plans. The discount rate was 3.57 % as at 30 June 2023 (31 December 2022: 3.68 %). Following the increase of the funding by € 72 million, the provisions for pensions further declined to € 94 million as at 30 June 2023 (31 December 2022: € 158 million).

(21) Other liabilities

€ mn	30 Jun 2023	31 Dec 2022
Lease liabilities	41	44
Deferred income	2	1
Liabilities from other taxes	21	23
Contract liabilities	34	25
Miscellaneous	14	18
Total	**112**	**111**

(22) Equity

€ mn	30 Jun 2023	31 Dec 2022
Subscribed capital	180	180
Capital reserves	721	721
Retained earnings	2,129	2,076
AT1 bond	300	300
Other reserves		
Reserve from remeasurements of defined benefit plans	-79	-73
Reserve from the measurement of equity instruments (fvoci)	-4	-4
Reserve from the measurement of debt instruments (fvoci)	-6	4
Reserve from foreign currency basis spreads	1	-8
Currency translation reserves	-11	-7
Non-controlling interests	57	69
Total	**3,288**	**3,258**

The item “Reserve from the measurement of debt instruments (fvoci)” includes loss allowance of € 1 million (31 December 2022: € 1 million).

Treasury shares

No treasury shares were held during the period under review.

Distributions

Consistent with its strategy, Aareal Bank does not plan to distribute dividends in 2023 for the 2022 financial year.

The Management Board proposes to the Annual General Meeting that the net retained profit of € 61,054,365.42 for the 2022 financial year, as reported under the German Commercial Code (HGB), be carried forward.

In addition, on 30 April 2023, the Management Board resolved on a distribution in relation to the AT1 instruments, in accordance with the terms and conditions of the notes.

Within Aareal Bank Group’s consolidated statement of financial position, a distribution on the AT1 bond reduces the retained earnings item within consolidated equity.

Notes to Financial Instruments

A detailed description of the system in place at Aareal Bank Group to measure, limit, and manage risks throughout the Group is presented in the Risk Report as part of the Interim Group Management Report. The disclosures on the description and the extent of risks arising from financial instruments in accordance with IFRS 7 are included (in part) in the Risk Report as well.

(23) Determination of fair value

The determination of fair value is governed by IFRS 13 and applies to both financial instruments and non-financial assets or liabilities. In accordance with IFRS 13.9, the fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction under current market conditions at the measurement date. Determination of the fair value is based on the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. Another factor to be taken into account is whether Aareal Bank can enter into a transaction for the relevant asset or liability at the price in that market at the measurement date. The principal market is the market with the greatest volume and the highest level of activity to which Aareal Bank has access. The most advantageous market is the market that maximises the amount that would be received to sell the asset, or minimises the amount that would be paid to transfer the liability.

Fair value hierarchy

In accordance with IFRS 13.72 et seqq., the fair value determination is based on the fair value hierarchy pursuant to which the inputs used are classified into various hierarchy levels on the basis of their respective market proximity and objectivity. The fair value of assets and liabilities is allocated to Level 1 of the fair value hierarchy if it is determined on the basis of unadjusted qualifying prices in active markets for identical assets or liabilities. Fair values determined using inputs other than qualifying prices included within Level 1 that are observable for the financial instrument, either directly or indirectly, are included in Level 2 of the fair value hierarchy. Fair values determined using valuation techniques where one or more material inputs are not based on observable market data are assigned to Level 3 of the fair value hierarchy. The estimation uncertainties as regards fair value measurement increase the higher the level is.

Measurement methods

The property and public-sector loans included in loan receivables are measured using the discounted cash flow method for the purpose of the determination of fair value. Discounting of future cash flows of a transaction is based on transaction-specific risk-adjusted interest rates. These are derived on the basis of a virtually risk-free market interest rate for each currency depending on the relevant term, taking into account add-ons for risks specific to the counterparty as well as credit costs. In the case of loans subject to fixed interest rates, the contractually agreed payments are used as future cash flows. The future cash flows for floating-rate loans are derived using the future forward interest rates, taking into account the relevant spread for customer-specific terms and conditions. In the case of defaulted loans, future cash flows are reduced by the expected losses.

Debt securities and promissory note loans for which no current market price is available in an active market are measured through an analysis of future payments using the fully-capitalised earnings value approach, where the inputs are based on observable market data to the extent possible. These approaches include the discounted cash flow (DCF) method which is used to determine the present value of contractual cash flows until the expected end of the term. The present value is determined based on the benchmark curve applicable for the relevant market, taking into account mark-ups based on credit quality and liquidity. The valuation model used for options included in the transaction is the commonly used Black-Scholes model or numerical procedures.

In the case of unquoted financial investments in equity instruments, the costs of acquisition may also be the best estimate of fair value. Their recoverability is reviewed regularly.

The fair value of OTC derivatives is determined on the basis of sector-specific standardised measurement models, such as the present value method or option pricing models. These techniques are based on inputs of active markets, such as interest rates, yield curves and credit spreads. The fair value of foreign exchange forwards is generally based on current forward exchange rates quoted on active markets. Since the derivatives are part of highly effective collateral agreements (Credit Support Annex to the ISDA Master Agreement and Collateral Annex to the German Master Agreement on Financial Derivatives Transactions) which are each subject to a master collateralisation agreement, measurement adjustments to reflect any potential counterparty credit risk or own credit risk (CVA and DVA) are not required for reasons of materiality. The Bank uses the overnight interest rate swap curve (OIS curve) for the measurement of derivatives secured by cash collateral.

Amortised cost is an adequate estimate of fair value for cash funds, other loan receivables as well as short-term money market receivables and liabilities.

(24) Fair value hierarchy in accordance with IFRS 13

The carrying amounts of financial instruments held by Aareal Bank Group which are reported at fair value in the statement of financial position are presented in the following table according to the three-tier fair value hierarchy pursuant to IFRS 13.72 et seq. The presentation is made for each class of financial instrument:

31 June 2023

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Financial assets (fvoci)	**3,575**	**3,235**	**338**	**2**
Money market and capital market receivables (fvoci)	3,573	3,235	338	–
Equity instruments (fvoci)	2	–	0	2
Financial assets (fvpl)	**2,151**	**0**	**1,863**	**288**
Loan receivables (fvpl)	283	–	–	283
Money market and capital market receivables (fvpl)	5	0	–	5
Positive market value of designated hedging derivatives (fvpl)	1,081	–	1,081	–
Positive market value of other derivatives (fvpl)	782	–	782	–
Financial liabilities (fvpl)	**3,214**	**–**	**3,214**	**–**
Negative market value of designated hedging derivatives (fvpl)	1,616	–	1,616	–
Negative market value of other derivatives (fvpl)	1,598	–	1,598	–

31 December 2022

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Financial assets (fvoci)	**3,552**	**2,162**	**1,388**	**2**
Money market and capital market receivables (fvoci)	3,550	2,162	1,388	–
Equity instruments (fvoci)	2	–	0	2
Financial assets (fvpl)	**2,258**	**0**	**1,826**	**432**
Loan receivables (fvpl)	427	–	–	427
Money market and capital market receivables (fvpl)	5	0	–	5
Positive market value of designated hedging derivatives (fvpl)	1,104	–	1,104	–
Positive market value of other derivatives (fvpl)	722	–	722	–
Financial liabilities (fvpl)	**3,514**	**–**	**3,514**	**–**
Negative market value of designated hedging derivatives (fvpl)	2,183	–	2,183	–
Negative market value of other derivatives (fvpl)	1,331	–	1,331	–

During the first six months of the financial year 2023, € 34 million in financial assets (ac) were transferred from Level 1 to Level 2, and € 1,783 million in financial assets (ac) were transferred from Level 2 to Level 1. Furthermore, € 1,705 million in financial liabilities (ac) were transferred from Level 2 to Level 1.

The fair values of loan receivables recognised at fair value in the statement of financial position that are assigned to Level 3 of the fair value hierarchy developed as follows during the period under review:

Loan receivables (fvpl)

€ mn	2023	2022
Fair value as at 1 January	**427**	**598**
Change in measurement	**-36**	**-16**
Portfolio changes		
Additions	66	81
Derecognition	173	187
Deferred interest	-1	0
Fair value as at 30 June	**283**	**476**

Financial instruments held in the Bank's portfolio contributed € -40 million to the net gain or loss from financial instruments fvpl (H1 2022: € -20 million).

Regarding loan receivables (fvpl), the add-ons for risks specific to the counterparty represent the material input parameter not observable in the market. Regarding the non-defaulted loans, an increase/decrease by 1 % would lead to a decrease/increase of the fair value by approximately € 4 million (H1 2022: approximately € 6 million).

(25) Comparison of carrying amounts and fair values of financial instruments

The fair values of financial instruments are compared with their carrying amounts (including loss allowance) in the following table. The presentation is made for each class of financial instrument:

€ mn	30 Jun 2023 Carrying amount	30 Jun 2023 Fair Value	31 Dec 2022 Carrying amount	31 Dec 2022 Fair Value
Financial assets (ac)	**41,733**	**41,113**	**40,000**	**39,302**
Cash funds (ac)	6,248	6,248	5,424	5,424
Loan receivables (ac)[1]	30,757	30,314	29,463	28,959
Money market and capital market receivables (ac)	4,635	4,458	5,016	4,822
Receivables from other transactions (ac)	93	93	97	97
Financial assets (fvoci)	**3,574**	**3,575**	**3,552**	**3,552**
Money market and capital market receivables (fvoci)	3,572	3,573	3,550	3,550
Equity instruments (fvoci)	2	2	2	2
Financial assets (fvpl)	**2,151**	**2,151**	**2,258**	**2,258**
Loan receivables (fvpl)	283	283	427	427
Money market and capital market receivables (fvpl)	5	5	5	5
Positive market value of designated hedging derivatives (fvpl)	1,081	1,081	1,104	1,104
Positive market value of other derivatives (fvpl)	782	782	722	722
Financial liabilities (ac)	**42,097**	**41,672**	**40,022**	**39.746**
Money market and capital market liabilities (ac)	29,249	28,816	26,425	26,138
Deposits from the housing industry (ac)	12,361	12,361	13,115	13,115
Liabilities from other transactions (ac)	105	105	96	96
Subordinated liabilities (ac)	382	390	386	397
Financial liabilities (fvpl)	**3,214**	**3,214**	**3,514**	**3,514**
Negative market value of designated hedging derivatives (fvpl)	1,616	1,616	2,183	2,183
Negative market value of other derivatives (fvpl)	1,598	1,598	1,331	1,331

[1] Including non-current assets held for sale

Segment Reporting

(28) Segment results

€ mn	Structured Property Financing 1 Jan - 30 Jun 2023	Structured Property Financing 1 Jan - 30 Jun 2022	Banking & Digital Solutions 1 Jan - 30 Jun 2023	Banking & Digital Solutions 1 Jan - 30 Jun 2022	Aareon 1 Jan - 30 Jun 2023	Aareon 1 Jan - 30 Jun 2022	Consolidation/ Reconciliation 1 Jan - 30 Jun 2023	Consolidation/ Reconciliation 1 Jan - 30 Jun 2022	Aareal Bank Group 1 Jan - 30 Jun 2023	Aareal Bank Group 1 Jan - 30 Jun 2022
Net interest income	365	313	111	23	-14	-6	0	0	462	330
Loss allowance	160	107	0	0	0	0			160	107
Net commission income	1	4	16	15	137	119	-5	-6	149	132
Net derecognition gain or loss	12	22							12	22
Net gain or loss from financial instruments (fvpl)	-41	18	0	0	0	0			-41	18
Net gain or loss from hedge accounting	0	-7							0	-7
Net gain or loss from investments accounted for using the equity method				-1		-1				-2
Administrative expenses[1]	120	146	52	37	175	118	-5	-6	342	295
Net other operating income/expenses	7	-2	-1	-1	1	3	0	0	7	0
Operating profit	**64**	**95**	**74**	**-1**	**-51**	**-3**	**0**	**0**	**87**	**91**
Income taxes	25	34	23	0	-19	-1			29	33
Consolidated net income	**39**	**61**	**51**	**-1**	**-32**	**-2**	**0**	**0**	**58**	**58**
Consolidated net income attributable to non-controlling interests	0	0	0	0	-9	1			-9	1
Consolidated net income attributable to shareholders of Aareal Bank AG	39	61	51	-1	-23	-3	0	0	67	57
Allocated equity[2]	1,508	1,616	405	287	40	39	945	815	2,898	2,757
RoE after taxes (%)[3][4]	4.1	6.7	25.1	-0.8	-117.6	-12.5			4.0	3.7
Employees (average)	**747**	**803**	**475**	**388**	**2,118**	**1,995**			**3,340**	**3,186**
Segment assets	**34,757**	**36,803**	**13,534**	**13,207**	**738**	**731**			**49,029**	**50,741**

[1] During the course of a regular review, intra-Group cost allocation between the SPF and BDS segments was adjusted in 2023, aligning it to the size of the respective segment.
[2] For management purposes, the allocated equity is calculated for all segments on the basis of a standardised capital requirement pursuant to Basel IV (phase-in) of 15 %. Until 30 September 2022, the calculated output floor for the BDS and Aareon segments was 72.5 %. Reported equity on the statement of financial position differs from this. Aareon's reported equity as disclosed in the statement of financial position amounts to € 107 million.
[3] On an annualised basis
[4] The allocation of earnings is based on the assumption that net interest payable on the AT1 bond is recognised on an accrual basis.

Commission income[1] from contracts with clients (revenue within the meaning of IFRS 15) is allocated to the segments as follows:

	Structured Property Financing		Banking & Digital Solutions		Aareon		Consolidation/ Reconciliation		Aareal Bank Group	
	1 Jan - 30 Jun 2023	1 Jan - 30 Jun 2022	1 Jan - 30 Jun 2023	1 Jan - 30 Jun 2022	1 Jan - 30 Jun 2023	1 Jan - 30 Jun 2022	1 Jan - 30 Jun 2023	1 Jan - 30 Jun 2022	1 Jan - 30 Jun 2023	1 Jan - 30 Jun 2022
€ mn										
Recurring services			5	5	134	110	-7	-8	132	107
Non-recurring services					34	37			34	37
Banking business and other activities	4	4	14	13				0	18	17
Total	**4**	**4**	**19**	**18**	**168**	**147**	**-7**	**-8**	**184**	**161**

[1] The breakdown of the previous year's figure was adjusted. Aareon's net commission income from ERP products (€ 107 million) and from digital solutions (€ 40 million) comprises € 110 million from recurring services and € 37 million from non-recurring services. Furthermore, commission income in the BDS segment was reclassified from other activities to recurring services.

Other Notes

(27) Contingent liabilities and loan commitments

€ mn	30 Jun 2023	31 Dec 2022
Contingent liabilities	138	131
Loan commitments	1,249	1,230
of which: irrevocable	944	905

(28) Employees

The number of Aareal Bank Group employees is shown below:

	30 Jun 2023[1)]	Average 1 Jan – 30 Jun 2023[2)]	31 Dec 2022[1)]	Average 1 Jan – 31 Dec 2022[2)]
Salaried employees	3,134	3,162	3,143	3,067
Executives	179	178	173	169
Total	**3,313**	**3,340**	**3,316**	**3,236**
of which: part-time employees	720	672	609	597

[1)] This number does not include 274 employees of the hotel business (31 December 2022: 28 employees).
[2)] This number does not include 179 employees of the hotel business (1 January to 31 December 2022: 154 employees).

(29) Related party disclosures in accordance with IAS 24

Transactions with related parties occurred during the reporting period. In the context of the acquisition of Aareal Bank by Atlantic BidCo GmbH, one related party of the Supervisory Board sold shares in the amount of € 38,000. Atlantic BidCo GmbH will be included in the consolidated financial statements of Atlantic Lux HoldCo S.à r.l. going forward. Moreover, one member of the Management Board, one member of the Supervisory Board and one related company of a Supervisory Board member made a regular way purchase of debt securities totalling € 1.2 million.

(30) Events after the interim reporting period

There were no material events after the end of the interim reporting period which would require reporting here.

(31) Executive bodies of Aareal Bank AG

Supervisory Board

Prof. Dr Hermann Wagner [1) 2) 3) 4)]
Chairman of the Supervisory Board
German Chartered Accountant, tax consultant

Barbara Knoflach [1) 4) 5)]
Deputy Chairwoman of the Supervisory Board
Former Global Head of BNP Paribas Real Estate Investment Management and Deputy Chief Executive Officer of BNP Paribas Real Estate S.A.

Klaus Novatius [1) 2) 6)]
Deputy Chairman of the Supervisory Board
Aareal Bank AG

Sylwia Bach [5) 6)]
(since 16 March 2023)
Aareon Deutschland GmbH

Henning Giesecke [2) 3) 4)]
Former Chief Risk Officer of UniCredit S.p.A. and UniCredit Bank AG

Denis Hall [2) 4) 5)]
Former Chief Risk Officer Global Consumer Banking of GE Capital EMEA

Thomas Hawel [5) 6)]
(until 15 March 2023)
Aareon Deutschland GmbH

Petra Heinemann-Specht [2) 3) 4) 6)]
Aareal Bank AG

Jan Lehmann [5) 6)]
Aareon Deutschland GmbH

Hans-Hermann Lotter [1) 2) 3)]
Self-employed consultant for private equity investments, mergers, takeovers and restructurings, and Managing Director of Atlantic BidCo GmbH

Marika Lulay [1) 5)]
Chairwoman of the Technology and Innovation Committee
Chief Executive Officer and Managing Director of GFT Technologies SE

Sylvia Seignette [3) 4)]
Chairman of the Risk Committee
Former CEO for Germany and Austria, Crédit Agricole CIB (formerly Calyon)

José Sevilla Álvarez [1) 3) 5)]
Former Chief Executive Officer of Bankia S.A.

Management Board

Jochen Klösges
Chairman of the Management Board

Nina Babic
Member of the Management Board

Marc Hess
Member of the Management Board

Christof Winkelmann
Member of the Management Board

[1)] Member of the Executive and Nomination Committee; [2)] Member of the Remuneration Control Committee; [3)] Member of the Audit Committee;
[4)] Member of the Risk Committee; [5)] Member of the Technology and Innovation Committee; [6)] Elected by employees

Responsibility Statement

To the best of our knowledge, and in accordance with the applicable reporting principles for interim financial reporting, the interim consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the interim management report of the Group includes a fair review of the development and performance of the business and the position of the Group, together with a description of the material opportunities and risks associated with the expected development of the Group for the remaining months of the financial year.

Wiesbaden, 3 August 2023

The Management Board

Jochen Klösges **Nina Babic**

Marc Hess **Christof Winkelmann**

Review Report

We have reviewed the condensed interim consolidated financial statements as of 30 June 2023 of Aareal Bank AG, Wiesbaden – which comprise the statement of financial position as of 30 June 2023, statement of comprehensive income, statement of changes in equity, statement of cash flows – condensed – and the notes to the financial statements – condensed – together with the interim group management report for the period from 1 January to 30 June 2023. The preparation of the condensed interim consolidated financial statements in accordance with IAS 34 "Interim Financial Reporting", and of the interim group management report in accordance with the requirements applicable to interim group management reports, is the responsibility of the Company's management. Our responsibility is to issue a report on the condensed interim consolidated financial statements and on the interim group management report based on our review.

We performed our review of the condensed interim consolidated financial statements and the interim group management report in accordance with the German generally accepted standards for the review 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 review so that we can preclude through critical evaluation, with a certain level of assurance, that the condensed interim consolidated financial statements have not been prepared, in material respects, in accordance with IAS 34 "Interim Financial Reporting", and that the interim group management report has not been prepared, in material respects, in accordance with the requirements applicable to interim group management reports. A review is limited primarily to inquiries of company employees and analytical assessments and therefore does not provide the assurance attainable in a financial statement audit. Since, in accordance with our engagement, we have not performed a financial statement audit, we cannot issue an auditor's report.

Based on our review, no matters have come to our attention that cause us to presume that the condensed interim consolidated financial statements have not been prepared, in material respects, in accordance with IAS 34, "Interim Financial Reporting", or that the interim group management report has not been prepared, in material respects, in accordance with the requirements applicable to interim group management reports.

Frankfurt/Main, 4 August 2023

KPMG AG
Wirtschaftsprüfungsgesellschaft
[Original German version signed by:]

Wiechens	**Winner**
Wirtschaftsprüfer	**Wirtschaftsprüfer**
[German Public Auditor]	**[German Public Auditor]**

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Financial Calendar

10 August 2023	Annual General Meeting
9 November 2023	Publication of results as at 30 September 2023

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This report is also available in German language.
The German version shall be authoritative.

Aareal Bank Group

08/2023

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