PETRUSADVISERS

Marija Korsch, Marc Oliver Heß
Aareal Bank AG („**Aareal**")
Paulinenstraße 15
65189 Wiesbaden

London, 10 February 2021

Dear Ms. Korsch, dear Mr. Heß,

We have read the initial results of your ongoing strategic review announced on 17 January 2021 with interest but write to direct you to a strongly improved final version for 24 February 2021 as follows:

Summary of the Aareal Proposal

Our understanding of the communicated cornerstones of the strategy review that is supported by McKinsey is as follows:

- Consolidated operating result of euro 300 million by 2023 assuming no changes to interest rates
- 8% post-tax RoE by 2023 assuming 15% CET1 (Basel 4, phase-in, revised IRBA ratio)
- 40% cost-income-ratio in the Structured Property Financing segment (SPF) by 2023; supported by efficiency measures covering organizational matters, processes and infrastructure
- Expansion of the SPF real estate financing volume to euro 30 billion by 2023
- Optimization of the capital structure: Aareal is planning to refinance the AT1 / Tier 2 components by 2023
- Allocation of capital: Beyond a dividend of up to euro 90 Million in 2021, significant amounts of capital are to be distributed to shareholders in order to achieve the 15% CET 1 and 8% RoE targets
- Consulting / Services segment: growth of commissions and fees planned in the payment processing area
- Completion of Aareon unbundling combined with focus on profitable growth of Aareon

Preliminary Assessment of the Strategy Review - More of the Same …

Based on the limited information published, we cannot draw final conclusions. However, already at this stage some key points become clear and we demand that you fundamentally rework those by 24 February:

1. **Too little RWA-efficient growth:** a central component of our demands has been to grow RWA-efficient income components at Aareal Bank[1]. This will be necessary to increase the quality of Aareal Bank's earnings and at the same time reduce the dependency on interest rates and regulation of capital requirements. However, management seems to plan commission growth only in the payment processing area and not in the core SPF segment where the current base is very small (ca. euro 5 million in 2020[2]): This will **not** suffice!
2. **You rely on RWA-intensive growth:** management instead wants to increase the RWA-intensive SPF lending book to generate interest income by deploying capital and taking on risk. Consequently, the dependency on the commercial real estate lending business that has not earned its cost of capital in five years will increase.
3. **Reduction of equity:** capitalization is another area where management seems to rely on a favorable change in regulation. Achieving 8% RoE with euro 300 million of group operating profit is only possible if the bank receives regulatory approval for a significant reduction of capital – we estimate that the current plan includes ca. euro 600-700 million[3] by 2023. Instead of reducing the regulatory dependency by means of good work, management is increasing it.
4. **Cost:** the planned 40% cost-income-ratio for SPF is designed to suggest cost focus at Aareal. Upon closer look, it becomes apparent that management is not planning any significant measures. Instead of accepting that Aareal Bank has not earned its cost of capital for years which puts a sustainable future of the bank at risk, management wants to hide the lack of profitability by increasing their risk-taking:
    a. **Higher than sector-customary remuneration:** in our letter of 24 November 2020, we have pointed out the unparalleled levels of management remuneration (2019 management board compensation represented 13% of group net income). In the meantime, we have found that such – compared to industry benchmarks - dramatically oversized pay packages and pension commitments prevail not only on the management board level but also the leadership levels below. We therefore demand that the independent review of potential

[1] *Defined as Aareal Bank AG excluding Aareon.*

[2] *Annualised Net Commission Income for the SPF segment from 9M 2020A.*

[3] *Assumes euro 300 million AT1 repayment and reduction of Group Book Equity to c. euro 2.3 billion.*

claw-backs of historical bonus payments be expanded to include an analysis of Aareal's compensation levels. We estimate that euro 20-30 million can be saved without even reducing the number of employees.

b. **0%-2020 bonus:** we reiterate our demand for **0%-Bonus for 2020** and no future bonus payments until Aareal Bank achieves an 8-10% post-tax RoE.

c. **Workforce age structure:** according to our work, Aareal has failed to counter an over-aging of the workforce by means of dynamic HR management. This is one of the reasons why manager compensation levels are dramatically higher than industry standard. We demand that this point be included in the external expert review of Aareal's personnel and cost structures.

d. **Efficiency:** we assume that your plan does not include any optimization measures. You must rework this, especially considering your bloated management structure with numerous senior staff levels across the matrix and very narrow areas of accountability. As we have repeatedly offered, we are very happy to recommend experts with entrepreneurial experience to support Aareal Bank in this endeavor.

5. **Palatial Headquarters and Pensions**: as of yet, you have remained silent with respect to these key symbols of your money wasting - identified as obvious improvement potential by us more than 9 months ago. Evidently, these represent dear comfort factors to Aareal's bank managers. But this is no reason not to generate value to shareholders by addressing them now.

Aareon – no shareholder value without a spin-off to us shareholders

As early as in 2019, we demanded a spin-off of Aareon to us shareholders. The business of Aareon is simply too different from that of the bank. Management was of the view that Aareon was not ready to be independent and hence you got private equity on board to help accelerate this development. We assume that the contribution by Advent has by now resulted in tangible progress as reflected in your bringing forward the target date for doubling the guided EBITDA from 2025. The acquisition of Realpage Inc. by private equity (Thoma Bravo) has once more shown how valuable Aareon is; and how low the implied valuation of Aareal Bank is – namely negative [4]. As long as Aareon remains part of a regulated bank with no sustainable strategy, this value will not materialize for us shareholders. We therefore demand a spin-off to us shareholders in the second half of 2021 or at the very latest in the first quarter of 2022.

CEO succession

On 8 November, shareholders were informed of Hermann Merkens´ medical leave for three to four months. More than three months have passed since then. Shareholders remain completely in the dark! We demand that you create clarity with respect to the future leadership of Aareal and that you prioritize external candidates for the position. Aareal needs an experienced decision-maker who can re-position the bank for profitable growth and successfully spin off Aareon.

Entrepreneurial decision making cannot be outsourced to consultants. The McKinsey plan currently aims for 'more-of-the-same'. For the highly paid ladies and gentlemen on the Aareal management board plus the equally well-paid manager suites below the plan would mean a few more well compensated years. No wonder you have chosen the path of least resistance at the expense of a sustainable future for Aareal Bank. We are deeply concerned about the current situation, but it is not yet too late – we urge you to work harder and in the interest of a sustainable, ethical bank and your shareholders!

Sincerely,

Klaus Umek
Managing Partner

Till Hufnagel
Partner

[4] *Based on a valuation of Aareon in line with the Thoma Bravo / Realpage transaction multiples (i.e. 9x EV/Sales and 32x Adj. EBITDA 2020E), resulting in an implied negative value of Aareal Bank (i.e. Aareal Group excluding Aareon) of -euro -225-460 million.*