Sareb

Sociedad de Gestión de Activos
Procedentes de la Reestructuración
Bancaria, S.A.

ANNUAL ACTIVITY REPORT 2017

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2017

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01 ABOUT THIS REPORT

Once again, this year Sareb presents its Annual Activity Report, drawn up following the guidelines within the IIRC[1] international integrated reporting framework. In addition, this report has been drawn up in accordance with GRI Standards[2]: core option.

The company continues advancing in its commitment to improve transparency and the quality of the information to be published twice a year and, furthermore, responds voluntarily to the requirements contained in RD-Law 18/2017, under which public interest companies with more than 500 employees have to submit accounts regarding the disclosure of non-financial information.

The orientation and approach of the content were determined by the conclusions of the materiality assessment performed within the framework of the preliminary work for preparing the report and which, in addition to financial aspects, includes others of a social and environmental nature.

The information and quantitative data in this report relate to the activity engaged in by the company in 2017. Also, where necessary, and with the aim of making it easier for the reader to understand the evolution of the business from the outset, the figures and facts relating to previous years are also included. This is especially relevant in this year, 2017, when Sareb completes the first third of its activity.

Lastly, the content of this report is also supplemented with the other publications available on Sareb's corporate website, which can be accessed following the links placed throughout the report for expanding on the information.

1 International Integrated Reporting Council

2 Global Reporting Initiative

02 INTERVIEW WITH JAIME ECHEGOYEN

Five years have passed since Sareb was created for taking on the assets posing problems for the nine banks in difficulties which were receiving public aid. Sareb's mission is to carry out the orderly liquidation, within a 15-year period, of a portfolio consisting 80% of loans and 20% of properties, for which it paid €50,781 million. Having completed the first third of its life, now is the moment for taking first stock of the achievements attained by the company.

How do you assess these first five years of life of Sareb?

These first years of life of Sareb have been essential for consolidating the company's operational structure and setting the bases that will help us to fulfil the mandate with which we have been entrusted. In this period we have generated revenue of almost €20,700 million, which has enabled us to reduce our portfolio by more than €13,600 million, or 26.7%, and cancel around 12,900 million -25.4% of the total- of the debt guaranteed by the Government that we issued for acquiring the assets.

This has been possible through professional management which enabled Sareb to reduce the number of debts owed to the company by almost 3,000, to handle over 51,300 procedures from developers and to sell almost 68,300 properties on the retail market.

Although it is true that doubts were generated with the creation of Sareb as it came about in a context of economic instability and lack of confidence in the Spanish banking system, five years later we have become an international reference, not only for countries undergoing similar difficulties, but also for other international organisations of the same nature who see in Sareb an example of efficient management and an effective mechanism for restoring the health of balance sheets of the banks.

What has been the role of Sareb in emerging from the recession?

The company has contributed to restoring the health of the financial system and reactivating the housing market. The creation of Sareb has not only allowed the nine banks which transferred their assets to reduce the developer risk from their balance sheet situation, but it has also allowed for greater confidence of the capital markets in Spanish banks, which has lead to a reduction in financing costs and a reactivation in lending.

From the perspective of the real-estate sector, the difficulty in obtaining credit and the uncertainty and impossibility of having price references for segments of the industry such as land, brought the sector to a standstill in which there were practically no transactions being carried out.

Sareb's contribution has also helped to revitalise the property market in this respect. In our first summer as an operating company, in August 2013 we closed our first big institutional transaction which opened the market by establishing a floor in prices, and enabled both Sareb and various banks to progressively sell off their property and financial asset portfolios. From then on, between 2013 and 2015, foreign investment in construction and real estate activities in Spain went up by more than 300%.

Our activity has also had a significant impact on the economy in general. With this, between 2013 and 2017 Sareb has contributed €23,248 million to the Gross Domestic Product (GDP), equivalent to 0.42% of the national wealth accumulated over the period, according to the Socio-Economic Impact Report drawn up by the EY consultancy firm.

Furthermore, in these five years we have also contributed, to the extent of our possibilities, to palliating the housing needs of groups at risk of exclusion. It is worth mentioning that we have placed a pool of 4,000 properties for rented social housing at the disposal of the authorities, of which at today's date we have already committed 2,360 through arrangements with 10 autonomous regions and six town councils.

Furthermore, in September 2013 we joined the United Nations Global Compact as a sign of our commitment to implementing the ten principles promoted therein, which address issues related to human rights, labour standards, the environment and corruption. Every year we renew our commitment and Sareb's advances in these matters are set out in the corresponding annual Progress Report for each financial period.

What are the Sareb's distinguishing elements for fulfilling its mandate?

"Beyond fulfilling our mandate, we want to contribute to leaving a positive mark on the sector once our mission is concluded, in 2027. A mark of professionalism, thoroughness and innovation."

Since its inception Sareb is characterised by a thorough and professional management that places innovation at the centre of its strategy. Beyond fulfilling our mandate, we want to contribute to leaving a positive mark on the sector once our mission is concluded, in 2027. A mark of professionalism, thoroughness and innovation.

We began by promoting servicing in Spain, which was a determining factor in the transformation of the sector, when, in 2015, our portfolio was awarded to four companies specialising in the management and marketing of property and financial assets –Altamira Asset Management, Haya Real Estate, Servihabitat and Solvia.

Loan management is another of the elements that differentiate our activity. With a total portfolio of financial assets that today represents almost 70% of the total, we are working continuously towards better management and seeking innovative solutions that will foster collaboration with the developers, so that they can reduce their debts with Sareb and continue with their business.

But we have also sought other parallel channels for speeding up the divestment of this type of assets. Along these lines, Sareb has created an online channel for the sale of loans through which it has concluded transactions amounting to €35 million in 2017, and which has contributed to spur the dynamism of this market and make it more transparent. This is especially relevant if we take into account the problems in Europe, where the banking industry has accumulated unpaid loans amounting to almost a billion euros.

In 2018 we have now launched an auction channel on our website to give greater visibility to the properties appearing as guarantee for our loans, and which are auctioned through the courts.

During this time we have also searched for new dynamic solutions to enhance the value of the properties. At today's date we have approved the construction of more than 5,200 properties by having developments built on land belonging to us and finishing construction work that had been stopped. All of this in collaboration with the development sector.

Lastly, we would highlight the creation of a REIT, Témpore Properties, which has enabled us to accelerate the pace of divestment and increase the offer of properties for rental on the market, a segment increasingly more in demand by Society.

These are only some examples of our contribution, but innovation and professionalism are also present in our way of working. The task that has been entrusted to us requires a team of professionals who are able to continuously adapt to change and the flexibility needed for fulfilling our mission within a specific time period.

To finish, what can be expected of Sareb from this point on? How will the company evolve over the coming years?

Sareb still has a great challenge facing it. In the next ten years we have to be capable of fulfilling our our mandate of divestment and cancelling the debt assumed.

To do this, we have to intensify our pace of divestment, not only by boosting our commercial activity from the perspective of the real-estate business, but also developing new formulas that contribute to heighten the value of our portfolio. In this respect innovation will continue to play a leading role.

We are 100% committed and involved. We are on the right path and we thank our shareholders, clients and Society for the confidence placed in Sareb during its first five years of life.

03 WHAT IS SAREB?

A key instrument for the recovery of the financial and real-estate sector in Spain

Sareb was founded in November 2012, as part of the conditions contained in the Memorandum of Understanding (MoU) –signed between the Spanish and international authorities– to assist the restructuring and recapitalisation of the Spanish banking sector.

The agreement established that a management company would be set up to which the properties awarded and developer loans would be transferred from banks undergoing difficulties due to their excessive exposure in the real-estate sector, so that they could liquidate their assets in an orderly manner over a 15-year period, until November 2027.

In 2013 Sareb received
200,000
ASSETS
valued at
€50,781m
of which...

80%
loans to developers

20%
property assets

Mission

Divesting assets over a maximum of 15 years, optimising their value. Sareb has to guarantee its viability as a company in order to meet the commitments assumed with shareholders, investors and Society as a whole.

Vision

Sareb is a private undertaking committed to fulfilling the public mandate that it has been entrusted with, contributing to the recovery of the financial sector and the Spanish economy. In this process the professional qualifications and ethics of its employees are crucial.

Values

Integrity: This means assuming that actions and attitudes will preserve the ethical standards of Sareb's corporate culture.

Transparency: Sareb assumes the commitment to openness in communicating its policies and procedures, aware that it acts under the watchful eye of society as a whole.

Civic engagement: The company operates under ethical standards and with socially responsible criteria.

More information on What is Sareb?
https://www.sareb.es/es_ES/conoce-sareb/quienes-somos/que-es-sareb

SIGNIFICANT EVENTS: a tour through the first 5 first years of Sareb

2012

NOVEMBER

- Creation of Sareb.

DECEMBER

- First subordinated debt subscribed.
- Assets received from BFA-Bankia, Catalunya Banc (CX), Banco de Valencia, Novagalicia Banco and Banco Gallego.

2013

FEBRUARY

- Second subordinated debt subscribed. Sareb complements its own resources with €4,800 million (€1,200m in capital and €3,600m in subordinated debt).
- Assets received from Liberbank, Caja 3, CEISS and BMN.

MAY

- Approval of the Sareb Code of Conduct.

AUGUST

- Closing the first institutional operation with the allocation of the 'Bull' portfolio to the venture capital fund H.I.G. Capital.

OCTOBER

- Creation of a pool of 4,000 properties for social purposes.

2014

MARCH

- It was announced that €259m had been written-off from the loan portfolio.

JULY

- Signing of the first agreement for assignment of social housing.

DECEMBER

- Management of the assets was assigned to four real-estate management companies or servicers: Altamira, Haya Real Estate, Servihabitat and Solvia.

2015

MARCH

- Further write-off of €719m from the loan portfolio.
- Launch of the new Sareb corporate website, which shows all the properties being marketed by the company.

OCTOBER

- The Bank of Spain Circular was published establishing the criteria for measuring Sareb assets.

NOVEMBER

- For the first time, Sareb announced the development of land it owns.

2016

MARCH

- A further recovery to the Sareb portfolio with €2,044m in provisions*.

APRIL

- Conclusion of the migration of information on the portfolio of assets allocated to each of the four servicers: (*Altamira, Haya Real Estate, Servihabitat and Solvia*).

MAY

- The company approved the capitalising of €2,170m of subordinated debt to cover write-offs in the portfolio.

SEPTEMBER

- Sareb joined forces with developers in the real-estate sector for developing a total of 19 plots for residential use under a system of co-investment and swaps.

DECEMBER

- The changes introduced into the accounting legislation allow Sareb to reflect impairment against equity instead of charging it to profit/(loss).
- Closing the largest institutional transaction, the sale of the 'Eloise' portfolio, for a nominal value of €553m.

* Arising from application of the 2015 Bank of Spain Circular which establishes the criteria for valuing Sareb's assets and requires it to capitalise €2,171m of the Company's subordinated debt.

2017

APRIL

- Creation of the area for Development, Promotion and Investment (DPI) to enhance the value of the portfolio.

MAY

- The creation of the REIT, Témpore Properties, was announced, which will be provided with a selection of residential properties for rental.

JUNE

- Launching of the online channel for the sale of loans.

NOVEMBER

- Sareb sold the mortgage loan guaranteed by the InTempo building in Benidorm.
- Témpore Properties started operating with a portfolio of 1,554 assets transferred by Sareb for the value of €175m.

DECEMBER

- Sareb, the first public capital entity with AENOR certification in Criminal Compliance and Anti-Bribery.
- Sale of the 'Tambo' portfolio, a portfolio of NPL with a nominal figure of €150 million.
- Allocation of the largest institutional transaction of the year, the 'Inés' portfolio, with NPLs for a nominal value of €375 million.
- Record in property sales, with a total of 18,925 units, 86% residential.

* Non Performing Loans

An international reference: beyond Europe's borders

Since it was created, The Sareb business model has become an example to be followed in other countries looking for formulas similar to the one applied in Spain for restoring the health of their financial systems

Since the beginning, the company has maintained smooth international relations, not only with investors, but also with counterpart institutions, public representatives and a variety of official bodies. In 2017, members of Sareb met with representatives of the BAMC[3], the bank asset management company of Slovenia and other Slovene institutions, to share experiences and analyse the perspectives facing both entities in the future.

In 2017 this interest in Sareb's activity has also extended to countries such as Vietnam, whose representatives of the State Bank[4] visited Sareb headquarters to acquire first-hand knowledge of the company model and other issues relating to the capital structure, the type of assets it possesses and new alternative ways of creating value that it is currently exploring in order to fulfil its mandate of divestment.

[3] Slovenia's Bank Asset Management Company (BAMC)

[4] Vietnam already has a bad bank which accounts for 50% of the non performing loans (NPL) of its economy.

1. National asset management companies in Europe

1 **SWEDEN**
Retriva and Securum
- Created: 1992
- Perimeter: Real estate assets
- Nominal Value: €5,800m

2 **GERMANY**
FMS
- Created: 2006

Perimeter: All types
Nominal value: €70,000m

EAA (DÜSSELDORF)
- Created: 2009
- Perimeter:Structured assets
- Nominal Value: €75,500m

3 **DENMARK**
Finansiel Stabilitet
- Created: 2008
- Perimeter: Developer loan
- Nominal Value: €2,280m

4 **SWITZERLAND**
SNB StabFun
- Created: 2008
- Perimeter: Subprime mortgages, CREE and securitised loans
- Nominal Value: €30,000m

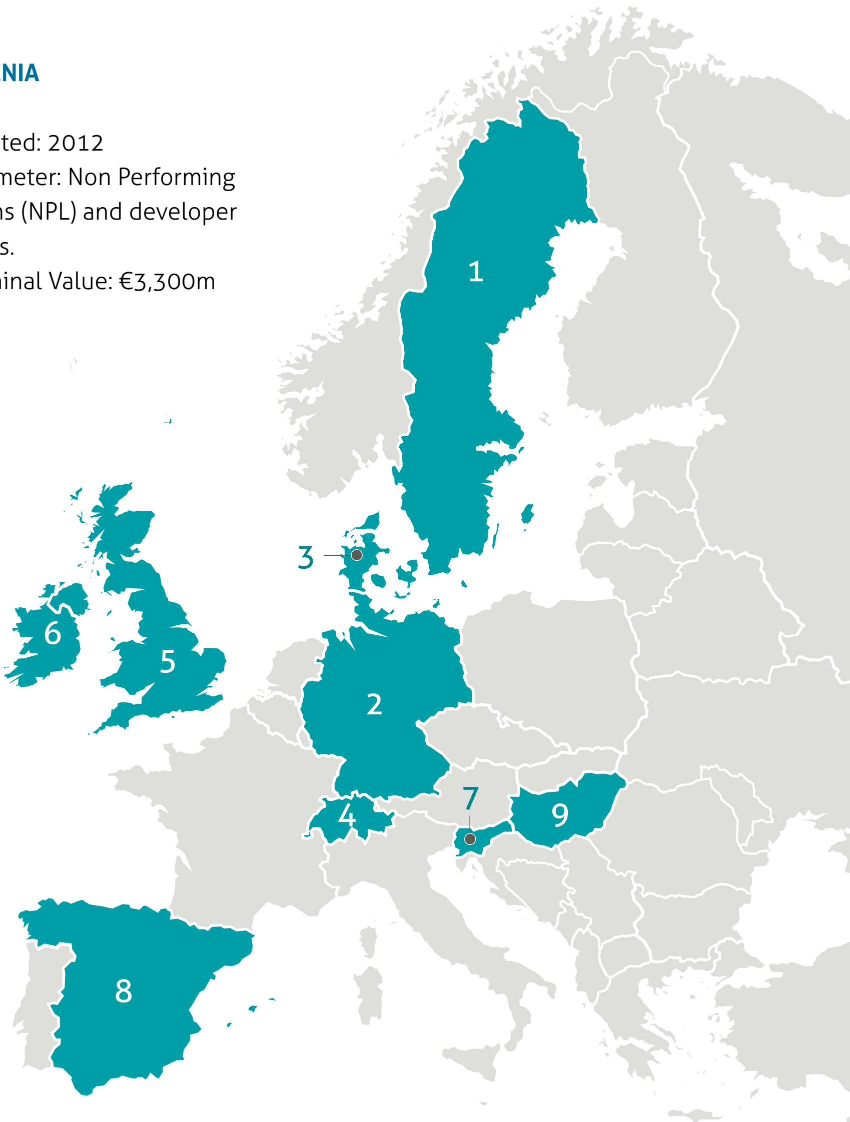
5 **UNITED KINGDOM**
UKAR
- Created: 2008
- Perimeter: Mortgages
- Nominal: Value: £25,000m

6 **IRELAND**
NAMA
- Created: 2009
- Perimeter: CRE, land and property developments
- Nominal Value: €74,000m

7 **SLOVENIA**
BAMC
- Created: 2012
- Perimeter: Non Performing Loans (NPL) and developer loans.
- Nominal Value: €3,300m

8 **SPAIN**
Sareb
- Created: 2012
- Perimeter: 80% developer loans and 20% real estate assets
- Nominal Value: €107,000m

9 **HUNGARY**
MARK
- Created: 2015
- Perimeter: Real estate
- Nominal Value: $362m



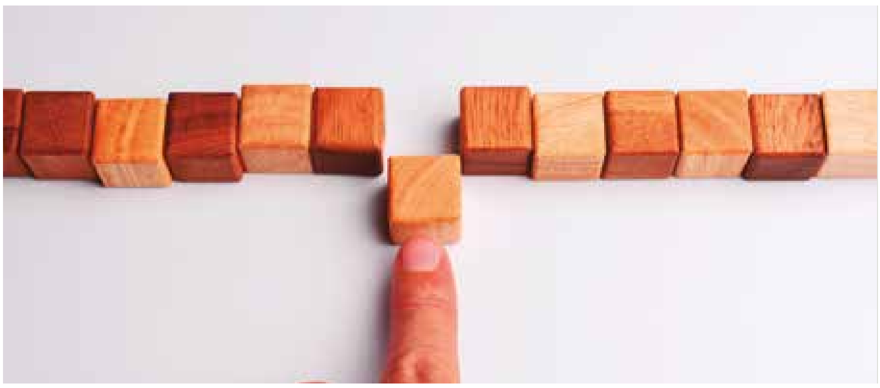
What are they saying about Sareb?

The European Commission has made reference on occasions to the important role of Sareb in the resolution of the financial crisis in Spain, thanks to being rapidly created and put into operation, which has contributed to the recovery and reactivation of the housing market[5].

Also the progress in divestment and payment of debt using an "effective approach to management", and the minimisation of the negative effects of bank write-offs "in the economy, the property market and the banking sector" have been issues recognised by institutions such as the International Monetary Fund (IMF)[6] and the European Systemic Risk Board (ESRB)[7], respectively.

In its ninth supervisory visit to Spain, the European Commission and the European Central Bank urged Sareb to introduce additional measures into its management following the negative financial results obtained[8].

Sareb, along with other European asset management companies, is currently participating actively in working groups for defining the common criteria to be employed by future asset management companies that are created in the Eurozone based on the agreements reached in the Economic and Financial Affairs Council of the EU. I.e. from the type of assets to be included in the perimeter for transfer, to the shaping of the most suitable capital structure and the criteria for good governance that are to govern companies of this kind.



[5] Evaluation of the Financial Sector Assistance Program. Spain 2012-2014 and What makes a good 'bad bank'? The Irish, Spanish and German Experience.

[6] Spain. Financial Sector Assessment Programme. September 2017

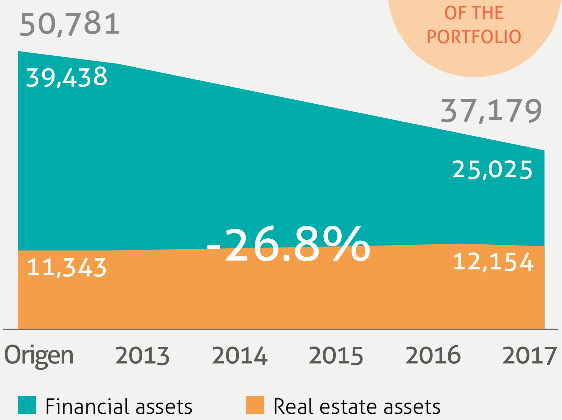
[7] Resolving non-performing loans in Europe. July 2017

[8] Statement by the staff of the European Commission and the European Central Bank following the ninth post-programme surveillance visit to Spain.

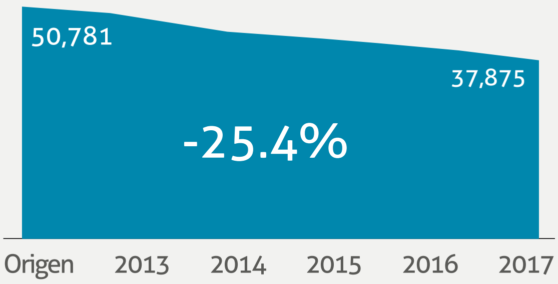
Balance 2012–2017

EVOLUTION OF THE PORTFOLIO (€m)[9]

13,602 m€ REDUCTION OF THE PORTFOLIO



REPAYMENT OF DEBT (€m)[10]



€2,780m INTEREST PAID TO SAVING BANKS

68,278 PROPERTIES SOLD

51,361 FINANCIAL PROPOSALS MANAGED

5,209 HOMES UNDER CONSTRUCTION

4,000 AFFORDABLE HOMES

Agreements

10 AUTONOMOUS REGIONS

6 TOWN COUNCILS

2,360 PROPERTIES COMMITTED

€20,697m REVENUE

€12,906m REPAID DEBT[11]

[9] Not including accumulated amortisation/depreciation or impairment

[10] Includes amortisation/depreciation of €889m to be made in 2018 and charged against 2017 and €604.8M repaid in February 2018 and charged against 2017.

[11] It takes into consideration the repaid debt, the direct, indirect and induced economic contribution, the interest on the debt and taxes paid.

Social and economic impact of Sareb

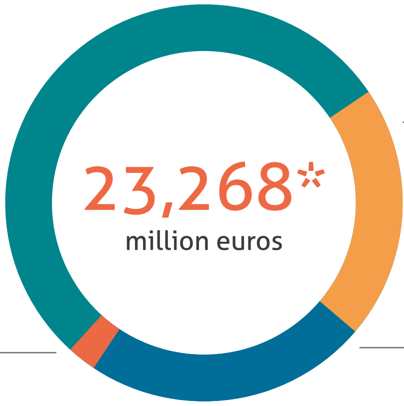
In 2017 the consultancy firm, EY, prepared the 'Report on the Social and Economic impact of Sareb', in which it describes the scenario before and after the creation of the company from the perspective of the evolution of certain macroeconomic indicators and identifies the principal social and economic effects arising from its activity in the period 2013-2017.

Amongst the main impacts set out in the report, it highlights the contribution to the economy over those five years, in which it has injected €23,268 million into the Spanish Gross Domestic Product (GDP), the equivalent of 0.43% of the national wealth accumulated for the 2013-2017 period. That figure, resulting from the company's activity during the years analysed, is composed as follows:

2. Sareb's contribution to the Spanish economy between 2013 and 2017:

Repayment of debt
€12,906m

Taxes paid between 2013-2017
€773m



Interest paid on the debt
€4,197m

Direct, indirect and induced contribution to the economy, (added to the GDP between 2013 and 2017)
€5,392m

* Data obtained from the final closing figures for 2017 which updates the €23,248m of Sareb's contribution to the Spanish economy between 2013 and 2017 calculated by EY using 2017 year-end projections.

Employment and affordable homes:

In the report, EY estimates that with its activity Sareb has promoted the creation of 34,127 direct, indirect and induced jobs in Spain during the period analysed.

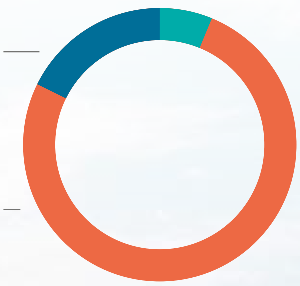
34,127
jobs created directly, indirectly and induced during the 5 years

3. Contribution to employment

1,594
Direct employment

6,092
Induced employment

26,441
Indirect employment



Parallel to its divestment activity, Sareb also engages in activities of corporate social responsibility and has demonstrated its commitment and contribution to palliating the problem of social housing in Spain. Since the outset, Sareb has signed agreements for assigning affordable homes with 10 autonomous regions and six town councils, with which it has already committed 2,360 properties which to the present day, have benefited 5,900 people[12].

4,000[12] properties intended for social purposes (2,360 of them already committed).

5,900[13] people are already benefiting from these social housing programmes.

Agreements for assignment of social housing

10 AUTONOMOUS REGIONS

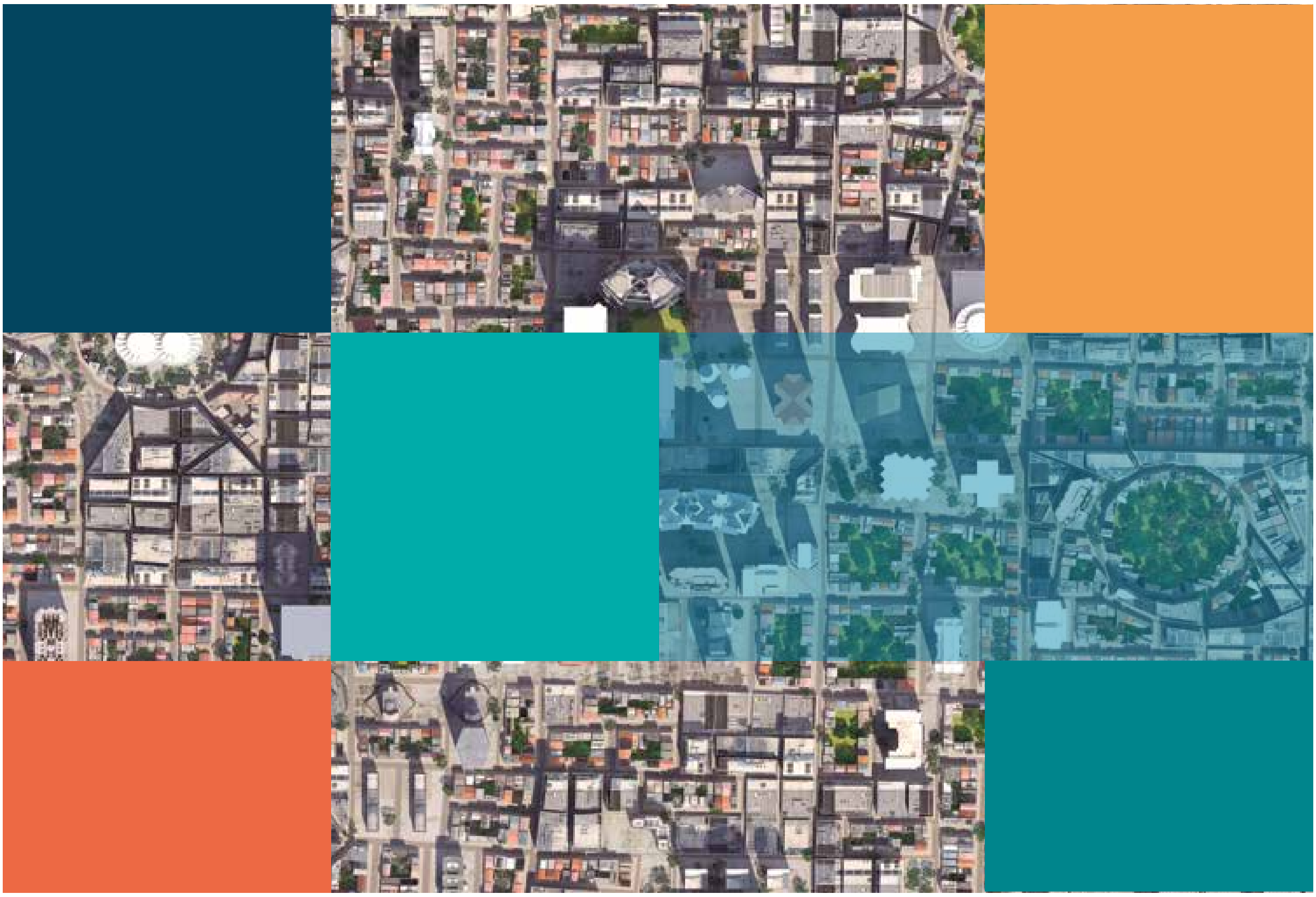
6 TOWN COUNCILS

[12] Estimate based on the average size of homes according to the National Institute of Statistics (INE) (2.5 people in 2016) (considering committed properties)

[13] Source: Sareb

More information on the Report on the Social and Economic impact of Sareb (2013-2017) at https://www.sareb.es/en_US/about-us/our-contribution

04 SAREB IN 2017



Main figures for the year

Advancing with the fulfilment of our mandate

€3,833m
TOTAL INCOME

PER CHANNEL

Wholesale	Retail
6%	94%

PER TYPE OF ASSET

Loans	Property assets
69%	31%

€2,622.8m
LOANS

Repayment and sale of loans	€1,073m
Sales Growth Plans (PDVs)/ Sales from the developer balance sheets	€890.5m
Amortisations and collections	€356.3m
Interest	€303m

€1,191.2m
PROPERTY ASSETS

Residential	€614.9m
Land and commercial property	€514.9m
Income and others	€61.4m

PORTFOLIO OF ASSETS

-7.3%

	Loans	Property assets	Total
2017	€25,025m	€12,154m	€37,179m
2016	€27,842m	€12,292m	€40,134m

BALANCE OF OUTSTANDING DEBT

-7.5%

2017	€37,875m
2016	€40,925m

€-3,050m
Repayment of debt charged against 2017

MANAGEMENT AND SALE OF LOANS

+25%
+13,124
PROPOSALS MANAGED

-4%
14,575
NUMBER OF DEBTORS

MANAGEMENT AND SALE OF PROPERTIES

2013	9,000
2014	15,000
2015	11,200
2016	14,000
2017	18,925

RECORD

18,925
PROPERTIES SOLD

OWN UNITS
10,864

UNITS OF AGREEMENTS WITH DEVELOPERS
8,061

PROPERTY DEVELOPMENT

5,209
NEW HOMES

COMPLETED
1,458

APPROVED
3,751

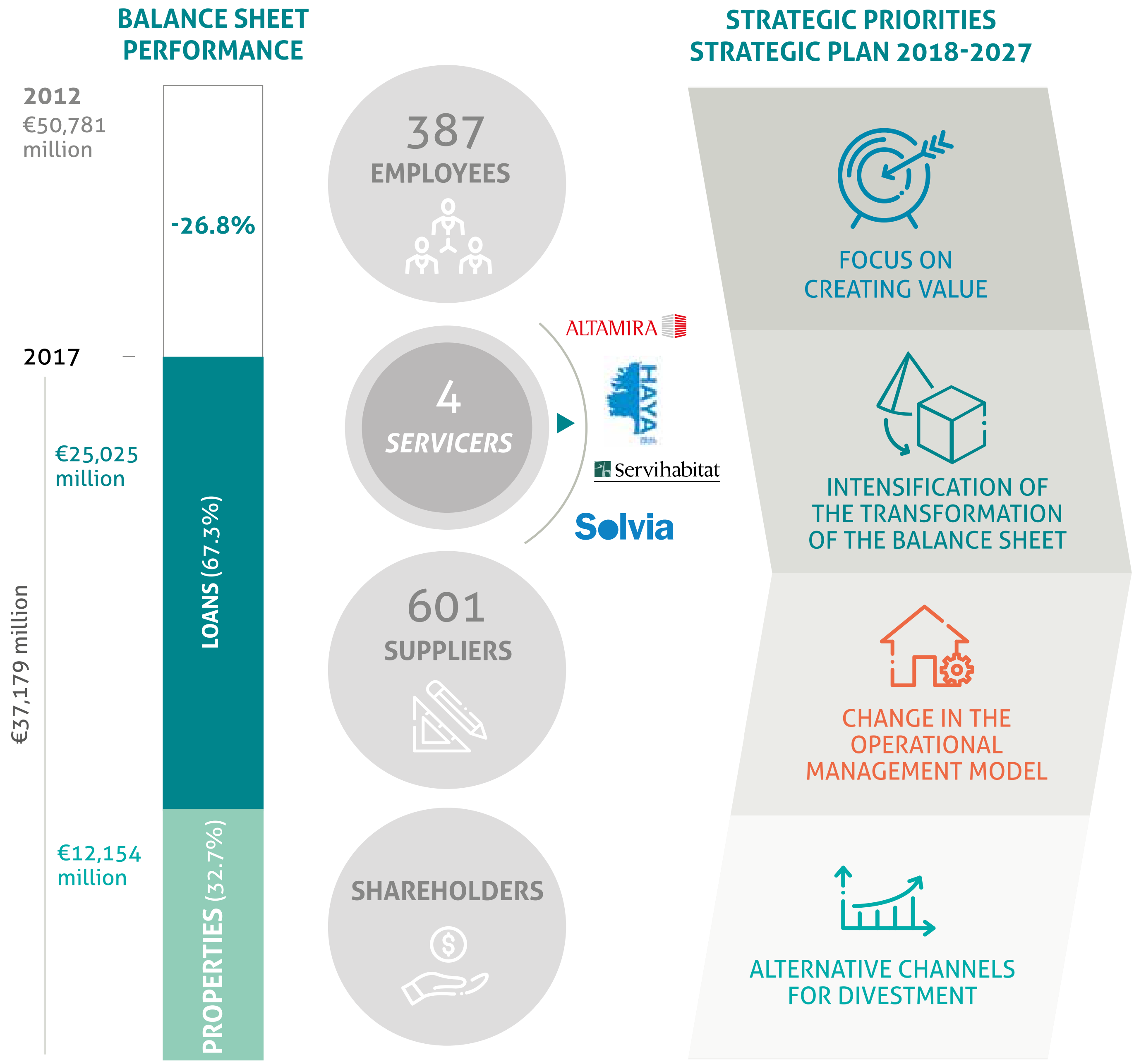
Our contribution to the overall agenda

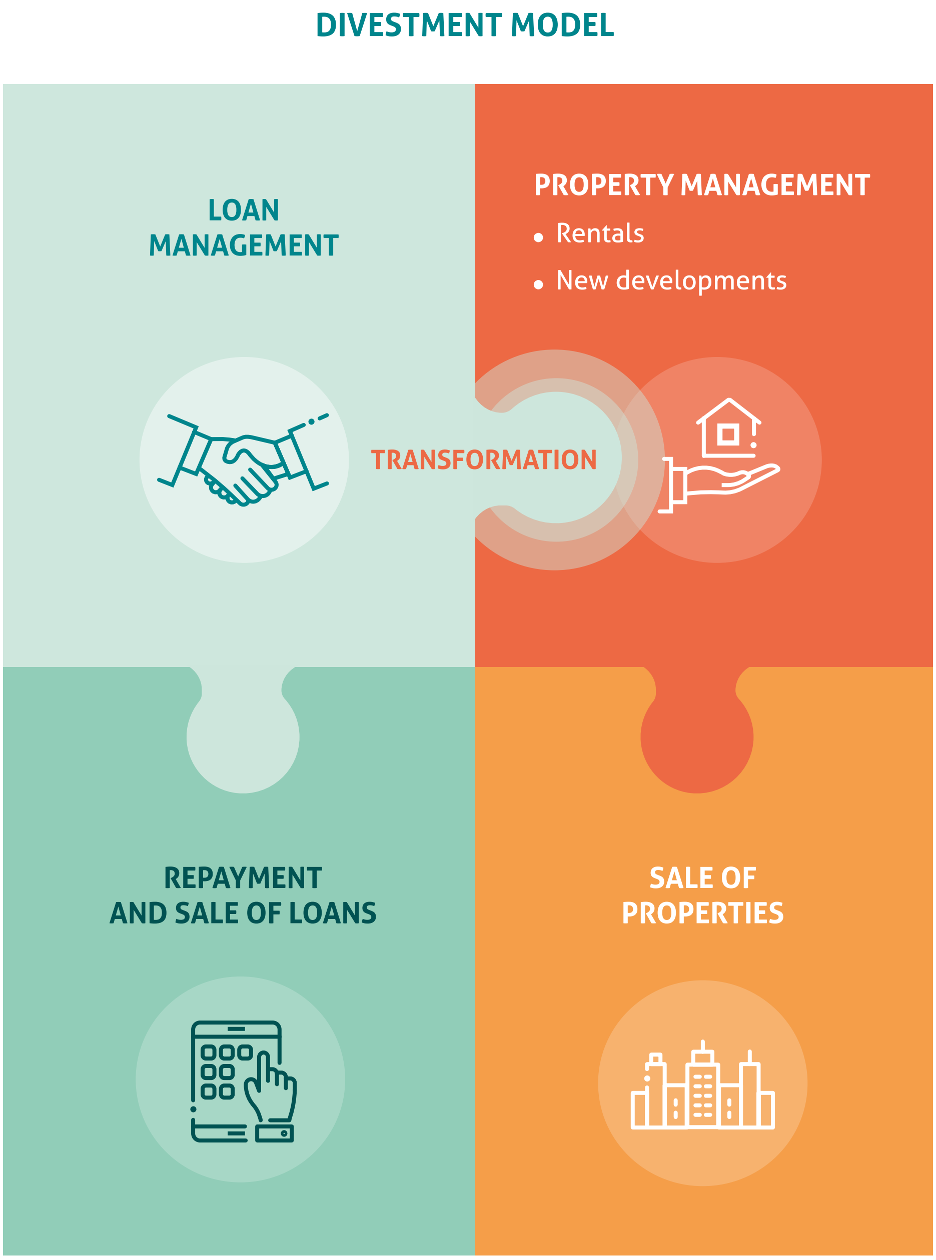
The singular nature of Sareb, and its role in the contribution to the recovery of the Spanish financial and real-estate sector, is also highly relevant to the fulfilment of the Objectives of Sustainable Development approved by the United Nations General Assembly in 2015.

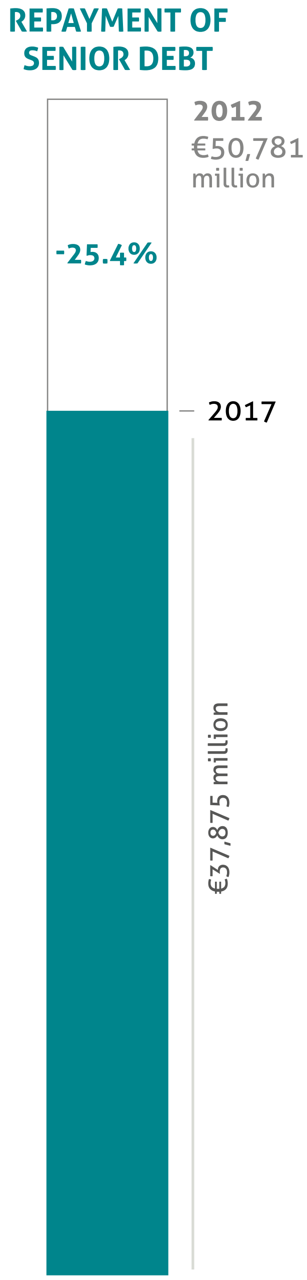
Thus, in 2017, and as a first step in assessing Sareb's contribution to the Overall Agenda, the company has identified the objectives and associated goals on which its activity has the greatest direct impact, notwithstanding any other indirect impact.

Sareb	Goals
8 DECENT WORK AND ECONOMIC GROWTH	8.2. To achieve higher economic productivity levels through diversification, technological upgrading and innovation, amongst other things, focussing on the sectors with high added value and which are labour-intensive. 8.3. To promote policies aimed at development supporting the production activities, the creation of decent jobs, enterprise, creativity and innovation, and to boost the formalisation and growth of microenterprises and small and medium businesses, by also facilitating access to financial services. 8.10. To strengthen the capacity of domestic financing institutions for promoting and widening access to the banking, financial and insurance services for everyone.
11 SUSTAINABLE CITIES AND COMMUNITIES	11.1. From now until 2030, to ensure that everyone has access to adequate, safe and affordable housing and basic services and to improve the marginalised neighbourhoods.
17 PARTNERSHIPS FOR THE GOALS	17.13. To increase global macroeconomic stability including through policy coordination and coherence. [Systematic issues: Institutional and policy coherence] 17.17. To foster and promote the creation of effective alliances in the public and public-private spheres and civil society, making the most of experience and the strategies for obtaining resources from those alliances. [Alliances between multiple stakeholders]
16 PEACE, JUSTICE AND STRONG INSTITUTIONS	16.6. To create efficient, transparent institutions at all levels that can be held accountable.

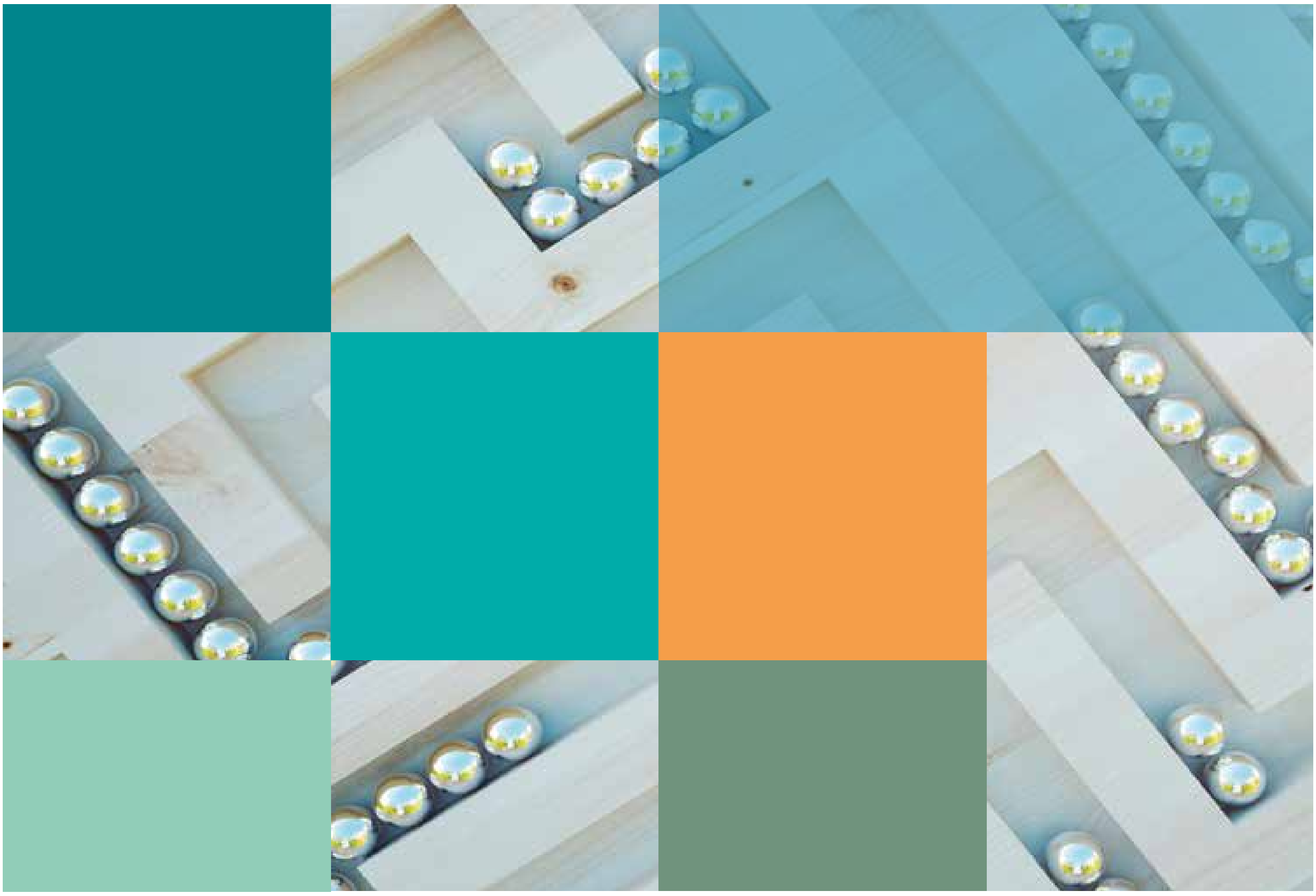
05 BUSINESS MODEL




DIVESTMENT MODEL
LOAN MANAGEMENT
PROPERTY MANAGEMENT
• Rentals
• New developments
TRANSFORMATION
REPAYMENT AND SALE OF LOANS
SALE OF PROPERTIES


REPAYMENT OF SENIOR DEBT
2012
€50,781 million
-25.4%
2017
€37,875 million

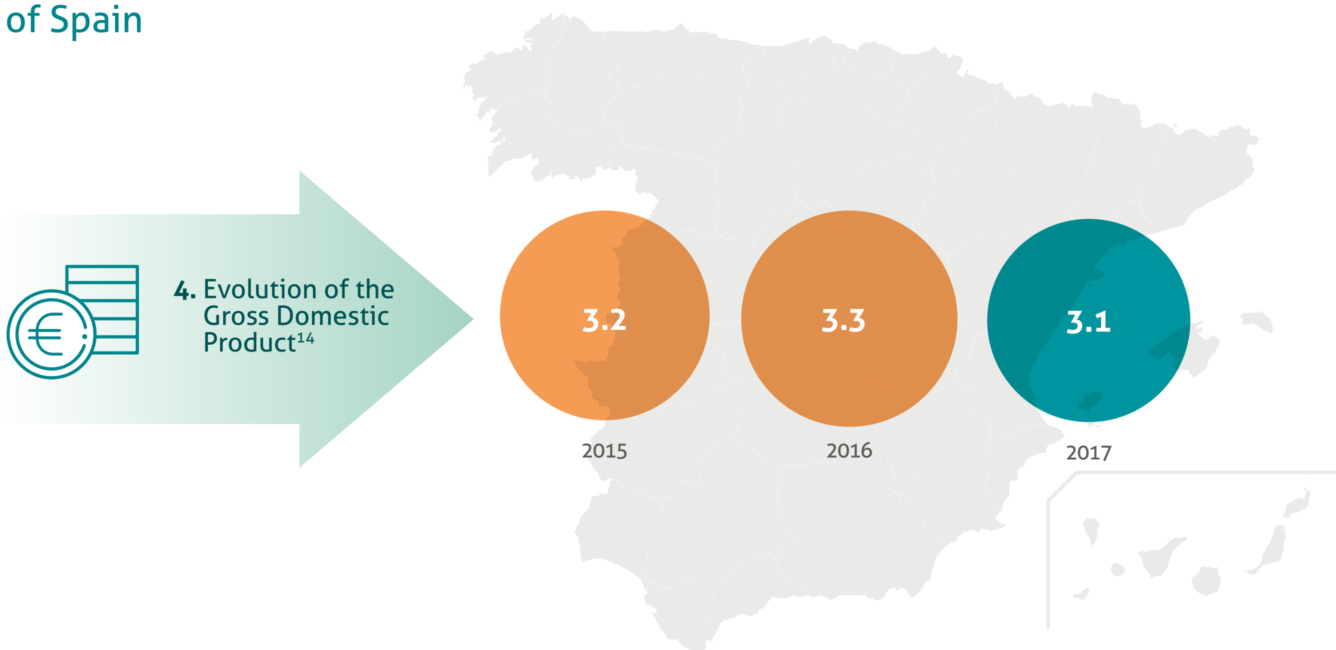
06 THE SAREB ENVIRONMENT



Evolution of the economic context

2017 was marked by a general recovery of the residential property market, with more than 530,000 homes sold throughout the whole of Spain

In 2017, the Spanish economy has shown an upward trend, with the GDP growing by 3.1%, largely thanks to a greater contribution of consumption as a result of increased consumer confidence in job creation and access to financing.



The residential property market

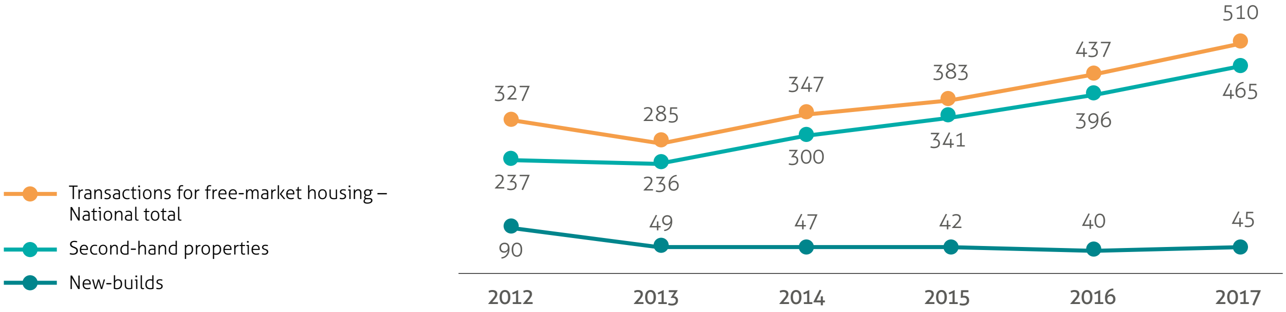
Homes

The residential market has recovered strongly over the past years, especially since 2016, reaching a volume of transactions in 2017 close to that of 2008, with a total of 532,367 properties sold, 16.3% more compared to the previous year.

In this respect, the sale of new-builds has seen positive growth, although the higher sales volume is mainly due to resales.

[14] Source: Bank of Spain

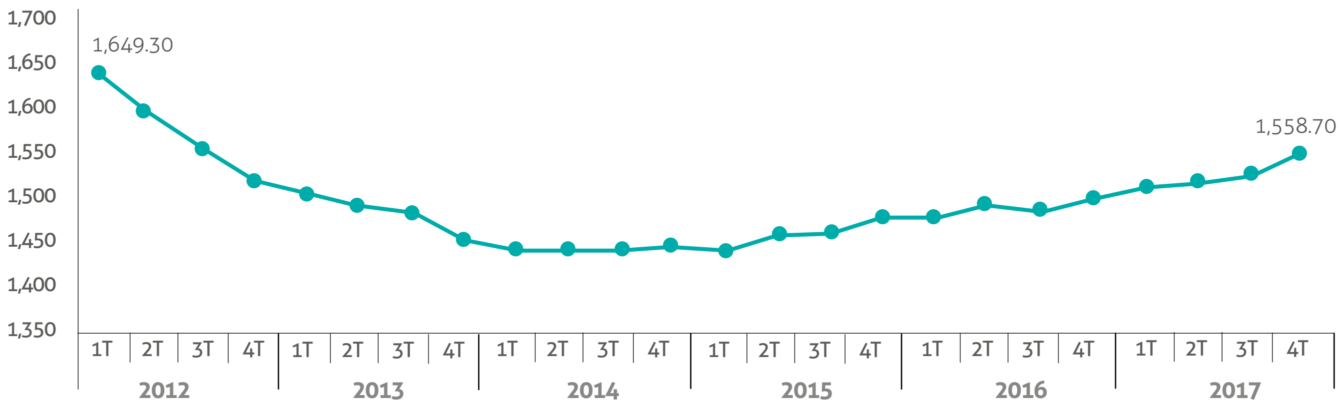
5. Transactions for free-market housing – National total of new properties and resales (thousands of units)[15]



Per autonomous region, Andalusia, Catalonia, Region of Valencia and Region of Madrid continue to be those registering the highest number of transactions, where 64.3% of properties sold in the year were concentrated. These four autonomous regions together have seen an average growth in sales of 16.62% compared to 2016.

Housing prices have remained relatively stable in the recent years of recovery, with an upward quarterly evolution since the last quarter of 2016 and with a 2.4% increase in this last financial period.

6. Free-market housing (appraised value (€/m²))[15]

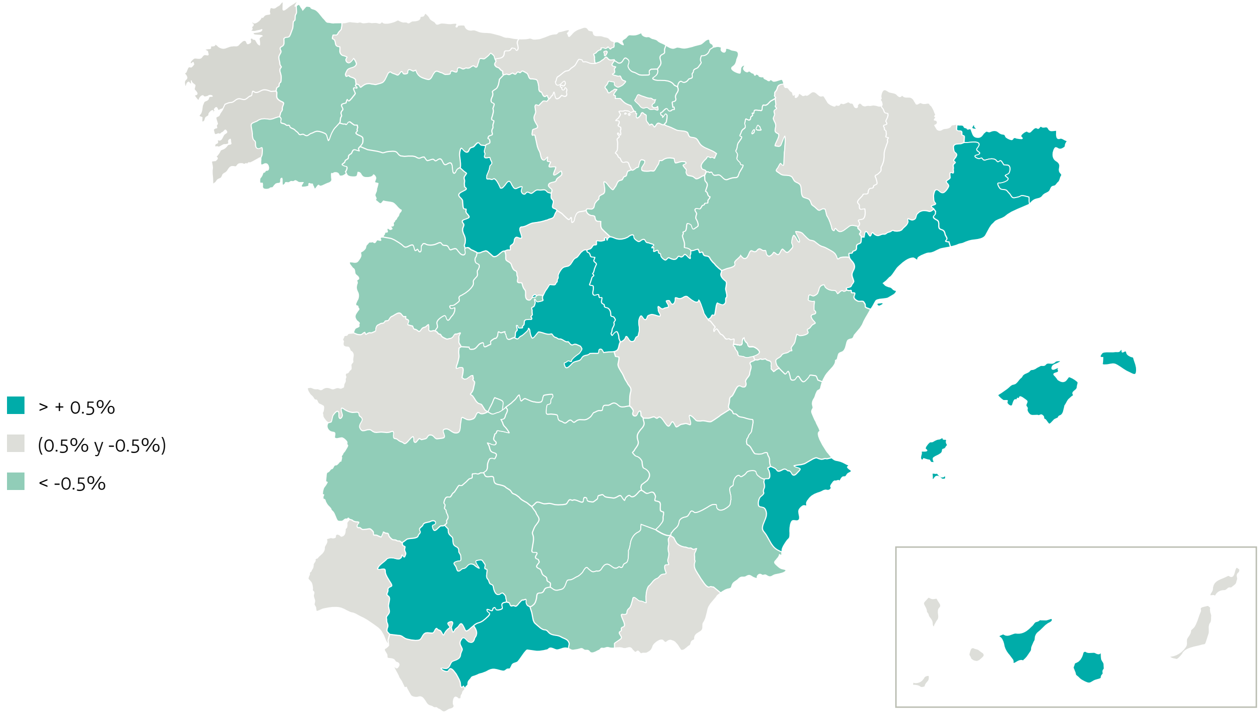


Catalonia and Madrid are the autonomous regions where the highest price increases were seen, compared to the national average of 5%.

However, the evolution in prices is uneven in the different Spanish provinces, as can be seen on the following map.

[15] Source: Ministry of Public Works

7. Evolution of the average appraised value of free-market housing between 2016 and 2017[16]

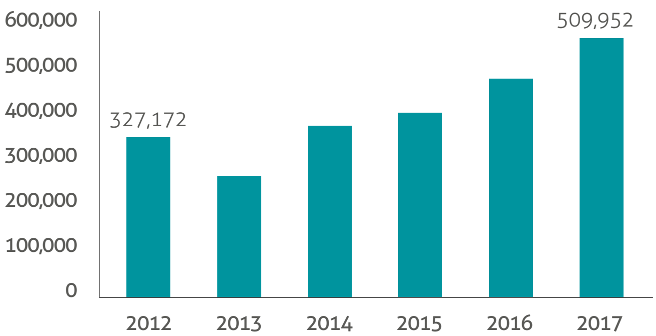


Land

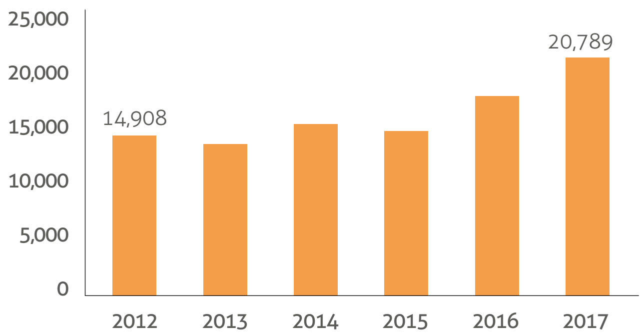
In terms of sales and evolution of prices, the market for land has behaved similarly to that for residential property, with a positive evolution in the number of transactions, although the latter seems to be at a slower pace. With this, in 2017 land transactions went up to 20,789 units, 19.5% more than in 2016.

8. Transactions for homes and plots of land[16]

Total number of sales: free-market housing

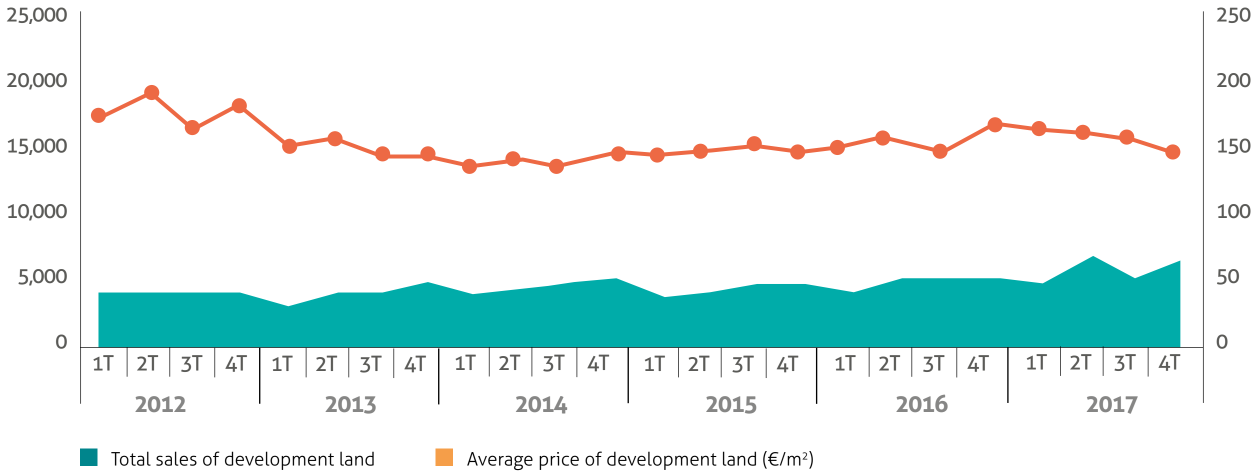


Total number of sales: development land



[16] Source: Ministry of Public Works

9. Development land (Price / Transactions)[17]



The non-residential property market[18]

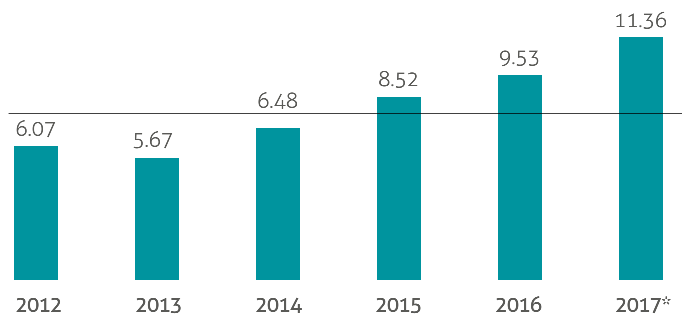
The non-residential property market is mainly composed of offices, industrial and logistics warehouses, shopping centres and hotels.

Generally speaking, the improved figures of the Spanish economy have been favourable to the results in all product categories, as can be seen in the following sub-sections per type of asset.

Offices

The office sector has been one of the more adversely affected by the real-estate crisis, although a slight recovery can be seen –in respect of the evolution of average monthly rent– since 2015.

10. Office Average rent (€/m²/month)[19]



[17] Source: Ministry of Public Works

[18] The source taken for the following analysis was the reports from the analysis departments of consultancy firms specialising in each product type.

[19] Source: Spanish Property Market Annual Statistics – RR de Acuña & Asociados

The cities showing the highest volume of transactions for investment in and rental of office space continue to be Madrid and Barcelona

The cities showing the highest volume of transactions for investment in and rental of office space continue to be Madrid and Barcelona.

In Barcelona, rents continue their upward trend, mainly in the prime areas, where there is less availability. Furthermore, an increase is seen in investment in co-working spaces.

Commercial premises and shopping centres

During the course of 2017 the retail sector has continued to maintain its appeal for investors[20], and both the number of transactions concluded and the volume of investment have continued to rise. Rents have performed positively mainly in the more important hubs of the major cities such as Madrid and Barcelona.

Improved financing terms, higher consumption and consumer confidence in the domestic economy have increased the attraction for investment projects in shopping centres. In the short and medium term, special attention should be paid to the evolution and boom in e-commerce, as it is having an increasingly greater impact on international trade.

Foreign capital continues to dominate the investment market, although domestic capital is gaining presence little by little, partly thanks to vehicles like the REITs.

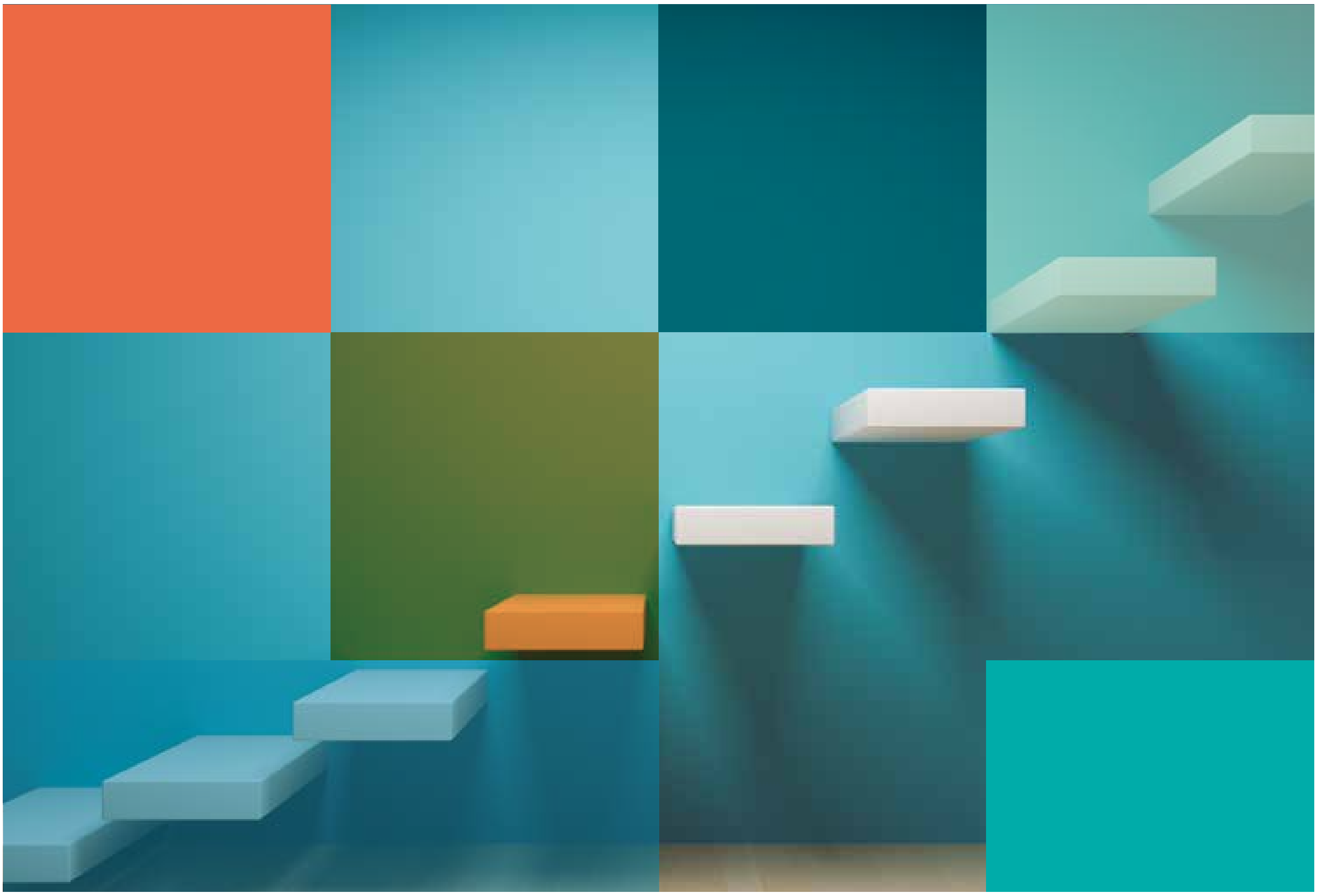
Industrial and logistics-related properties

In 2017 the industrial market took an upward turn, with significant levels of contracts completed in cities such as Madrid, where the area under contract has doubled compared to the previous year; this reduces the level of available assets and causes the market to move out to secondary areas.

In this respect, e-commerce continues to generate new needs in order to adapt to the strong demand and the scarcity of specific product, and gives rise to a new attraction for Spanish and foreign investors due to its growth potential.

[20] Specifically, investment funds, REITs, private investors and insurance companies.

07 BUSINESS PERFORMANCE



Business Plan: opportunities on the horizon

The review of the Business Plan is focussed on the need to maximise the value of the portfolio and speed up the divestment process

Under the mandate entrusted to Sareb, the company is required to review and update its Business Plan every year, considering not only the experience accumulated since it was set up, but also the present circumstances of the environment and the expected evolution of the property market, interest rates and regulation.

In 2018, the Board of Directors of Sareb has already approved the updating of the Plan for the company's remaining useful life, in line with the need to continue exploring new channels that will contribute to maximising the value of its portfolio and optimising the operating management model, with the ultimate objective of ensuring the full repayment of the debt issued with the guarantee of the Treasury.

Focus on creating value

The objective of the department of Development, Promotion and Investment (DPI) –created in the first six months of 2017–, is to provide an impetus to those activities that display the greatest opportunities for creation of value in the medium and long term. The Business Plan concentrates a higher volume of resources for promoting new developments –mainly residential– on land belonging to Sareb and for completing construction in progress; also new investments on land in order to further their level of development.

This line of work also generates new channels of collaboration and encourages the search for partnerships with developers in the field of real-estate promotion, which will contribute toward increasing Sareb's capacity.

Intensification of the transformation of the balance sheet

The transformation of the balance sheet consists of converting financial assets –which are less liquid– into real-estate assets, which are more easily divested.

In line with the updating mentioned above, the plan again stresses the need to speed up this transformation process. The objective is that in 2021 the entire Sareb portfolio of property assets will have a relative higher weight than the financial assets.

This is particularly relevant in cases where the borrower companies have lost part of their business or if it is not possible to establish lines of collaboration for collecting the outstanding debt. All of which taking into account that Sareb always gives priority to seeking solutions agreed upon with the debtors before

enforcing loan guarantees. It is important to recall that in spite of the fact that properties are more liquid when it comes to selling, they also have higher levels of associated maintenance costs.

Change in the operational management model

Sareb is currently immersed in the process of transforming its management model and in the search for alternatives that will contribute to speeding up divestment, in a context of the recovery of the sector.

However, this recovery has to also extend to the regions and towns of lesser population, where the company owns a large number of assets. The updating of the Business Plan includes formulas for boosting sales in these geographical areas with a strong concentration of assets, so that this counters the downward price pressure of other properties as a result of the acceleration of the competition and the appearance of new players in the market[21].

Alternative channels for divestment

The creation of Témpore Properties opens a new channel for Sareb in the orderly divestment of its property assets, thanks to the framework agreement foreseen with the REIT so that it can continue increasing its portfolio with residential products in the coming years.

At the same time, the new online channel for the sale of loans provides an opportunity for speeding up the divestment of the portfolio of non performing loans (NPL). This platform contributes to bringing transparency to the market for the sale of this type of assets in Europe, whose banking sector has accumulated unpaid loans amounting to over a billion euros.

[21] Property development groups are put forward as another of the new players in the market. This type of group appears as a result of the restructuring of companies affected by the crisis and the consolidation of new projects.

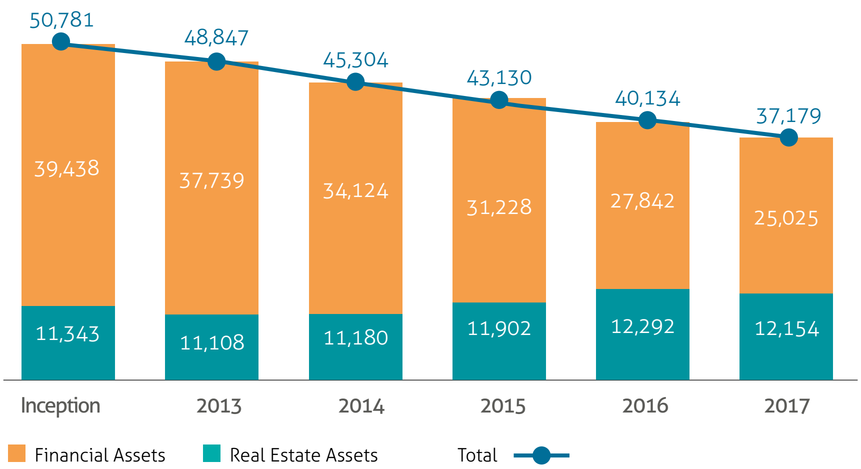
7.1

Divestment of the portfolio

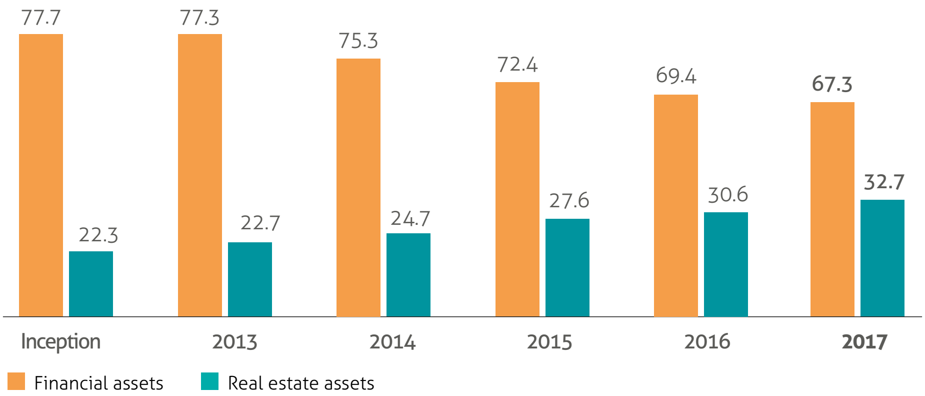
Sareb's asset portfolio has decreased by 26.8% since its inception.

At the close of 2017 Sareb's asset portfolio has gone down to €37,179 million –7.4% less than in December of 2016– as a result of the company's progress in its divestment process. Compared to the original starting portfolio of €50,781 million, the reduction represents 26.8%.

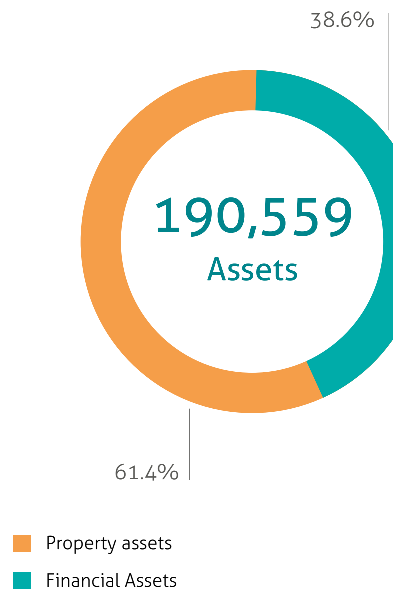
11. Evolution of the portfolio (€m)



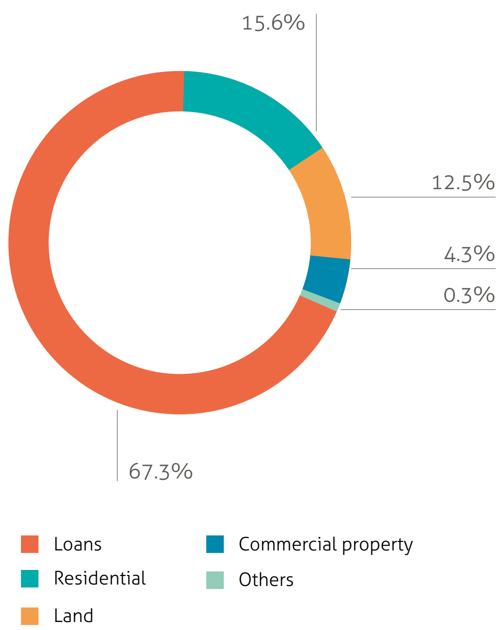
12. Composition of the portfolio (% of €m)



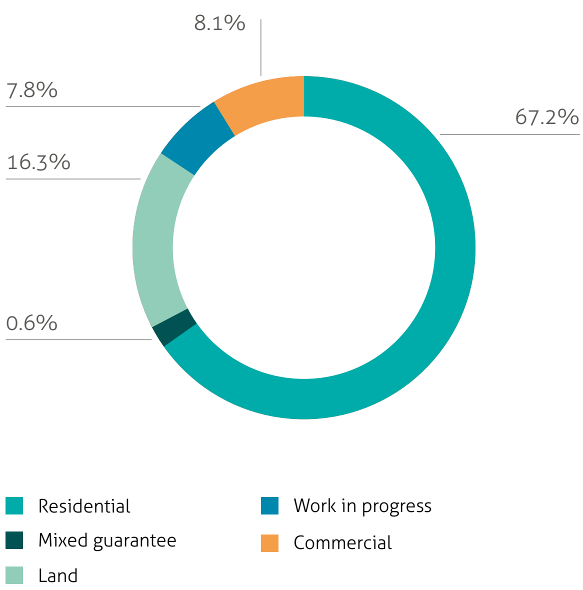
13. Portfolio (no. of assets)



14. Breakdown per type of asset (% of €m)

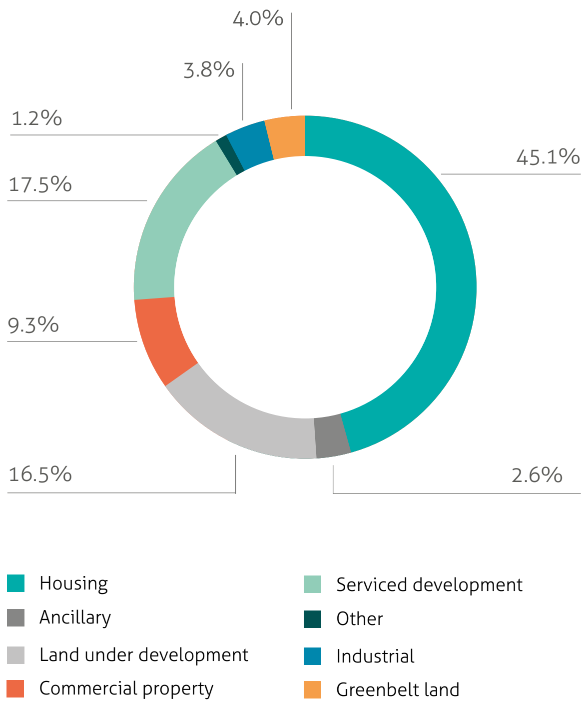


15. Breakdown of financial assets per type of guarantee (% of €m (NBV*))



* Net Book Value

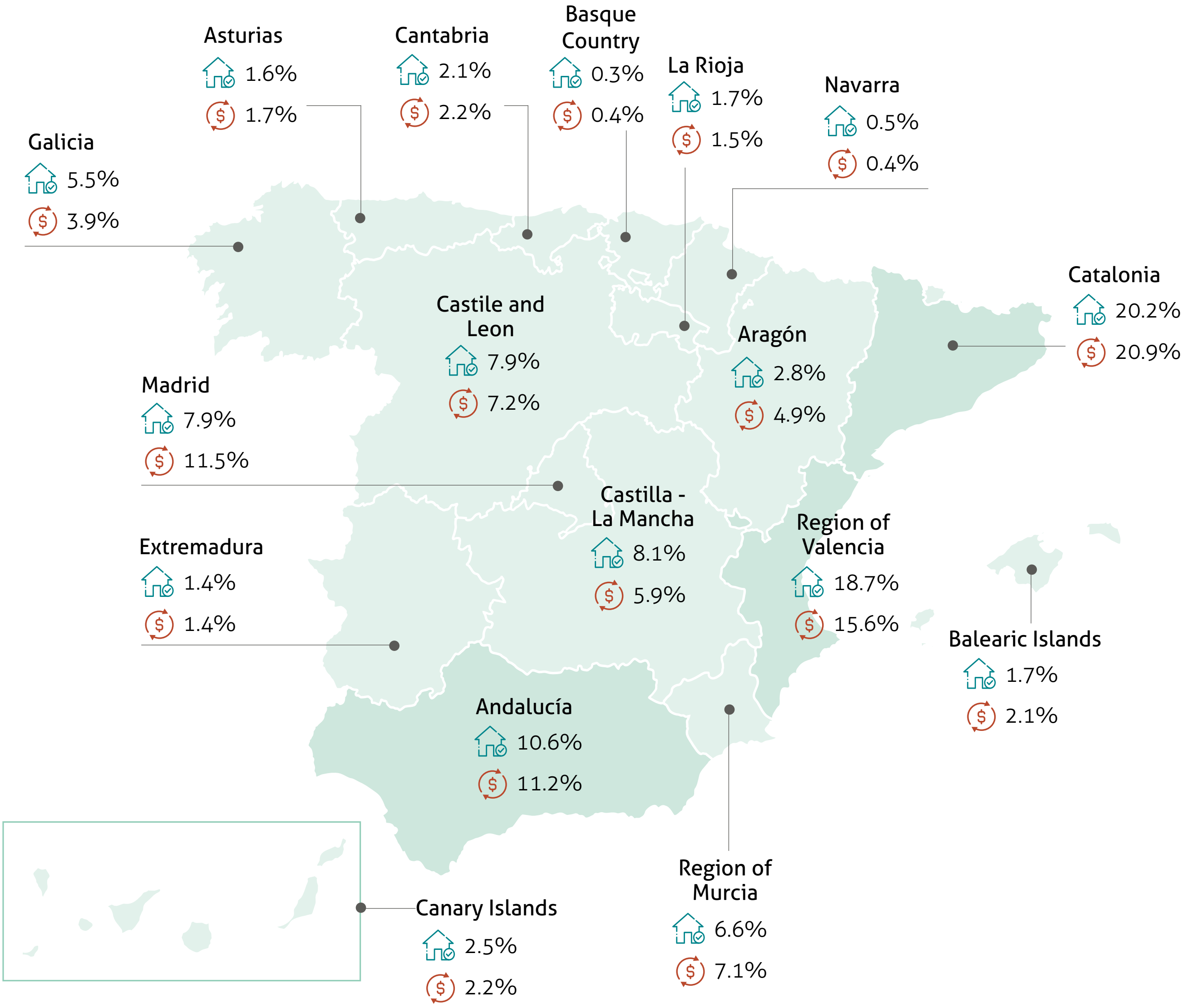
16. Breakdown of property assets per type (% of €m (NBV))



17. Geographical breakdown of the portfolio of property assets (% of units and of NBV[22])

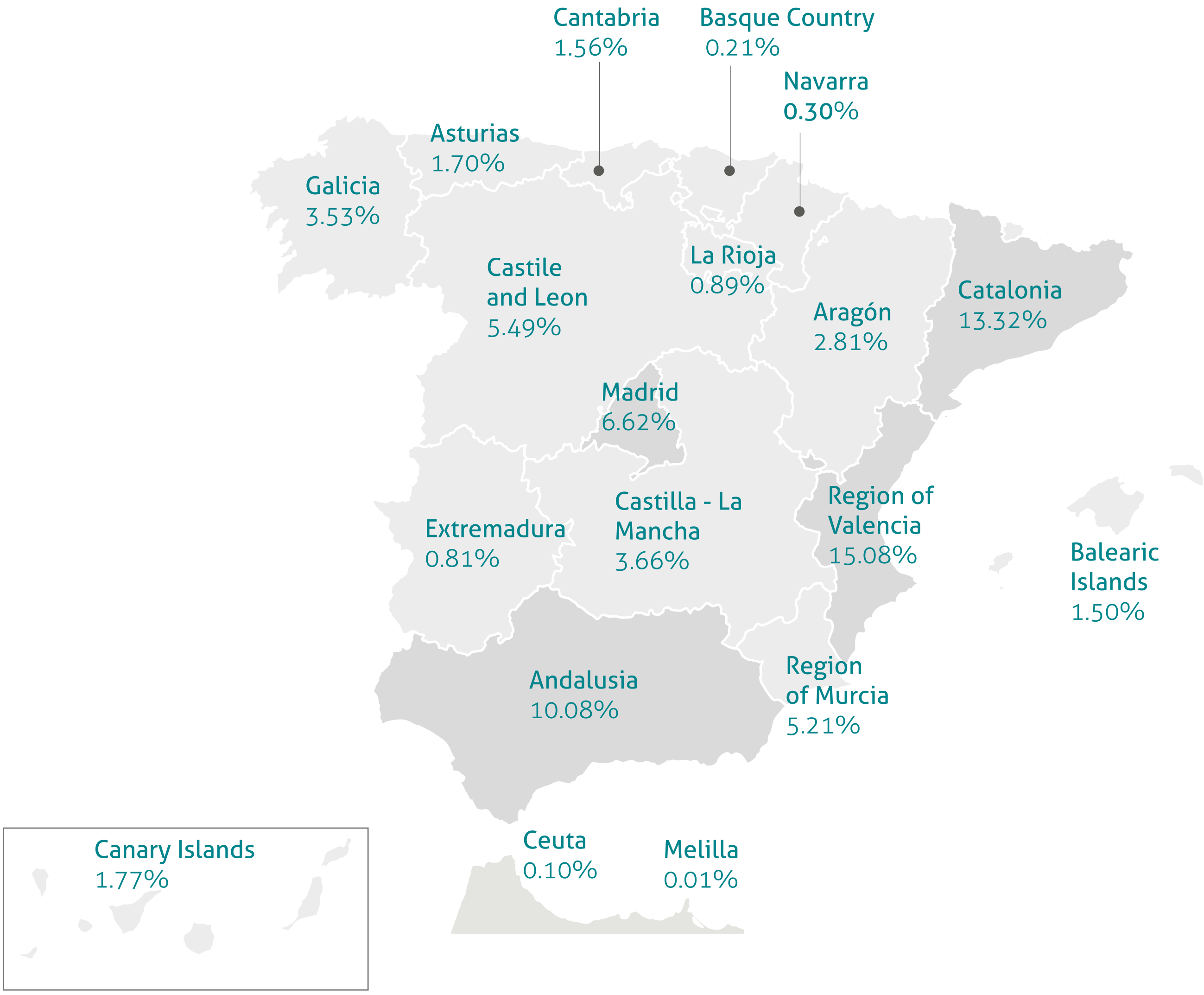
% of units

% of NBV



[22] Net Book Value

18. Geographical breakdown of the portfolio of first borrowers (% of €m based on debt)[23]



[23] El 25.4% de la deuda no está asignada a una comunidad autónoma concreta

7.2 Management and sale of loans

Loans account for the main part of Sareb assets

2017 began with a portfolio of 79,640 loans with a nominal value of €27,842 million of total debt, representing 69.3% of the assets making up the portfolio at that time.

At December 31, 2017, the weight of this type of asset on the portfolio as a whole has been reduced to 67.3%, accounting for a total of €25,025 million of nominal amount of debt. This is 10% less compared to the beginning of the year, as a result of the processes of sale and settlement of loans and the acceleration of the process of converting financial assets into properties.

Revenue from the management and sale of loans was €2,622.8 million in 2017, 7.7% less than in 2016, as a consequence of the reduction in the perimeter of loans.

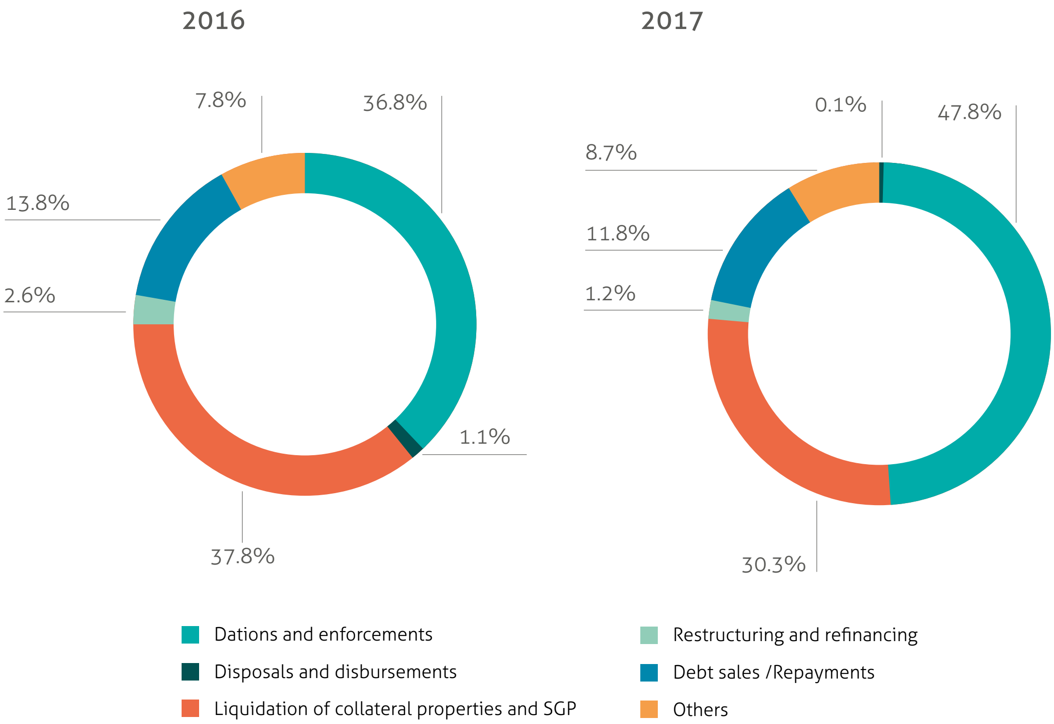
Active management of the loans portfolio

In its first five years of life, Sareb has managed a total of 51,361 proposals

From the perspective of financial asset management, Sareb bases its debt recovery strategy on ongoing collaboration and the search for solutions in conjunction with the debtors, which includes the sale of collaterals, debt restructuring operations and marketing of loans, in addition to loan repayments and dations in payment.

In 2017, 13,124 proposals were handled –24.9% more than in 2016–, of which 7,580 related to different borrowers.

19. Breakdown of proposals managed per type (%)



The increased volume of proposals managed corresponds to dations and foreclosures, with 6,276 cases processed during the year, 47.8% of the total.

Foreclosures enable Sareb to acquire ownership of the assets whenever it is not possible to reach an agreement with the debtors regarding their sale, while dations do require their collaboration. The fact of beginning these processes does not restrict the search for other alternatives for recovering the investment.

Next in importance is the liquidation of collateral (property-based guarantees) on the debtor balance sheets and Sales Growth Plans (SGP), which represents 30.3% of the total with 3,979 proposals managed in 2017.

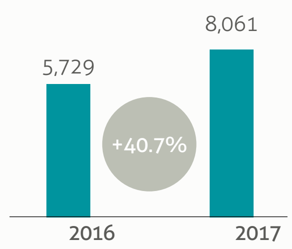
Sales Growth Plans and liquidation of collateral (property-based guarantees)

These operations allow Sareb to recover part of the debt without being involved in the costs and deadlines involved in mortgage foreclosure procedures.

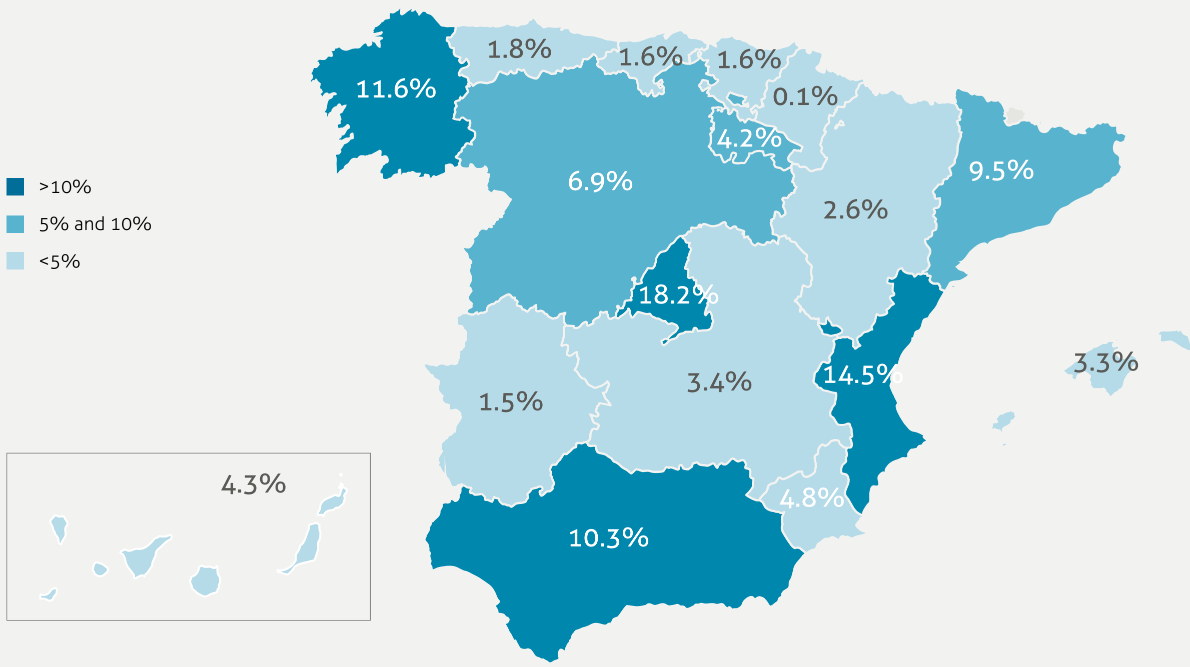
Following an agreement with the developers, the SGP facilitate the sale of properties –entire residential promotions or single buildings– which appear as collateral for the loans directly on the debtor balance sheets, thus enabling them to reduce their debt with Sareb.

In 2017, 8,061 properties were sold under this method, 40.7% more compared to the previous year. This increase is largely motivated by the increase in sales of residential properties, which went up by 48% compared to 2016.

20. Sales SGP and liquidation of collateral (no. of properties sold)



21. Geographical breakdown of the sales under Sales Growth Plans and liquidation of security properties per asset type (% of units)



Per autonomous region, the greatest volume of tertiary sales corresponded to the Region of Madrid, followed by the Region of Valencia and Galicia, locations in which the highest number of properties as collateral for loans held by Sareb are concentrated.

For its part, the proposals related to the sale or repayment of loans represent 11.8% of the total, with 1,547 cases processed.

On other occasions, the negotiations with borrowers lead to restructuring operations which is thought could be more valuable to Sareb than other collection strategies. This type of procedure, normally associated to major companies, is more complex and involves loan collateral that can be of interest to Sareb. In 2017, 157 proposals were approved which related to restructuring and refinancing.

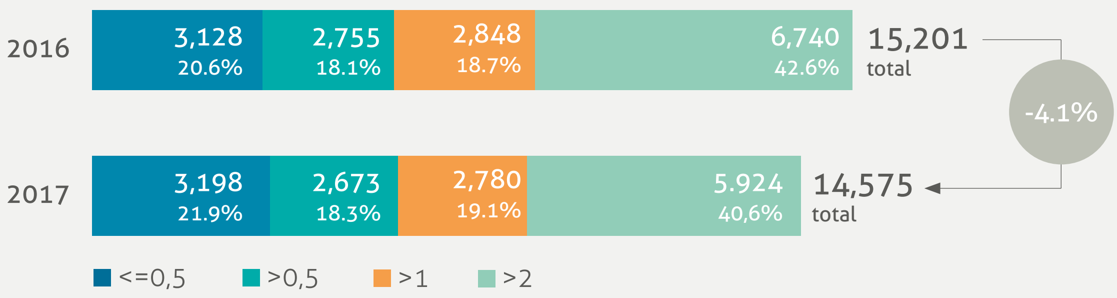
Type of borrower

The Sareb financial asset portfolio is made up by 14,575 borrowers, with a total debt of €70,385 million[24].

The high disparity between the nominal volume of debt and the level of concentration of the risk amongst the borrowers of Sareb means that its management becomes complex and requires greater systematisation of the processes.

At December 31, 2017, the distribution of borrowers per volume of debt follows the lines of the previous year. There is a slight increase –compared to 2016– in the number of debtors with exposure of less than one million euros, representing 40.2% of the borrowers; while the number of debtors with exposure in excess of two million euros went down by two percentage points, to 40.6%.

22. Number of borrowers per ranking of debt (€m)



[24] The total nominal volume of debt includes the associated interest and expenses, amongst other items.

Dynamism and efficiency in management

Sareb continues implementing the methods for segmentation of the loans portfolio started in 2016, which contribute to making the management of this type of assets more dynamic. This new model enables the company to speed up the process of converting the financial assets unpaid by the parties involved, defining a divestment strategy that is adapted to the characteristics of each asset.

Thorough follow-up of the procedural milestones relating to operations involved in legal action to facilitate the preparation of perimeters for action and to improve the effectiveness of Sareb's commercial activities.

Sareb has been a pioneer in innovation and in wagering on a more dynamic and transparent loans market with the launching of an online channel for the marketing of this type of asset through the web.

Special attention to the identification of operations in which, given the characteristics of the debtor and the associated loan, it is advised to hand over the assets as collateral.

The management of asset sales does not exclude the channel of negotiating with the debtor or the insolvency administrator.

In the scope of the ongoing work of coordinating with the servicers, during the year initiatives have been promoted making it possible to also revitalise management and for one to be better informed about their own portfolios:

- Liquidation of single items of collateral by identifying loans which have the properties that are the most attractive for selling, according to location and type; this makes it possible to optimise the return on each.
- Definition of plans for reviewing loans guaranteed by property developments for boosting the SGP.

- Initiatives for debt recovery through identification of the borrowers –or guarantors of the operations– with greater capacity for payment.
- Momentum given to the sale of loans in which there is an interest on the part of investors for acquiring Sareb positions when negotiations and agreements for repayment with the creditors are not successful.
- Identification of assets with financial guarantees for release or negotiation with borrowers.
- Commercial collection activities associated with filing legal action.

In 2017, it is also worth mentioning the work carried out jointly with the servicers to speed up the presentation and analysis of proposals and the formalisation of operations.

The online loan sales channel

Aimed at investors and professionals, this specialist channel, initially at its pilot test stage, boosts the divestment of the loans portfolio by providing greater visibility of these assets on the Sareb corporate website.

Launched in July 2017, the objective of this channel is to bring more transparency to the sales processes for this type of asset, while at the same time contributing towards greater market maturity, both at domestic and at European level.

At year-end, with this new sales initiative, Sareb had managed to sell loans for a nominal value of €186 million, €35 million through its own channel and €151 million through the servicers, who also have specific platforms for showing this portfolio.

These processes only relate to individual offers for loans.

More information on the Sareb loan sales channel
https://www.sareb.es/en_US/loans-sales-channel

Institutional sales

Sareb targets institutional buyers both through the wholesale channel –by the sale of portfolios– and retail, in which individual assets are marketed

Taken as a whole, the operations closed in 2017 with institutional investors amounted to €642 million, 35.4% more than in 2016. This increase is largely due to a greater number of smaller transactions carried out through the loan sales channels of Sareb and of the servicers.

As already mentioned, the retail channel revolves around the online loan sales channels where investors can locate and bid for any assets of interest to them, along with any other interested bidders. At the same time, activity in the wholesale channel is based on creating portfolios of loan sales which are awarded after a bidding procedure to the investor submitting the highest bid. The portfolios that were sold in 2017 are 'Inés', consisting of Non Performing Loans (NPL) for a nominal value of €372 million, awarded to Deutsche Bank, and 'Tambo', consisting of debt with a nominal value of €163 million and awarded to the Oaktree venture capital fund.

With regard to operations of lesser volume carried out in the retail channel through the platforms referred to above, special mention is made of the 'Amanda Project', consisting of the divestment of loans for a nominal value of €91.9 million and the 'Olive Project', involving the sale of debt for a nominal value of €84.2 million, in addition to the €35 million of revenue obtained through the Sareb loan sales channel in 2017.

During the year, Sareb has continued working toward having a more thorough understanding of its institutional investors in order to be able to offer them a response adapted to their requirements and to broaden its base to new investors with lower capacity.

With this, a total of 379 meetings were held this year with investors and analysts, plus 9 roadshows and 25 events.

7.3 Management and of properties

As the pace of converting financial assets into properties accelerates, so will the proportion of revenue relating to Sareb's real-estate activity increase

At year-end of 2017 Sareb's portfolio of property assets continues to be in line with the position at the end of 2016. This results from the fact that the sale of properties is countered with new properties entering through dations, foreclosures and new constructions.

From the perspective of revenue, the management and sale of properties accounts for 31% of total income obtained by Sareb in the year. The total sales figure rose to €1,191.2 million, 13.1% higher than the income for the previous year.

Marketing the properties

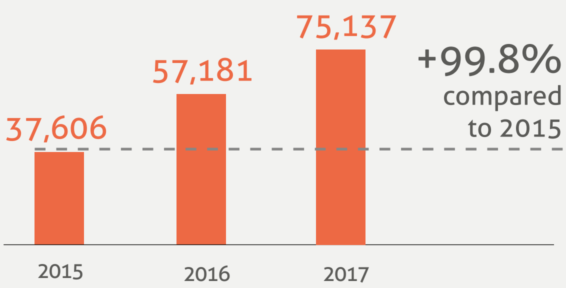
Assets being marketed increased by 99.8% compared to 2015.

In order to increase the number of properties marketed, Sareb keeps close control of its stock-list. In 2017, apart from adapting its organisational structure, the company has implemented new operational procedures for monitoring the publication of properties on a monthly basis, establishing marketing priorities in line with Sareb's commercial needs, as a supplement to other initiatives intended for improving the publication processes.

In 2017 there was a total of 75,137 properties being marketed, which is 99.8% more than in 2015, and 31.4% higher than the figure at the close of 2016.

The volume of properties marketed currently represents 64.2% of the total properties making up the Sareb portfolio.

23. Evolution of assets placed on the market (in figures)



Transformation of loans into properties

During the course of 2017 the value of the assets that have entered Sareb's stock-list as a result of the process of converting loans stood at €1,007 million. The entry of new properties into Sareb's portfolio of property assets also contributes to increasing the number of properties marketed.

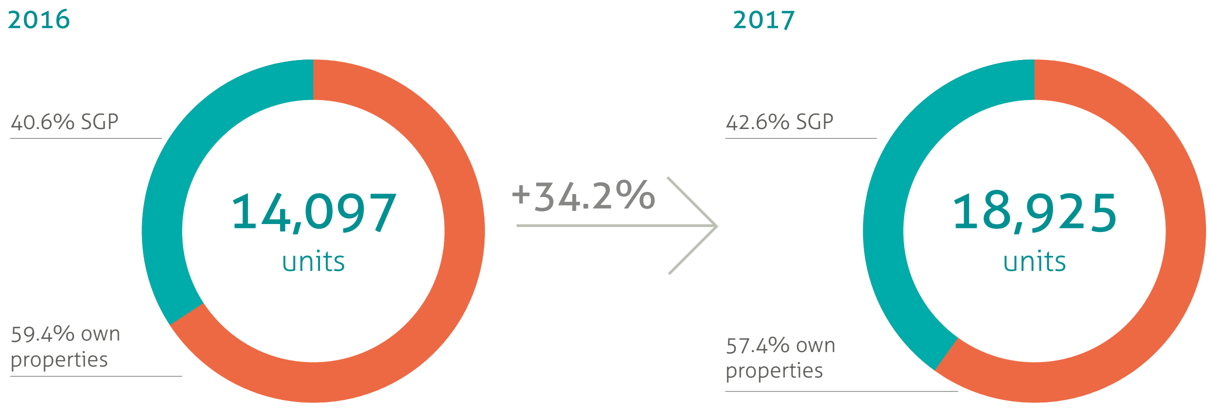
Property sales

In 2017 Sareb sold a record of 18,925 properties, 34.2% more than in 2016

In 2017 property sales beat all records and were 34.2% higher than the number of units sold in 2016, in line with the upward turn in the recovery of the housing market over recent years. In total, 18,925 units have been sold, of which 10,864 correspond to own properties, almost 30% more than in 2016. The rest, 8,061 properties, were units associated to Sareb loans sold from the developers' books through the liquidation of collateral and Sales Growth Plans (SGP)25[25].

Per autonomous region, Andalusia, Catalonia, Region of Valencia and Region of Madrid are those where the largest part of the year's sales activity was concentrated.

24. Property sales (% of units)

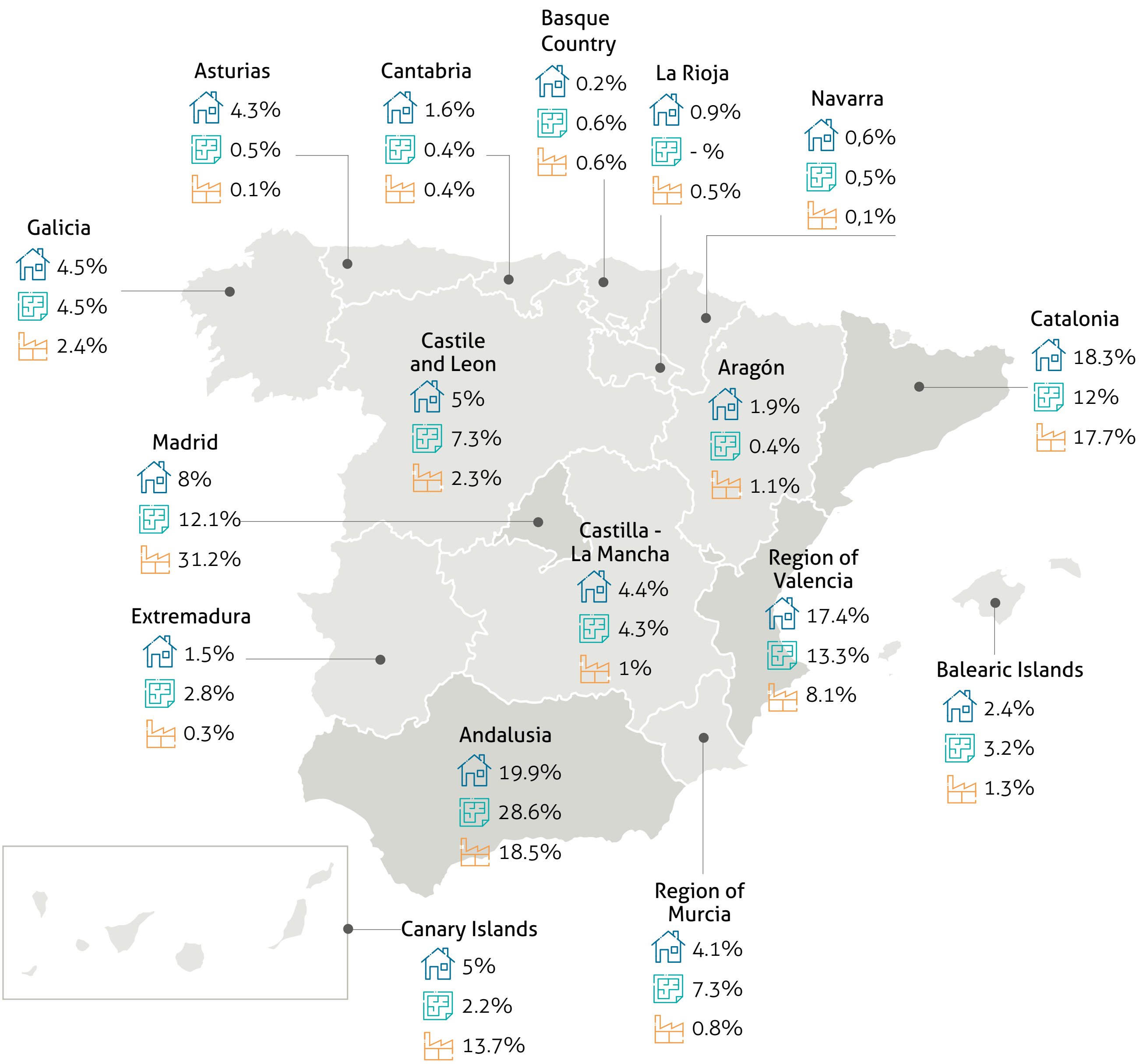


25. Sale of own real estate assets per type (% of units)

[25] Further information on the Sales Growth Plans (SGP) on page 43.

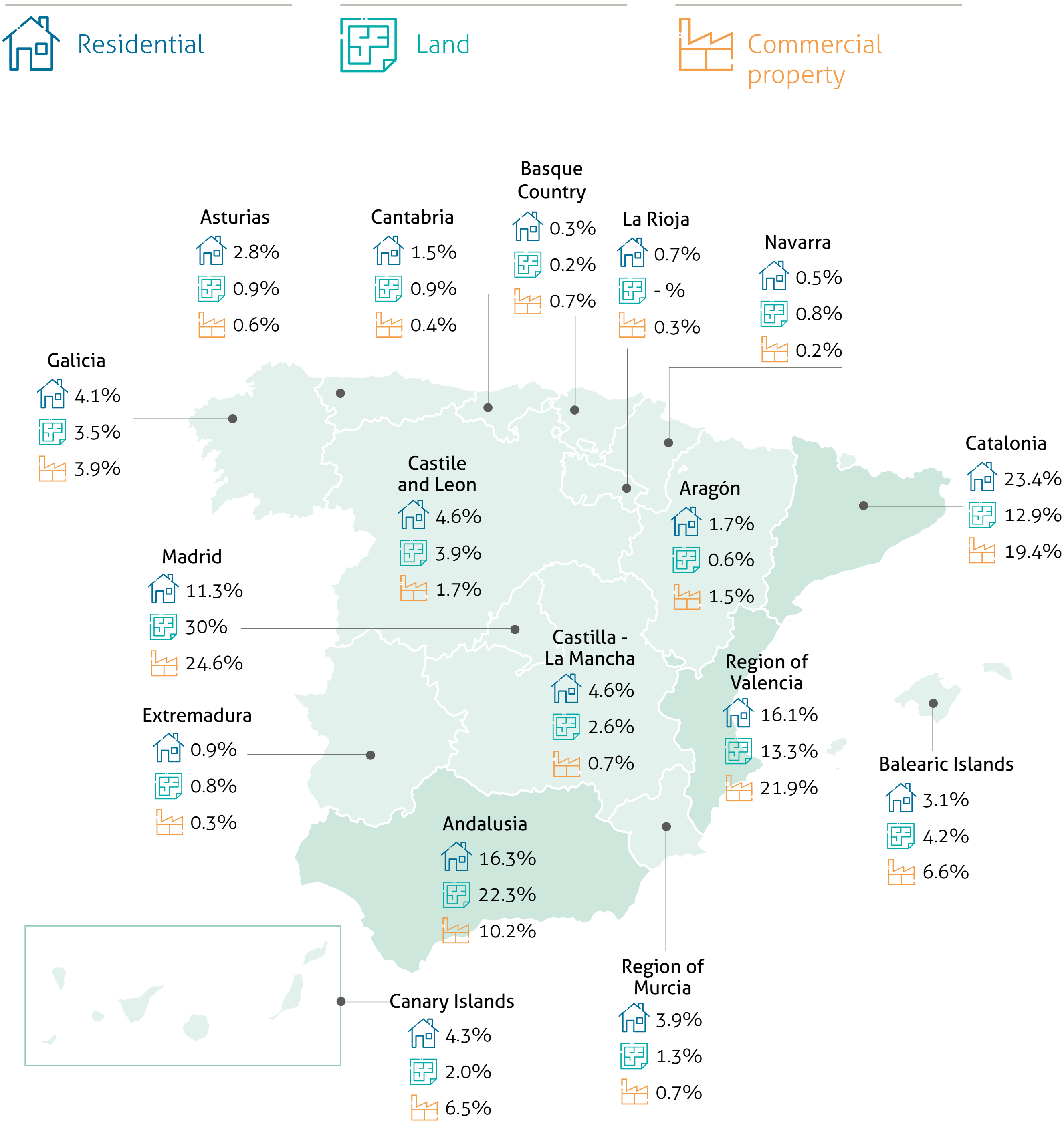
26. Geographical breakdown of sales of own properties (% of units sold)[26]

Residential | Land | Commercial property

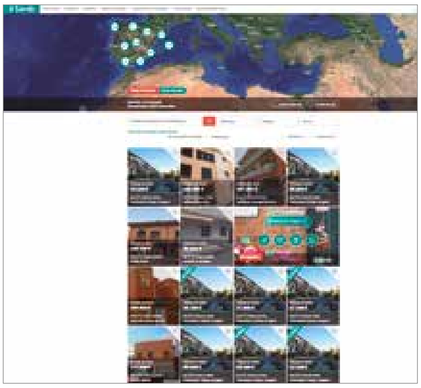


[26] Includes work in progress.

27. Geographical breakdown of sales of own properties (% of sales volume)[27]



[27] Includes works in progress.



Residential

In 2017 a total of 16,385 residential properties were sold[28], 35.8% more than in 2016. This growth can be explained by the recovery of the economy and residential real-estate activity, together with intense commercial actions taken by the servicers, who have worked on their organisational processes and structures. The thorough monitoring performed by Sareb has also had a positive effect.

Sales of own residential properties went up by 27.5% compared to the previous year, with a total of 9,066 units, representing 83.4% of the total of own properties sold in the year. In terms of declared price, sales of own residential properties stood at €603.4 million, i.e. 11% more than in 2016.

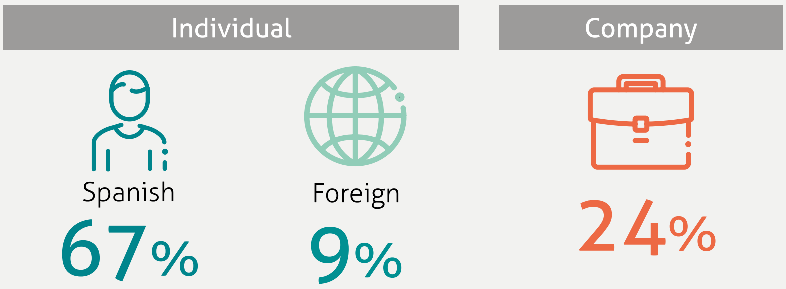
[28] Homes, garages and annexes.

In addition to the sales of own residential properties are those made from the developers' books, the Sales Growth Plans (SGP), which accounted for 7,319 units.

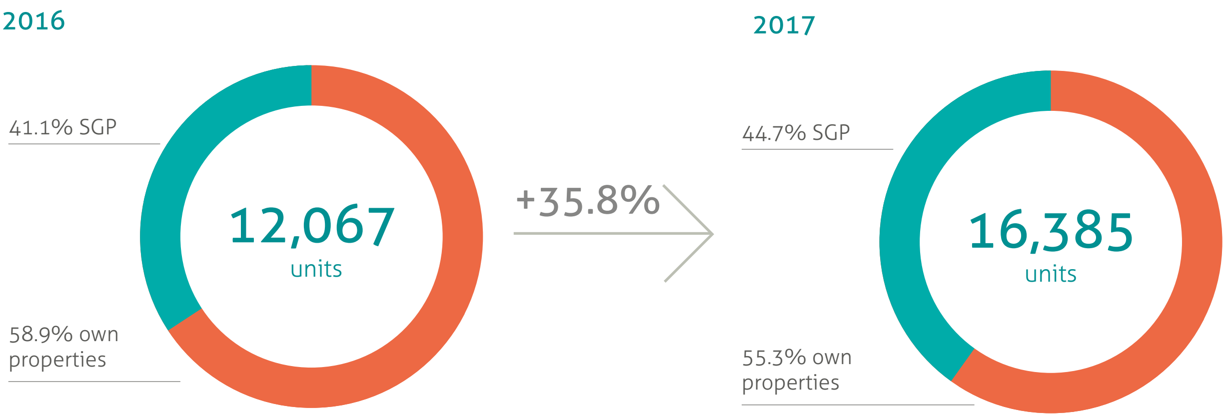
The average price of own properties sold by Sareb was around 109,157 euros in 2017, which is 10% lower than that for 2016.

Per autonomous region, the highest volume of sales of own properties is concentrated in Andalusia, Catalonia and the Region of Valencia, which, in terms of declared amount, accounts for more than half of the revenue obtained from the sale of own residential properties in 2017.

28. Profile of the buyer of an own residential property



29. Sales of residential properties (% of units)



Land

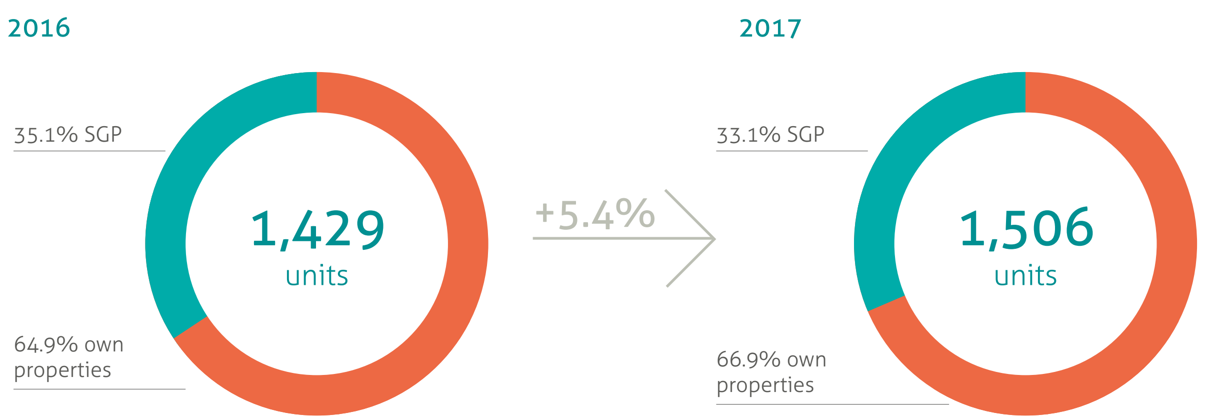
A total of 1,506 plots of land were sold in 2017, of which 1,007 related to its own units of land, 8.6% more compared to the previous year. In terms of declared price, sales of its own land reached €389.7 million this year, 6.4% more than in 2016.

The other plots of land sold, 499 units, correspond to collateral for loans within the framework of the SGP, which is in line with the 502 units sold in 2016.

Per autonomous region, Madrid accounts for 30% of the total sales concluded during the year, followed by Andalusia, Catalonia and Region of Valencia, which is consistent with the overall activity of the market in this sector, and where 80% of Sareb's sales volume in this category is concentrated.

The slower growth in land sales is related to the company's strategic decision to reserve certain plots of lands for development, which brings higher added value to those assets and makes the divestment process more efficient.

30. Land sales (% of units)



Commercial property

The recovery of the economy and the reactivation of the national production sectors, in particular with regard to the services sector, have contributed in 2017 to promoting the sale of commercial property assets and to substantially improving the results obtained in respect of the previous year.

In 2017 Sareb sold a total of 1,034 commercial properties, between its own assets and those appearing as collateral for loans. This category includes offices, commercial premises, industrial warehouses and hotels.

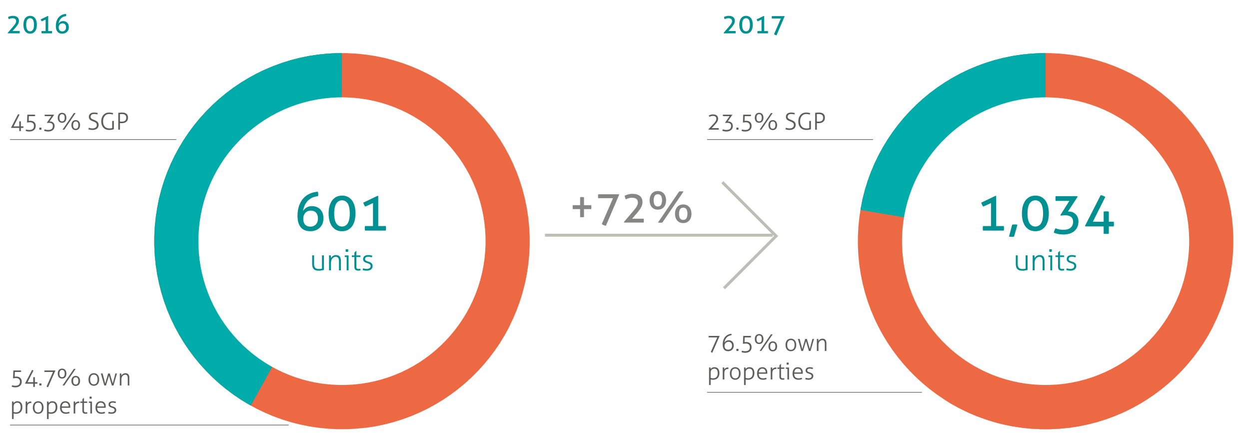
This represents a 72% growth on 2016, mainly due to the increase in sales of its own commercial property assets which, with 791 units sold, far exceeds the 329 properties sold in the previous year. However, there is a slight decrease of 10.7% in the sale of commercial properties from the developers' books compared to the previous year, with a total of 243 units sold.

In terms of declared price, sales of its own commercial property assets reached €129.2 million this year, 29.2% more than in 2016.

The good progress of the economy has particularly been noted in an improvement in the sale of single properties. Particular mention is made of the importance of the hotel and tourism sector which represents 27% of the sales of own commercial property assets, with a 10% share of the commercial property portfolio. However, the sale of commercial premises continues to represent a lower percentage, 24% of the sales of own commercial property assets, with a 45% share of the portfolio for this category.

In respect of the sale of commercial property assets per autonomous region, Madrid accounts for 25% of the total volume of revenue, along with the Region of Valencia and Catalonia, where 23% and 17%, respectively, are concentrated.

31. Sales of commercial properties (% of units)



Commercial activity

Sareb has boosted its commercial activity with the launch of its first advertising campaign on the radio and television

As part of its strategy for speeding up the pace of divestment, this year Sareb has intensified its commercial activity with the launch of 12 new campaigns through which more visibility has been given to a total of 22,808 properties amounting to €3,109 million, mainly residential but also commercial properties. In addition to sales campaigns, other initiatives have also been launched for rentals, both of commercial and residential properties.

As a result of Sareb's communication and marketing strategy, sales of properties associated to the marketing campaigns increased in 2017 to €335 million, 50.9% higher than the 2016 figure of €222 million.

The success of these sales campaigns lies in the design of actions taken by its own means and in coordination with the servicers, aimed at a very specific target public through the corporate website and the specific microsites designed for each campaign. All of which in conjunction with broad diffusion on the social networks.

A new feature this year was the first campaign on radio and television, which had a positive impact on sales to the tune of €51 million.

Amongst the more important campaigns, in the first half of the year Sareb launched two online campaigns for promoting the rental of residential and commercial properties, which was well accepted by the public. In total, 548 assets have been marketed, guaranteeing annual rent amounting to €2.7 million.

Sareb was also present as an exhibitor at the International Real Estate Fair, held in Madrid in May. Its participation in this type of event positions the company as a player of reference in the real-estate sector and contributes to giving greater visibility to its portfolio of products which are marketed by the servicers.

Breakdown of the marketing campaigns carried out

BARGAINS 2016 (January)*

- 2,211 residential properties
- Sales: €9 m

RESIDENTIAL RENTAL CAMPAIGN
(December '16 - February '17)

- 1,020 residential properties
- Rentals: 539 rentals/yearly income €2.5m

COMM. PROPERTY RENTAL CAMPAIGN
(February- June)

- 419 assets
- Rentals: 9 rentals/yearly income €0.2m

"TU CASA A TODA COSTA (Your home by the sea)"
(April - June)
Extended until 31 Dec.

- 3,100 residential properties
- Sales: €69m

"CASAS POR MENOS DE 60.000 €
(Homes for less than €60,000)"
(April - December)

- 1,561 residential properties
- Sales: €8m

"CASAS DE ESTRENO (New-build homes)"
(May - July)
Extended until 15 Dec.

- 4,046 New-Build Properties
- Sales: €65m

"VENTA TERCIARIO (Commercial property sales)"
(July - December)

- Approx. 209 assets
- Sales: €12m

"GRANDES CIUDADES (Major cities)"
(July - October) Extended until 31 January 2018

- Approx. 2,378 residential prop. approx.
- Sales: €25.3m

"REBAJAS (Bargains)" (September - December)
Extended until 31 January 2018

- 2,345 residential properties
- Sales: €21.6m

"CASAS DE 1-2 DORMITORIOS (1-2 bedroom homes)" (October - December)

- 4,909 residential properties
- Sales: €20m

LAND - STRUCTURES (Annual)

- 950 Plots of land and 276 Structures
- Sales: €106m

* Campaign initiated in 2016 and also in force during some weeks of 2017.
The sales figure only takes into consideration those corresponding to 2017.

Sareb Responde: customer service channel

Sareb's customer service channel has attended to a total of 180,152 enquiries in 2017, an increase of 233%.

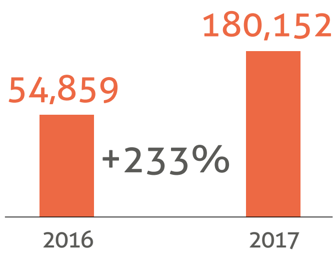
The increase in consultations compared to the previous year is largely due to the boost in sales activity, with more active campaigns and broad diffusion through radio and television. There has also been some influence from the growing number of properties published on the different major real-estate portals.

Along these lines, the requests related to issues about buying represent 70% of the total.

The resolution and follow-up of enquiries and requests made by clients takes place through the different channels that the company has at its disposal and which are described below.

It is also worth mentioning that while 15% of the enquiries were settled directly by Sareb Responde, the rest were referred to the servicers for their management.

32. Enquiries received through Sareb Responde



33. Type of enquiries received (% of the total)

Per type of client

Individuals	Company	Administration
87%	7%	6%

Per input channel

Sareb website	Telephone	Letters	Email
62%	27%	7%	4%
www.sareb.es/en_US/	900 115 500	Paseo de la Castellana, 89 28046-Madrid	sarebresponde@sareb.es

Per type of consultation

Commercial	Maintenance	Homeowner's association
70%	5%	4%
General Information	**Rental**	**Legal**
4%	15%	2%

Satisfaction surveys

Sareb also makes a quarterly follow-up to assess the satisfaction of any possible buyers of its properties.

At 31 December 2017, 81% of clients said they were satisfied with the general process for buying through the company. This progress is an improvement compared to the close of 2016, when the percentage of satisfied buyers was 76%.

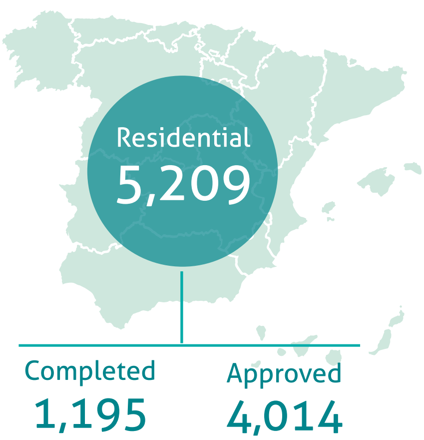
www.sareb.es

The new Sareb website includes a catalogue with more than 28,000 properties on offer.

In 2017, Sareb has also renewed its corporate website, giving it a more innovative design with the aim of bringing the whole commercial offer of the company under a single website, thus contributing to enhancing the brand name. In total, during the year www.sareb.es received more than 3.4 million visits, generating a total of 127,000 leads[29], becoming the preferred channel for making enquiries and requests about buying.

Property management

Creating value revolves around Sareb's need to optimise the profitability of the property assets received



Real estate development and land management

The main objective of the department of Development, Promotion and Investment (DPI), created in the first six months of the year 2017, is to locate land which is worth developing, from a business point of view, and any construction work that would be profitable to finish. At year-end of 2017 Sareb intends to place 5,209 properties on the market, of which 1,195 units have already been completed and 4,014 are approved for construction.

The department also handles the town planning formalities for the land.

So far, the company has invested €60.5 million in carrying out the work for the mentioned properties to be put on the market.

The selection of assets to be developed, their management and price setting takes place in conjunction with the servicers, ensuring the viability of the projects.

In order to promote and give impetus to the real estate sector, Sareb has started work on new developments in geographical areas with lower levels of investment interest, but a growing demand for housing. Many of these projects are being carried out in collaboration with developers and local partners who are bringing their knowledge and experience in the real estate development.

During 2017, the company held face-to-face meetings throughout Spain with organisations representing property developers in order to increase the visibility of its land portfolio and unfinished construction work.

These meetings have also helped the company to gain first-hand knowledge of the real needs of developers, who represent one of Sareb's main clients.

[29] All leads generated are redirected to servicers.

A major milestone in 2017 was the delivery of the first two promotions developed from scratch on Sareb land. These were Residencial Essencia, in Alicante, and a development located in an area at the western end of the Malaga seafront. Together they account for a total of 65 two- to four-bedroom homes.

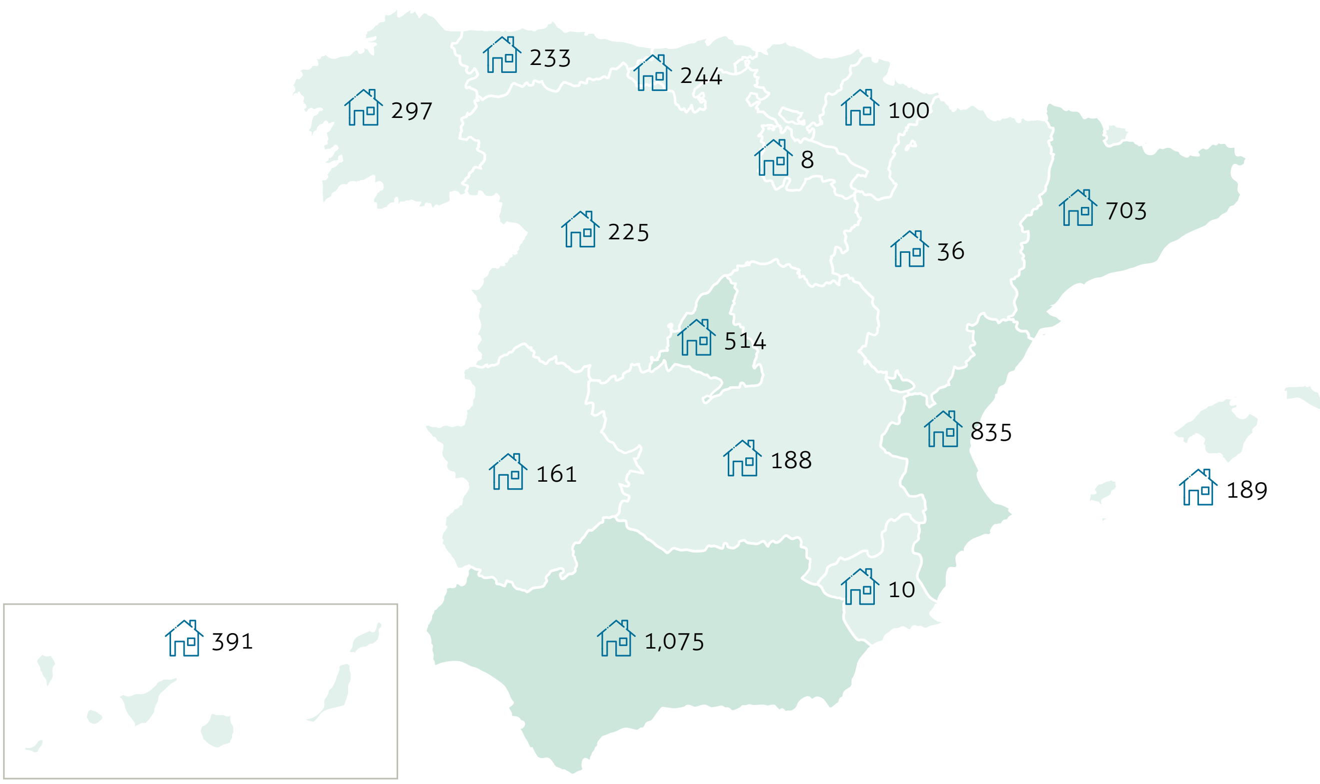
34. Total investment in the development of promotions on Sareb land and the completion of unfinished construction work (€m)

Promotion
65.6%

Unfinished construction work
34.4%

35. Geographical breakdown of planned promotion and development of housing (number of units)

Residential

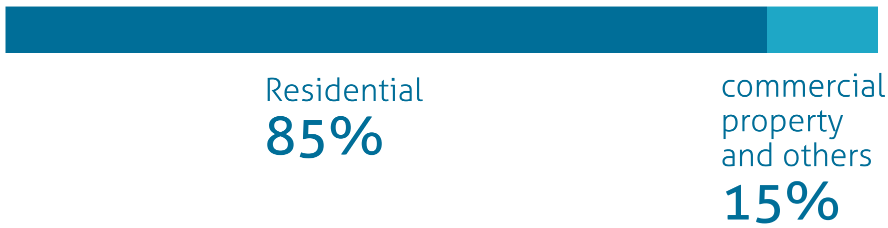


Rentals

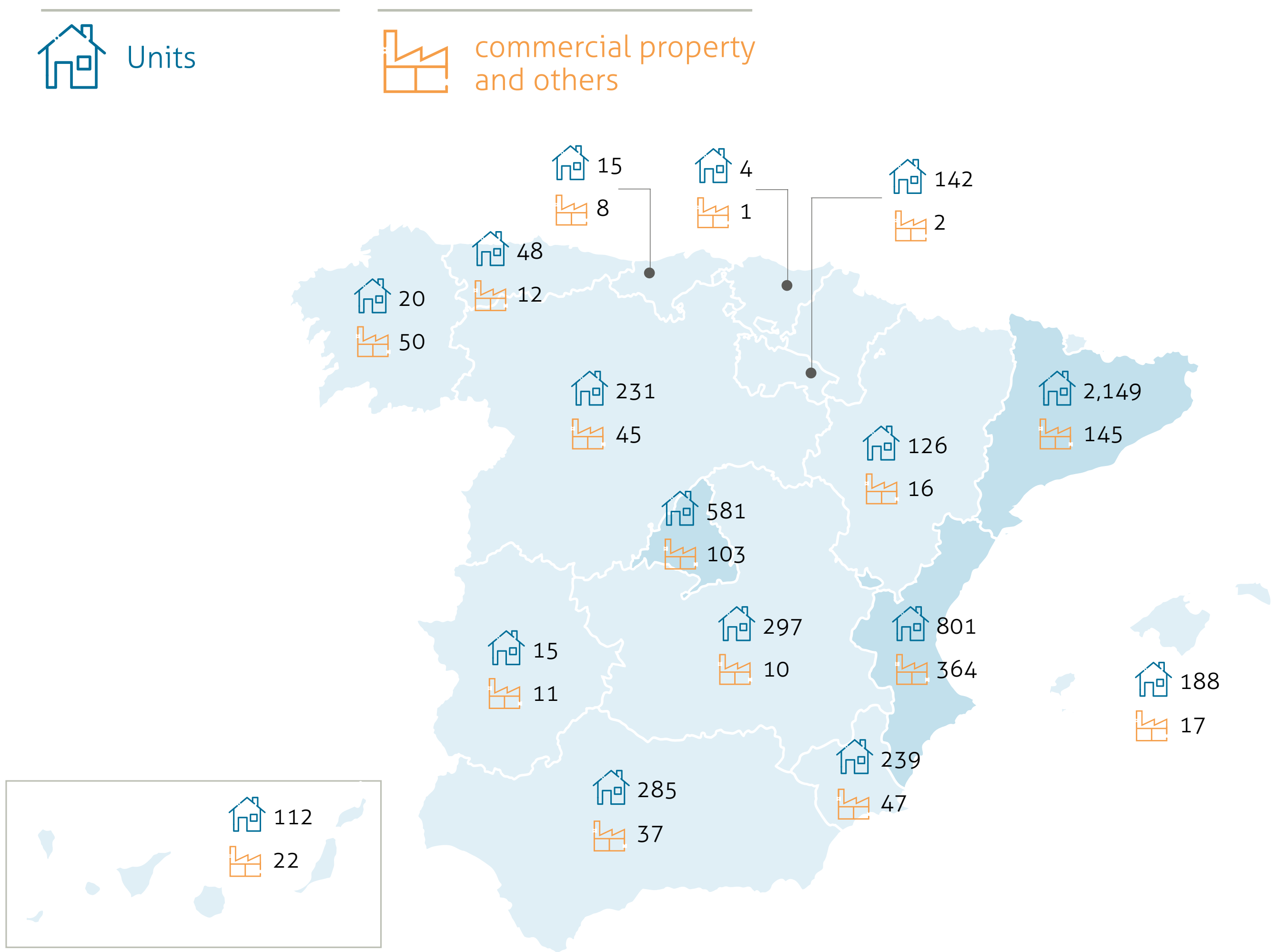
In line with the company's commitment to optimise the value of its real estate portfolio, 2017 saw Sareb significantly increase the number of assets that make up its portfolio of rental properties, which was also driven by improvements in management processes and new marketing plans defined in collaboration with servicers.

This meant that Sareb's rental portfolio reached a total of 6,145 properties by the end of 2017 (not including assets transferred to the REIT Témpore Properties), an increase of 33.4% over 2016. Of these, 85% are residential and the rest are commercial property assets.

36. Breakdown of property rentals per asset type



37. Geographical breakdown of the number of properties for rental



In terms of activity, the improvement and consolidation of the rental market in Spain has allowed the company to achieve an increase of 16% over the volume of rental income established in the budget for the year. 2017 also saw the company recover €11 million of accumulated debt in unpaid rents.

The rental business allows Sareb to recover part of the maintenance costs of properties that are not absorbed by market demand in the short term.

Finally, we should highlight the launch of the REIT Témpore Properties, a property investment vehicle focussed on residential rental and which constitutes an alternative divestment channel for Sareb that contributes to fulfilling the company mandate.

Témpore Properties, the REIT promoted by Sareb

The REIT was constituted with a total of 1,554 assets, of which 1,383 are homes and the rest are annexes[30], its value standing at €175.4 million at the end of November 2017.

The creation of Témpore Properties in 2017, promoted by Sareb and which has been assigned to Azora for management, is an alternative channel of divestment for Sareb; it maintains a framework agreement with the REIT so that it can continue increasing its portfolio with residential products in the coming years. Its launch has benefited from the rentals situation in Spain, which currently offers higher returns and renewed demand due to the effect of changes in the patterns of housing consumption.

The REIT, a specialist in residential property rentals, was listed on the Alternative Stock Exchange (MAB)[31] at the date of revising this report, with a clear vocation for seeking out new investors and diversifying its capital.

More information on Témpore Properties
https://www.temporeproperties.es/en

[30] Storerooms and garages.

[31] Since April 3, 2018.

Asset management and property maintenance

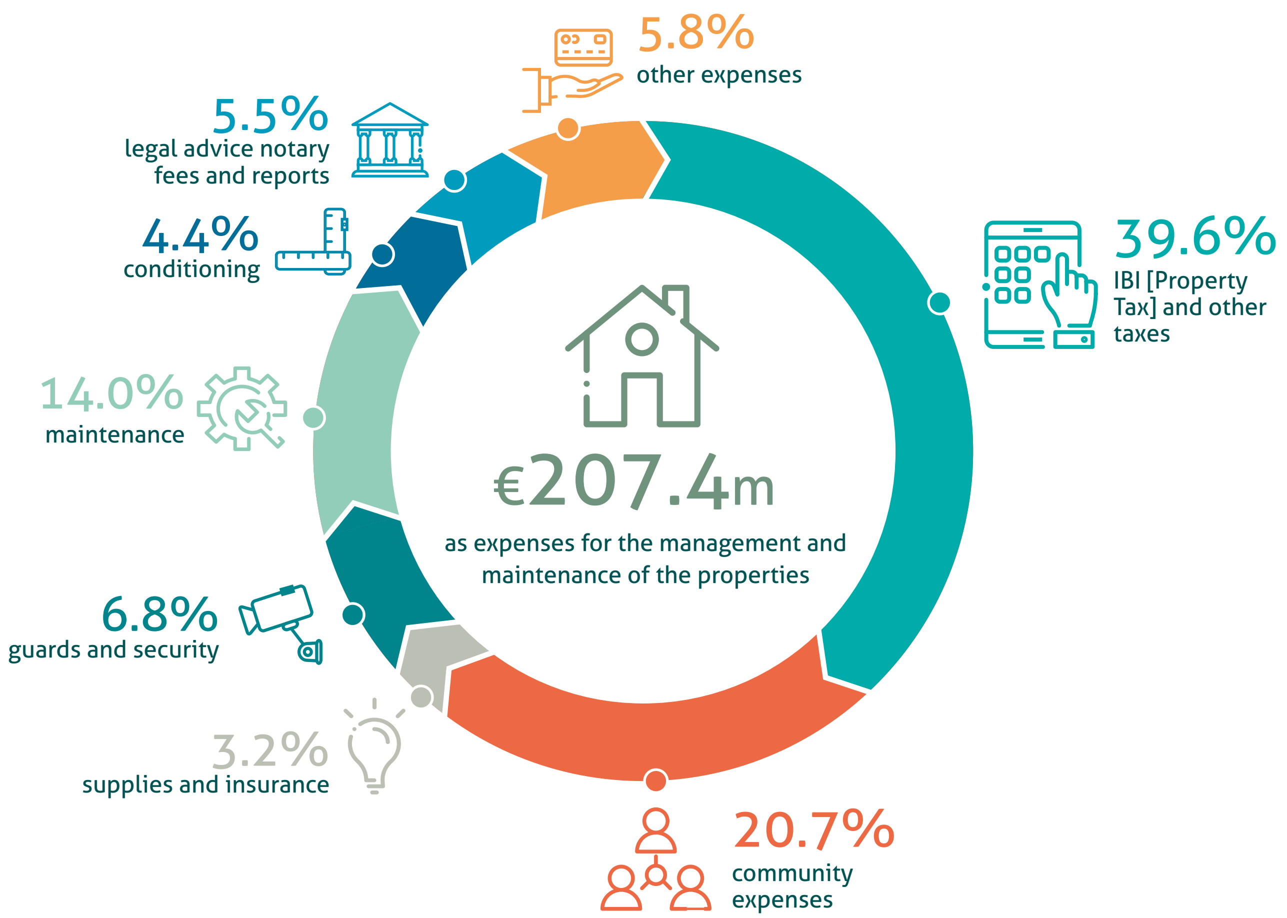
The management and maintenance of the properties that make up the Sareb portfolio has high associated costs, which the company has to assume until the moment of sale

The policy of good neighbourly relations that Sareb maintains in its relationships with homeowner's associations not only guarantees that Sareb's assets are kept up to date with all payments, but also that the housing stock remains in optimum condition until the moment of sale.

For this reason, Sareb allocated a total of €207.4 million to building maintenance and repair in 2017.

The payment of taxes on real estate and community expenses accounts for 65% of the expenditure allocated to the management of the company's property assets.

38. Expenses for the management and maintenance of the properties (% of €m)



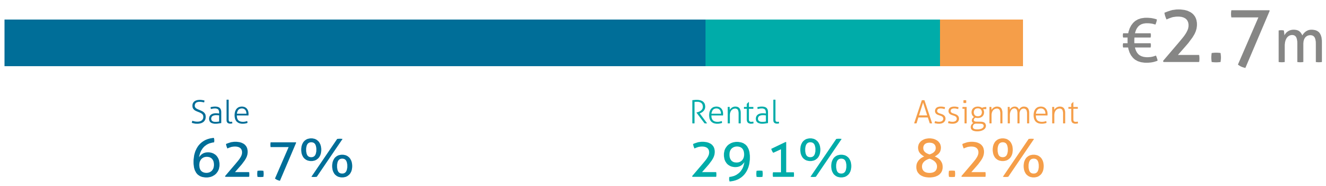
In addition, Sareb also allocates substantial resources to the upkeep of its property assets. This includes, for example, clearing of land, the provision of adequate security measures for works in progress or unfinished construction work, the installation and monitoring of alarm systems, and dynamic on-site security surveillance.

This year also saw Sareb signing a new contract with Ferrovial Servicios for the comprehensive maintenance of its portfolio of unfinished construction work, worth €2.3 million a year. It is expected that the scope of this agreement will extend to other portfolios during the coming months, either through new contracts or alternative models that guarantee the quality of this management.

39. Conditioning and investment in properties for marketing and transfer

Assets conditioned (% of the number of assets conditioned)

Investment in assets conditioning (% of the total investment volume)



Insurance cover and claims management

The company's risk coverage policy requires it to take out ample cover with reduced excesses and to sign policies with highly capable companies with acknowledged solvency.

Sareb covers any possible risks that could affect its assets by taking out different insurance policies which cover any type of potential damage to which its property assets are exposed.

This cover also includes civil liability for damage of any nature caused to third parties as a result of the company's activity, including any arising from decisions made by directors and senior management.

In 2017, Sareb renewed its programme of insurance for damage to property, civil liability and directors and senior management liability, as well as comprehensive construction cover and ten year building insurance.

The so-called Claims Management Protocols have also been updated, providing for more efficient and smoother management, along with the new procedure designed for implementing them. Lastly, this year the brokerage contract[32] was renewed with Aon.

Furthermore, Sareb makes an annual review of the map of insurable risks in order to determine which can be insured, and in that way to verify that adequate insurance cover is contracted at all times.

A new feature this year is the extension of the analysis of cover to take in risks that have not been insured to date.

Further information on risk management on page 88

[32] Both the contract with the broker and that with the insurance companies follow the most stringent selection procedures, using principles of advertising, competition and equal treatment.

7.4

Financial Information

The evolution of the results for the year has enabled Sareb to reduce its debt by 7.45% in respect of the previous year

Accounting Information

Having concluded the process of migrating the portfolios from the previous management companies to the present servicers in 2016, in 2017 a clearly stabilised situation is seen both for Sareb and for its new commercial and management network.

Accounting legislation and implicit losses

Sareb's activity is governed by the accounting framework for the valuation of assets established by the Bank of Spain in its Circular 5/2015 of September 30, subsequently complemented by Royal Decree-Law 4/2016.

That Circular establishes that the company has to value its portfolio and consider any possible unrealised gains or losses in its assets, consequently recognising any impairment in a Value change adjustments account forming part of the company's equity and which is not taken into consideration as grounds for a capital reduction or dissolution of the company.

In 2017, the valuation of the entire portfolio[33] revealed the need for an impairment fund to be created by the end of the year in respect of €4,229 million of financial assets (€3,389 million in 2016); that fund should be equivalent to 14.5% of their book value and 6.0% of the contractual debt.

Impairment established in the financial asset portfolio

Type	Debt	Guarantee	Vacbe*	NBV	Result	2016
Secured by property guarantee	53,574	26,750	20,105	22,102	-1,997	-1,190
Without first charges and participating	16,810	786	291	2,911	-2,620	-2,780
Awarded/dations			4,628	4,228	400	581
Total	**70,384**	**27,536**	**25,024**	**29,241**	**-4,217**	**-3,389**
Other adjustments					-12	
IMPAIRMENT OF FINANCIAL ASSETS					**-4,229**	

* Vacbe es el Valor Regulatorio según la Circular del Banco de España

The evolution of impairment reveals that the losses are concentrated in those financial assets not having effective collateral, or that are not directly backed up by any guarantee, that is to say, they are loans with zero value unless demonstrated otherwise.

Unrealised capital gains in the property asset portfolio

However, the estimates made for the property asset portfolio show the existence of a gain of €694 million, 9% of its net book value.

[33] Specifically, the method required by the circular has been applied to 98% of Sareb assets, representing 99% of the value of the whole portfolio.

The Income Statement shown below follows the guidelines of the General Chart of Accounts (PGC) which, for the purposes of turnover does not take into consideration the amount received, but instead the margin generated in transactions under the Sales Growth Plans (SGP), reductions and repayments of principal.

Income statement (€m)

			2017	2016
Turnover			**2,144**	**2,134**
	Real estate assets		**1,188**	**1,053**
		Sales of real estate assets	1,132	1,010
		Income from leases	49	42
		Bank Asset Funds (FABs) and others	7	1
	Financial assets		**955**	**1,081**
		Sales of financial assets	452	474
		Financial income from loans (margin)	503	607
Sales costs			**-1,394**	**-1,497**
	from financial assets		-413	-593
	from real estate assets		-981	-904
Gross accounting margin			**750**	**637**
	Other operating income		17	27
	Management, marketing and maintenance expenses		-683	-683
	Amortisations and others		-77	-85
Operating income/(loss)			**7**	**-105**
	Net financial income/(loss)		-541	-558
Pre-tax income/(loss)			**-534**	**-663**
	Corporate Income Tax		-31	0
Net income/(loss)			**-565**	**-663**

Evolution of turnover

If all collections and accruals are taken into consideration, the revenue from transactions with financial and real estate assets stood at €3,814 million in 2017 and a gross margin of €748 million which mainly corresponds to financial assets.

An additional amount of €19 million[34] in 2017 and 27 million in 2016 is to be added to these figures, both in revenue and in margins, which corresponds to the activity of the company (value adjustments, income from contract termination, receipts from assets under servicing).

In this context, 2017 has closed with a total business volume total amounting to €3,883 million, slightly less than the 3,923 million resulting from the previous year. However, the gross margin stood at €767 million, 16% higher than the previous €664 million.

In million €	Income	Gross margin
Retail financial assets	2,622.8	542.3
Retail real estate assets	1,191.2	205.5
Total regular business activities	**3,814.0**	**747.8**
Others	19.2	19.2
Total amount business management	**3,833.2**	**767.0**

Most of the revenue, €2,623 million, was obtained from the management and marketing of the financial assets, while 1,191 million corresponds to property assets.

In 2017, therefore, Sareb obtained a higher sales margin than in the previous year, in spite of the lower volume of revenue for the year. This effect could have been higher, as in the first quarter of the year several transactions took place under the previous accounting schema which in some way made transactions with negative margins feasible.

[34] Specifically the line of property management and sales.

Margin on real estate assets (€m)

	Income	Gross margin
Retail real estate assets	**1,191.2**	**205.5**
Residential	614.9	67.2
Single/Commercial property	514.9	76.9
Rents	61.4	61.4

Gains of seven million euros from business activity as against the loss of 105 million for the previous year

From the perspective of each of the business lines, the margin on the property assets increased by €56 million in relation to the previous year, as a result of the increase in the sales of single properties and land. In the case of financial assets, the evolution has been similar and amounts to €542 million. This figure also includes interest received and accrued. The increase has benefited from better margins in the sales of loans.

The operating expenses repeat the figures of the previous year, even though more expenses in management fees have been recognised after complete control was taken by the servicers, and in the costs of maintaining the growing portfolio of own properties, which include municipal rates and taxes, homeowner's associations, maintenance and repair expenses, security, etc.

All of this leads to an operating profit of €7 million as compared to the 105 of loss for the previous year. This result is clearly insufficient for covering the heavy financial costs arising from the borrowing which Sareb had to incur in order to acquire its portfolio, in spite of having reduced them in line with the evolution of interest rates.

Pre-tax losses stand at €534 million, as opposed to the €663 million obtained in 2016; the increase is of €31 million after taxes following the reversal of tax credits recognised for losses carried forward.

Operating expenses

The company's non-financial expenses amounted to €683 million in 2017, the same figure as for 2016. Of this figure, 35% relates to fees established under contracts with the servicers for management, administration and marketing.

The expenses for maintenance and repair of the property assets also account for another third of the total expense and, apart from the expenses for community, maintenance and insurance, they also take into consideration the payment of Property Tax (IBI) and other taxes. This is also influenced by the higher volume of resources allocated by the company for conditioning the properties assigned to town councils and autonomous regions for social purposes.

Among the expenses for structure, consideration should be given to the financial effort that Sareb makes every year to improve the information on its assets, which in 2017 included updating a significant number of appraisals. All of which is not only in order to comply with the regulatory requirements for valuing the portfolio, but also for achieving a more efficient management of the assets and, ultimately, obtaining better prices in the transactions.

Structure expenses (€m)

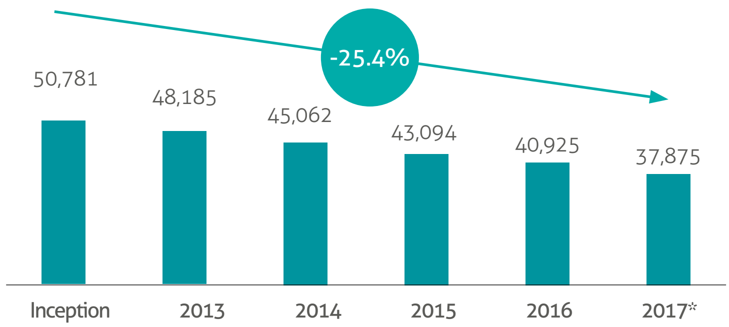
		2017	2016
Fees for management and marketing		**242.9**	**236.8**
	Management	120.8	104.4
	Marketing	122.1	132.4
Taxes (IBI, VAT, Capital gains and others)		**177.8**	**197.2**
	IBI, capital gains and others	89.2	92.5
	VAT	88.6	104.7
Expenses arising from foreclosure procedures and dation		**28.5**	**22.0**
Technical reports - Registration expenses and others		**12.2**	**8.0**
Communities and maintenance		**113.0**	**90.0**
	Communities	63.2	53.7
	Maintenance	49.8	36.3
Structure expenses		**66.7**	**66.5**
Staff expenses		**40.8**	**39.4**
Other operating expenses		**1.2**	**21.9**
Other current management expenses		**0.1**	**1.4**
Total expenses	**Total expenses**	**683.1**	**683.4**

Evolution of senior debt

Sareb continues to fulfil the commitment assumed when it was incorporated for paying the debt guaranteed by the Government

Sareb has made it possible for the senior debt issued when it was created to be reduced by €12,906 million, of which 25.4%, €3,050.5 million, correspond to 2017.

40. Evolution of senior debt since the inception of Sareb[35]



Sound financial management

In 2017 Sareb continued meeting the payments of the debt issued for acquiring the assets making up its portfolio, and also the interest generated.

In this period a total of €3,050 million of senior debt was repaid, charged against the cash generated in 2017. Of this, €1,526.2 million correspond to the bonds of Group 1.

41. Amortisation of bonds in 2017 (€m)

By February 2018, €604.8 million had already been amortised, corresponding to the Group 2 bonds, also charged to 2017.

42. Amortisation of bonds in February 2018 charged against 2017 (€m)

[35] Includes 604.8 million repaid in 2018 and charged to 2017 and the 889 million of the escrow account.

Write-off

According to the provisions of article 48 of the Royal Decree 1559/2012 of 15 November and the Resolution passed by the Steering Committee of the FROB (Fund for Orderly Bank Restructuring) on the conditions for the transfer of assets to Sareb, the company writes off any assets that do not meet the requirements necessary for being included in the perimeter sold to Sareb.

In 2017 no write-off had been made affecting Group 1 bonds, although the nominal value of Group 2 bonds went down by €30.5 million.

43. Write-off of bonds in 2017 (€m)

Group 2

Maturity 28/02/2018
€9.2m

Maturity 28/02/2019
€21.3m

Total: €30.5m

The amortisation of €889 million pertaining to the escrow account should also be taken into consideration –under the provisions of the senior debt contract– and that the perimeter of assets sold to Sareb has been written off for the amount of €30.5 million.

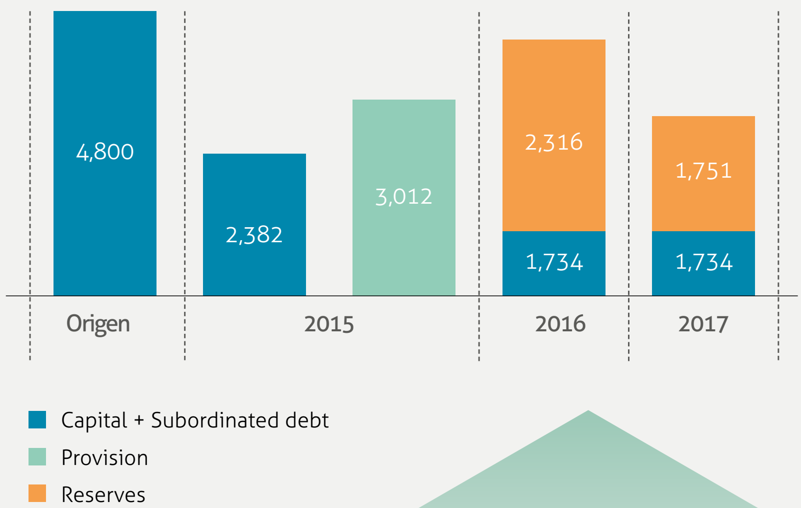
The financial costs of company debt since its inception amount to €4,197 million, of which 2,780 million went directly to the banks assigning the assets to Sareb, as interest.

Evolution of shareholders' equity

At the close of 2017, Sareb's capital and subordinated debt amounted to €1,734 million which, together with €1,751 million of reserves, make up the entire shareholders' equity totalling €3,485 million.

The above is in accordance to Royal Decree-Law 4/2016, which establishes that impairment is to be charged against a value change adjustments account, instead of being provisioned for out of the Income Statement.

44. Major equity (€m)



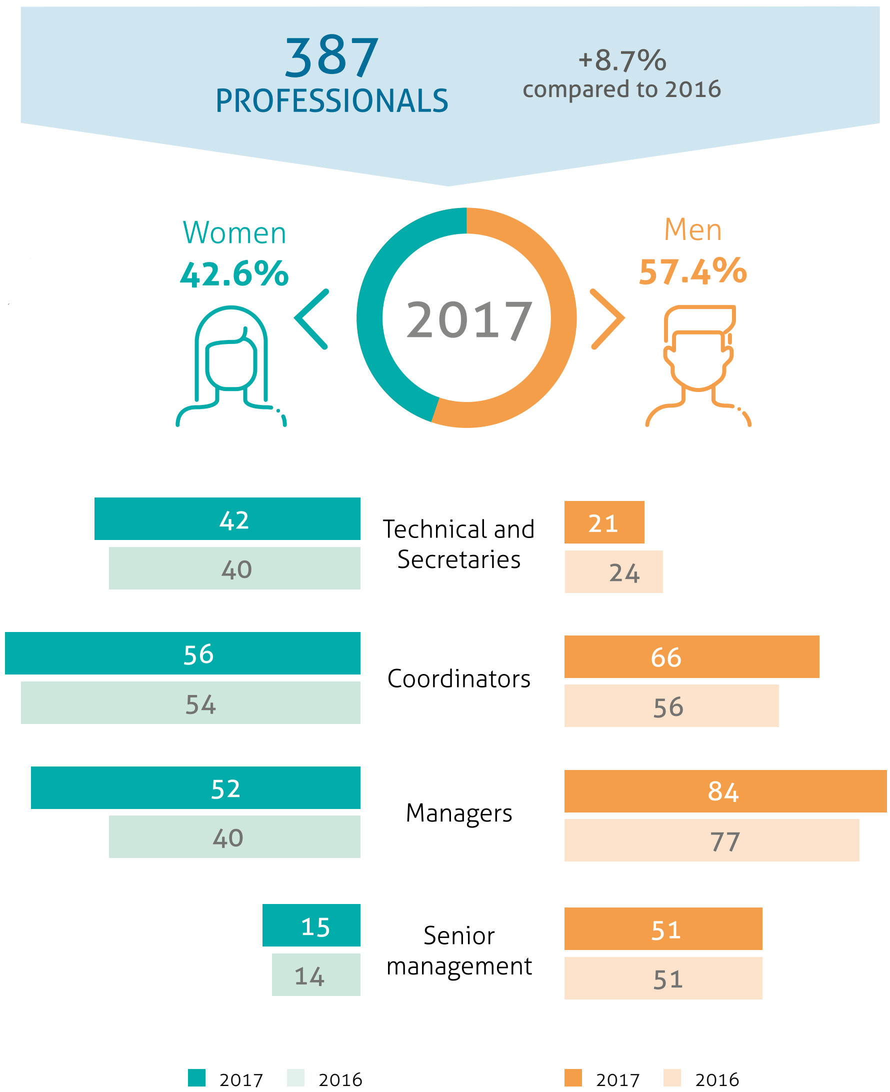
€3,485m
OWN RESOURCES

08 OUR WAY OF DOING THINGS

The professionals at Sareb

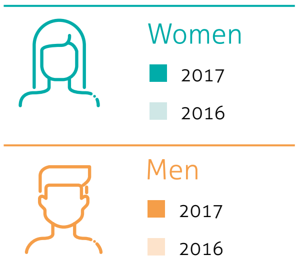
A differentiated management and approach to talent that focusses on the development and professional life of employees beyond the company

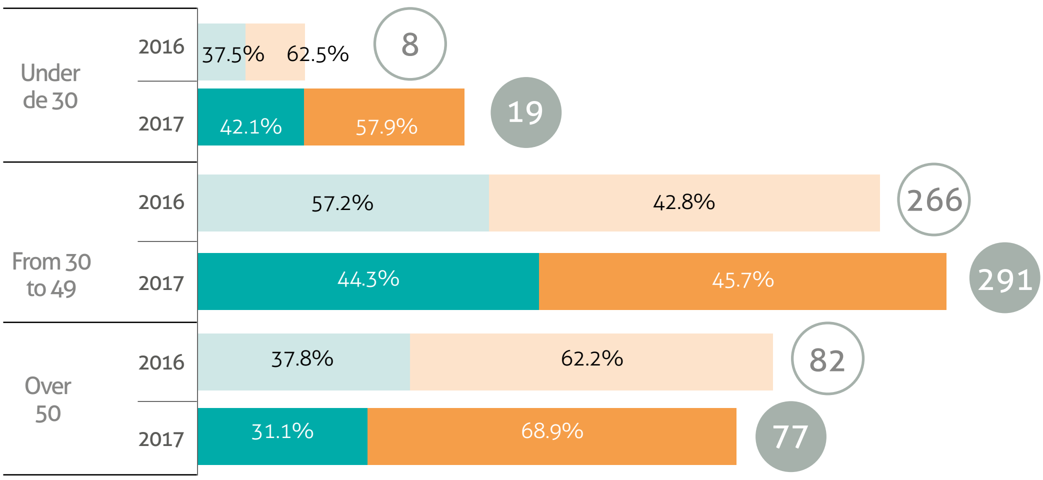
45. Profile of employees (number of employees)



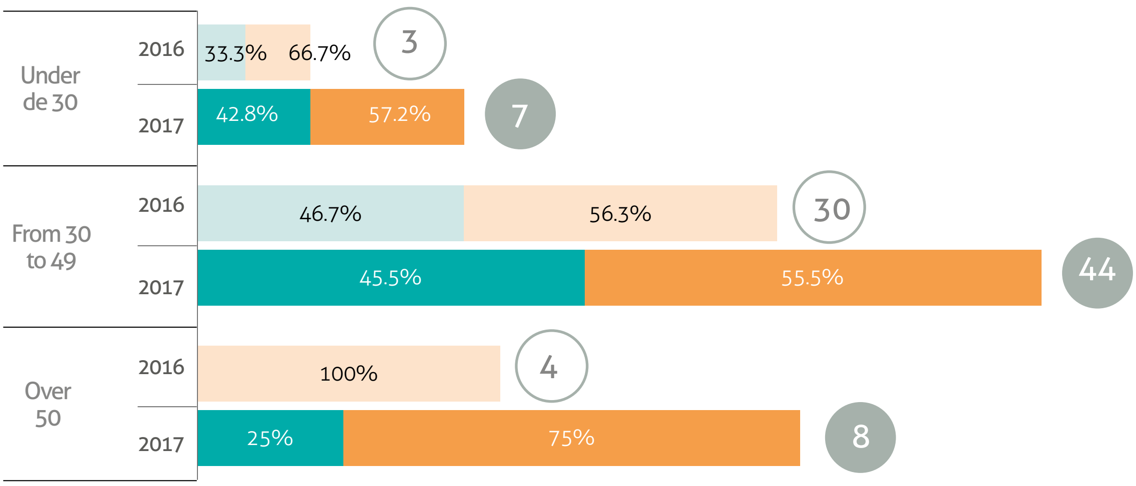
By the end of 2017, the number of Sareb employees totalled 387, an increase of 8.7% over the same period in 2016. This growth is due to the combination of two factors: an increase in new staff recruitments, with 59 employees joining the company in 2017 (a 59.5% increase over 2016) and a fall in employee turnover rates, which decreased significantly with respect to the previous year.

46. Breakdown of Sareb staff by age and gender

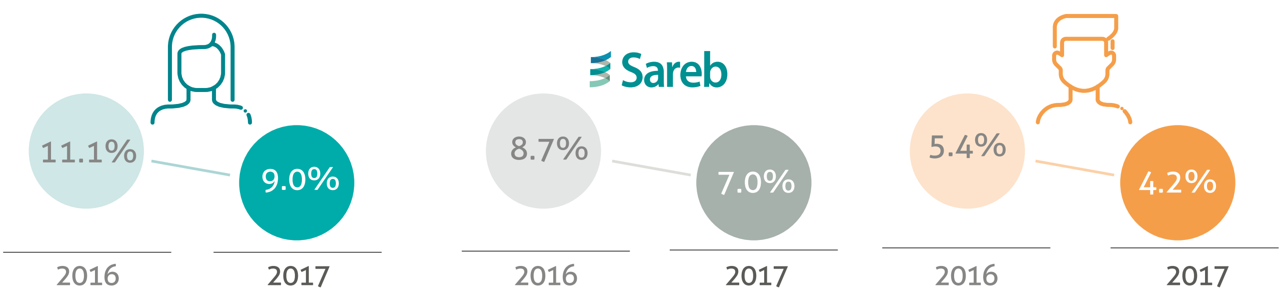




47. New staff recruitments in 2017 by age and gender



Employee turnover (Total)



People management at Sareb

Sareb is a unique business project with a limited lifespan that requires a differentiated approach to attract, select and retain the best talent. The company's strategy is based on a strong commitment to the professional development of its employees beyond Sareb's useful life.

This philosophy is reflected in the People Management Plan, which is based on four pillars that contribute to fulfilling the company's commitments and objectives with regard to its employees:

Sareb and me: People Management Plan

Attracting, selecting and introduction of employees	For Sareb to fulfil its mandate, it needs employees with High added professional value. At the close of 2017, the average work experience per employee is 17 years.
A new model of corporate culture	Leadership and organisational structure are based on Sareb values.
Learning and training: The driving force for talent	Staff development is the main transmitter of Sareb culture and contributes to improvements in staff commitment levels to the company. Employees can access a variety of tools to promote their development, which include the opportunity to live meaningful experiences and undertake self-learning through information and materials provided by the company, as well as benefiting from the training offered by the company in its annual employer development programmes.
Satisfaction and motivation	Continuous evaluation and monitoring – carried out every 18 months – of employee satisfaction and motivation allows for the development and implementation of ongoing improvement initiatives based on results.

Employee satisfaction has led to the involvement of employees in various internal and external initiatives implemented by the company's Communication department. A highlight of 2017 was the release of the documentary 'Sareb: piece by piece', in which employees, professionals from the real estate sector, journalists and beneficiaries of Sareb's social programmes tell the story of the evolution of the company during its first five years of existence.

Several months after its launch in December 2017, the video has reached a total of 180,000 visits.

In line with this management philosophy, the company also pays special attention to internally generated career opportunities, facilitating internal mobility in order to contribute to the ongoing professional development of employees, broadening their skill horizons and improving their future employability. A total of 43 internal movements took place in 2017.

Sareb also has a wide range of policies that support the Plan, including the Plan for Diversity, Equality and Work-Life Balance, which deserves special attention, as it aims to achieve an effective diversity of women and men, and to respond to the different generations that coexist in the organisation. It also reinforces the company's commitment to a more inclusive workplace environment and equal opportunities for all those who form a part of the company.

Sareb Escucha

The third edition of the Sareb Escucha survey achieved high levels of participation. Results show significant progress in satisfaction within the organisation compared to the previous edition.

In line with the commitments contained in the people management plan, Sareb conducts a survey on work climate, commitment and culture every 18 months, –Sareb Escucha– in which employees are asked to identify areas where progress has been made, and areas for improvement, with regards to all issues relating to culture, leadership, management and organisation, internal communication, training and the work environment, among others.

2017 saw the third edition of Sareb Escucha, with 87% of employees participating.

Results show significant progress in more than 90% of the issues that were raised in the previous survey, carried out in 2015.

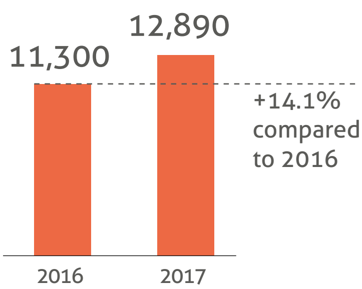
A new initiative this year is the introduction of gamification: a training technique in which theoretical content is presented through videogames

Professional development: learning by doing

Sareb offers its employees specific practical training adapted to the needs of the company, based on the philosophy of learning by doing.

A total of 12,890 hours of training were provided for 402 participants during 2017, representing an increase of 14.1% over training hours in 2016, with more than 900 euros invested per employee.

48. Total of training hours



12,890 h. total training hours

€939 investment in training per employee

402 participants in training courses

32 h. training hours per participant

52 technical training courses and **56** sessions for developing skills

9/10 results of satisfaction surveys regarding training

Learning by playing

Gamification allows Sareb employees to acquire and develop new skills for more effective performance through the use of video games.

During 2017 Sareb implemented a new learning method based on videogames (game-based learning) which facilitates the development of important skills such as leadership, negotiation, team management and time management, amongst other issues. Obtaining scores and moving through increased levels of difficulty enables participants to achieve new learning objectives and acquire knowledge.

Technical training

Essential for acquiring or reinforcing the knowledge required to carry out an employee's work.

Skills

Focus on leadership, team management, customer orientation and the achievement of results, from an innovative perspective.

All training programmes establish objectives of practical use for possible future careers outside the company, and at the same time strengthen technical aspects for immediate application, and provide employees with necessary team management training and other skills.

Sareb also has collaboration agreements with five of the most prestigious Spanish business schools -the IE Business School, the IESE Business School, the School for Industrial Organisation EOI, the Institute of Stock Exchange Studies (IEB) and the Official Association of Architects of Madrid (COAM)- to ensure quality training that meets the level and expectations of employees.

Employees also have to periodically complete other courses relating to Integrity.

In addition, and with the aim of continuing to enhance the skills and abilities of its professionals, Sareb annually evaluates the performance of the professional development of all its staff from a three-dimensional perspective: vertical, transversal and external. In addition to the evaluation made by an employee's colleagues, superiors and the employees themselves, this also includes the services of an external consultant, whose mission is to independently guide the development of the employee.

Sareb Ambassadors

Sareb professionals exemplify the values of the company and its social commitment to fulfilling its mandate. Within the framework of the Corporate Social Responsibility (CSR) programmes, 2017 saw further development of the Sareb Ambassadors initiative launched in 2016, in which volunteer employees share and disseminate Sareb's values and activities with the educational community.

A total of 99 sessions were held in 52 centres during the 2016-2017 academic year, attended by 3,515 students from nine Spanish provinces. The positive response to this initiative is reflected in the assessment surveys completed by the students, with a satisfaction level of 4.39 out of 5.

The company has already launched a new edition of Sareb Ambassadors for the 2017-2018 academic year, which started in September. By December 31, 2017, 31 new sessions had taken place in 17 centres in two provinces, with a total of 1,343 students taking part.

Preventive culture in the workplace

In 2017, Sareb began work on the process of obtaining certification for its management system, with regard to occupational health and safety, in accordance with the new ISO 45001 standard.

Since its inception, the company has been allocating resources exclusively to minimise risks in the workplace.

Occupational health and safety for Sareb staff is approached from a 'preventive culture' perspective, and goes far beyond mere regulatory compliance. This approach extends to all activities and people in the organisation, including those who perform activities on behalf of the company.

In order to ensure continued progress in risk control and improved performance in occupational health and safety, 2017 saw Sareb embarking on the procedures required to obtain certification of its management system, in accordance with the new ISO 45001 standard, which the company expects to receive in 2018.

Highest standards in processes

Knowledge and application of the rules that govern the operations of the company are essential requirements for implementing efficient management

Since its inception, Sareb has not only been concerned with compliance and the application of standards, but also with the need to have a documentary framework that is complete and simple to apply. Taking into account new documents and amendments to existing documents, 2017 saw the company publish a total of 136 policies, manuals and procedures.

Also this year, and in order to facilitate the control, custody and publication of all the documentation generated by the company, an internal management tool was introduced that ensures the traceability and monitoring of documentation, and contributes to improving the management of information and its distribution, not only among Sareb employees, but also among servicers. At this point, it should also be mentioned that this year saw the creation of "Espacio Sareb", a new collaborative website that servicers can access, specifically designed as a space for the exchange of information and documentation. One of its most important sections covers the operating rules that must be observed for the execution of delegated operations within the framework of the contract for the management and administration of Sareb's assets.

OS17 Project

2017 saw the implementation of the OS17 Project, a process of internal reflection approached from various angles, with the ultimate aim of defining a new, simpler and more agile operating model that will contribute to an eventual reduction in analysis, management and approval times for operations in each of the business lines.

The OS17 Project has drawn on the knowledge and experience of Sareb professionals in eight working groups that analysed proposals to improve efficiency. Within the framework of the OS17, an ideas competition was launched for employees to share initiatives that could help optimise work times in the company.

OS17: Areas of consideration

Extended enterprise	Reflection on the role of Sareb and the servicers in each process.
Functions and responsibilities	Specification of the functions of each player within the process, eliminating ambiguities and delays in decision-making.
Asset control	Improving information and documentation of assets to make operations faster and more fluid.
Delegation of powers	Improvements to the current delegation model for servicers.
Process of reengineering	Redefinition of operations, with the aim of simplifying their execution: industrialisation, elimination of reprocessing, improvements to the quality of operations, etc.
Technological perspective	Improvements in the use of the company's operating and information systems.
Operating Culture	Promotion of a new operating culture in the organisation that prioritises the importance of times, individual contribution and collaboration with servicers.

Progress achieved within the OS17 framework

Agreement with property registrars

Access to data relating to real estate sales completed in Spain since 2010.

Simplified presentation of valuation documentation

When documentation is presented, this helps to focus the tasks of network managers when analysing proposals.

Express meeting rooms

Reducing the number of participants and avoiding unnecessarily long meetings.

Impetus to innovation

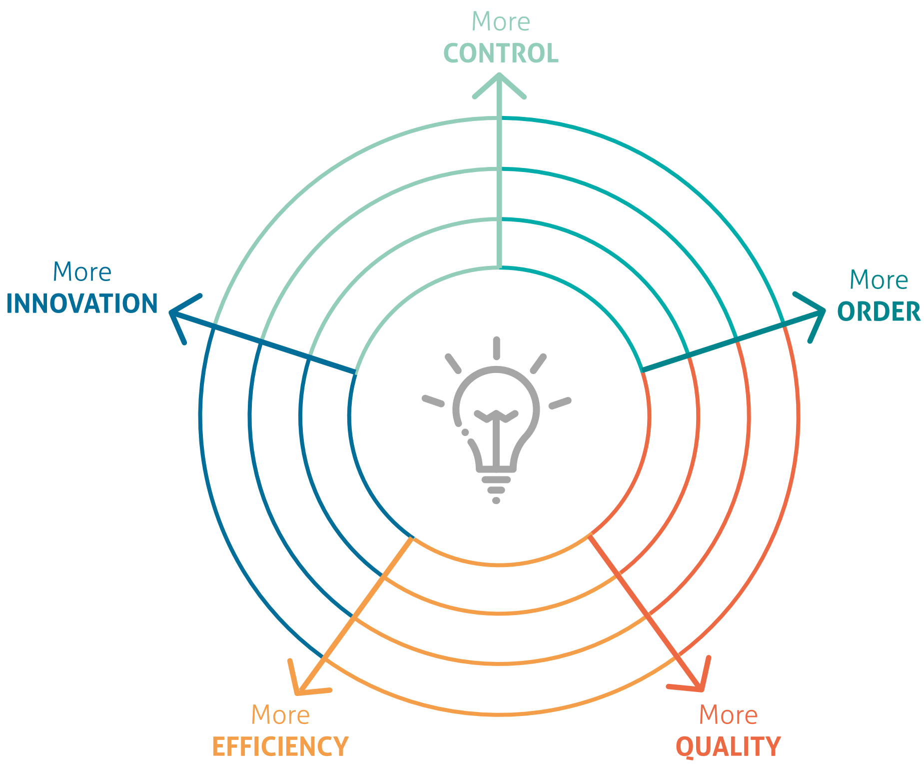
Sareb is committed to innovation as a disruptive lever for the fulfilment of its mandate

From its inception, the company has developed its activity with an innovative approach that aims to promote disruptive projects that contribute not only to the company's fulfilment of its mandate, but also serve to transform and energise the sector, and position Sareb as a benchmark company in the innovative ecosystem.

This focus is approached from two perspectives -external and internal- and is based on the concept of open innovation as a catalyst for new projects. This philosophy promotes association and agreements with other companies and third parties whose activities are aligned with those of the company, and gives added value to the Sareb business.

2017 therefore saw the company carrying out a review of its value proposal with regard to innovation, which has led to the company exploring new types of collaboration and initiatives with newly-created companies (start-ups). In addition, the company has created 10Y Ventures, a new initiative that will help to optimise the process to identify and apply best market practices, and to channel ideas that emerge within the company, with the aim of accelerating the business and the company's mandate to liquidate assets.

Sareb's strategic pillars of innovation



Advancing with our commitment to the environment

Sareb's activity does not have a significant impact on the environment, but the company works on new initiatives to keep its environmental impact at the lowest possible level

Within the framework of its Environmental Management Policy, Sareb develops initiatives aimed at respecting and protecting the environment, and the promotion of efficient use of resources through awareness campaigns and new efficiency measures. Noteworthy initiatives include the replacement of equipment with low-consumption technologies, promoting recycling and the provision of containers for batteries.

To this effect, 2017 also saw the company embarking on the process to obtain certification for international standard ISO 14001 on environmental management, in order to improve compliance with environmental regulations, while also working on gaining a deeper understanding and furthering progress in the identification, prevention and control of the environmental impact of activities carried out by Sareb.

In addition, Sareb is currently engaged in a feasibility study for the implementation of new measures that contribute to reducing its carbon footprint.

Main figures in Sareb's environmental management policy

545,225
KWh energy consumed

1,438
KWh / employee

4,171 kg
paper consumed

10.7
kg / employee

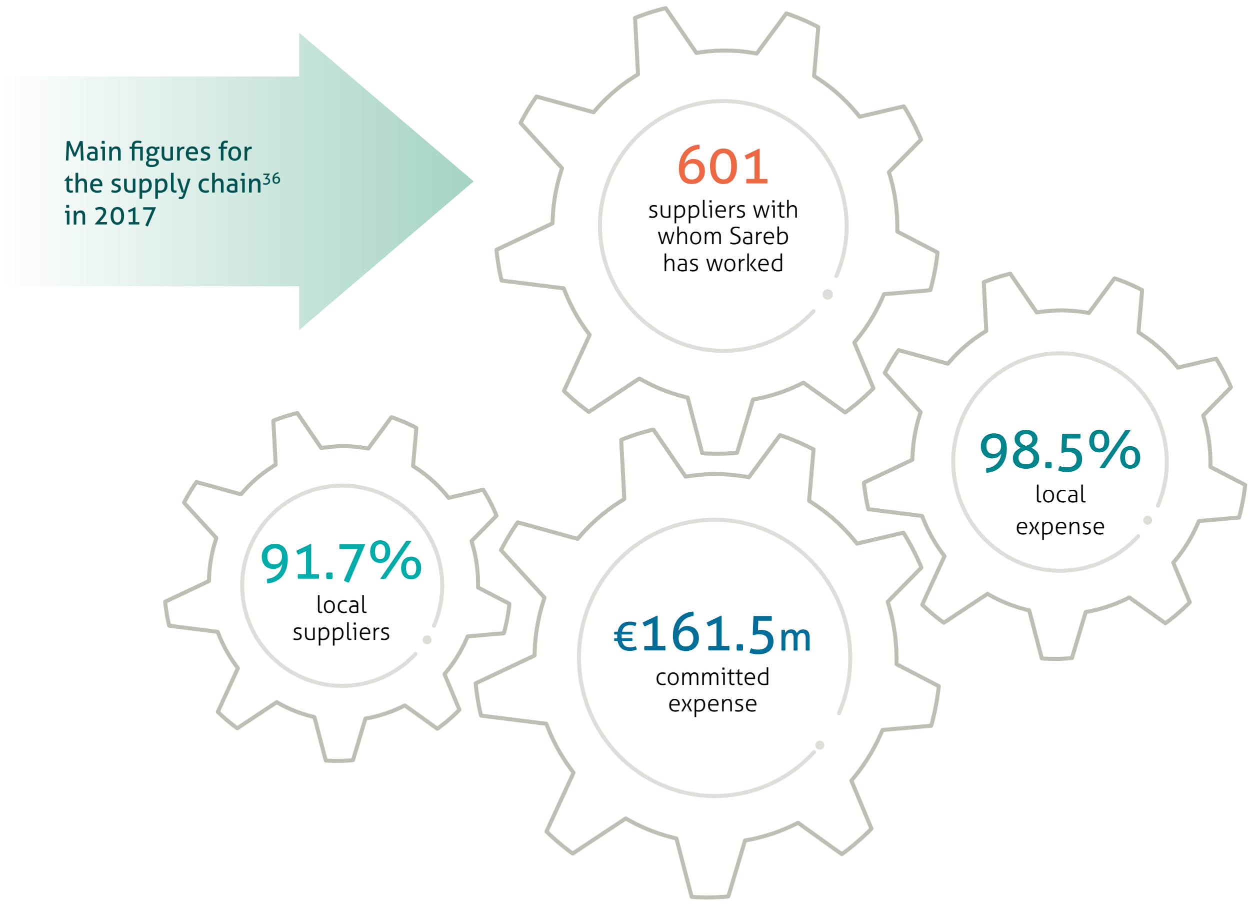
210
toner consumed

Responsible management with suppliers

The purchase of goods and services is based on the attaining the best value-for-money, in accordance with the principles of transparency, competition and non-concentration of suppliers

The purchase of goods and services is based on attaining the best value-for-money, in accordance with the principles of transparency, competition and non-concentration of suppliers. When choosing many of its suppliers, the company evaluates the degree to which these suppliers have progressed in terms of corporate social responsibility and their willingness to collaborate on these types of issues.

Also in 2017, and with the aim of promoting more efficient management of suppliers, Sareb implemented the digital signature of contracts in order to facilitate more efficient processes, reduce time spent on administrative procedures and reduce paper consumption. Framework agreements were also drawn up with regular suppliers in order to optimise the time required to contract suppliers and obtain more advantageous conditions for Sareb.



[36] The data provided corresponds to Sareb suppliers.
Servicers' providers are excluded from the scope of the information.

09 CORPORATE GOVERNANCE

The supervision, structure and operating rules of Sareb guarantee the transparency and integrity of its actions

Sareb meets the specific requirements for governance required under applicable legislation and acts under strict rules of ethics that safeguard its integrity at all times –as well as its transparency, commercial reputation and professionalism–. The special features of its corporate purpose and the public interest associated to its activity mean that the company is also subject to the supervisory system of the Bank of Spain and the Spanish National Securities Market Commission (CNMV). In addition, the Monitoring Committee, formed by the Bank of Spain, the Ministry of Economy, Industry and Competitiveness, the Ministry of Finance and Public Administrations, the CNMV and the European Central Bank (ECB), acts as an observer and analyses compliance with Sareb's general objectives.

Supervision

National and international

Bank of Spain

- Sole objective
- Specific requirements
- Standards of transparency
- Constitution and composition of the governing bodies

Spanish National Securities Market Commission (CNMV)

Issuer of fixed income and registration authority for Banking Asset Funds (FABs)

Monitoring Committee

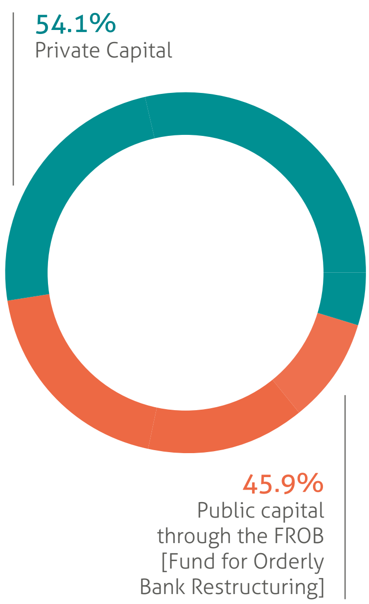
Fulfilment of general targets:

- Bank of Spain
- Ministry of Economy, Industry and Competitiveness
- Ministry Finance and Public Administrations
- Spanish National Securities Market Commission (CNMV)
- ECB (as an observer)

Governance

Monitoring of the best governance practices applicable to listed companies

Composition of capital



Compliance and regulation

Board of Directors

14 directors — 18 meetings in 2017

- **Executive Committee** — 6 members — 8 meetings in 2017
- **Auditing Committee** — 8 members — 10 meetings in 2017
- **Remuneration and Appointments Committee** — 8 members — 8 meetings in 2017
- **Support committees** — 11 meetings in 2017
  - Management Committee
  - Risks Committee
  - Investments Committee
  - Assets and Liabilities Committee

Independent Director

Strict regulatory regime: which helps to ensure that the business is carried out according to legislation, with integrity and ethics, in order to uphold its reputation

Internal control system

Strategic processes and government (SCEG*)
- Strategy and reputation

Ethical standards (SCISNE*)
- Integrity
- Criminal liability
- Money laundering and the financing of terrorism
- Reputation contagion risk (servicers)

Risk management (SCIR*)
- Credit
- Property price
- Liquidity
- Operating
- Interest rate

Financial Information (SCIIF*)
- Risk of reliability of financial reporting

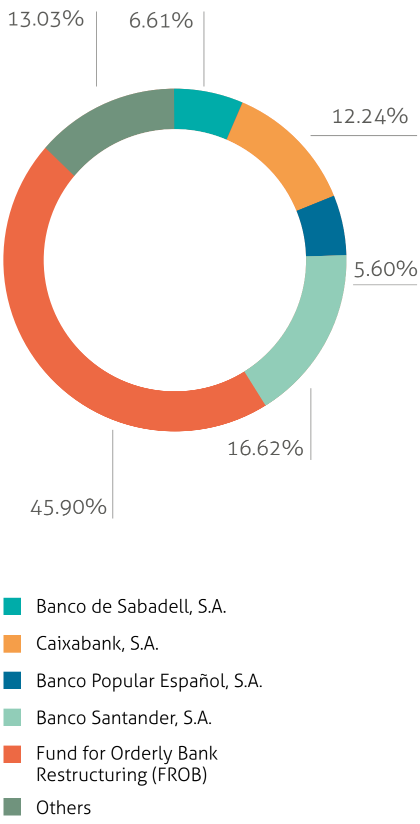
* Internal Control System on Ethical Standards (SCISNE); Internal Control System on Processes for Managing Business Risks (SCIR); Internal Control System on Financial Information (SCIIF); Internal Control System on strategic processes involving strategy and governance (SCEG)

Capital structure

Sareb was incorporated in November 2012, with 55% of the capital coming from private entities, while the Fund for Orderly Bank Restructuring contributed 45% of the capital

At December 31, 2017, the distribution of capital and subordinated debt was as follows:

49. Shareholder structure of Sareb[37]



A specific legislative framework

The regulatory framework defining the incorporation and development of Sareb is as follows:

- Act 8/2012, of 30 October, on the write-off and sale of property assets in the financial sector.
- Act 9/2012, of 14 November, on the restructuring and winding-up of credit institutions.
- Royal Decree 1559/2012, of 15 November, which establishes the legal system governing asset management companies.
- Circular 5/2015, of 30 September, on the accounting particularities of Sareb.

More information on Legislation
https://www.sareb.es/en_US/about-us/corporate-governance/normative

[37] The present capital structure is slightly different from the initial structure due to the effect of converting the subordinated debt.

The composition of the Board of Directors and its functioning

Sareb's Board of Directors has a balanced composition with an ample majority of non-executive directors

At the beginning of 2018 the Board of Directors of Sareb was composed of 14 members, of which one third are independent, in compliance with the provisions of Royal Decree 1559/2012, which establishes the legal system governing asset management companies.

In 2017, the changes in the composition of the Board of Directors were conditioned by the proprietary directors of Caixabank, José Ramón Montserrat Miró and Antonio Massanell, and the FROB member, Rodolfo Martín Villa, coming to the end of their term; they have been replaced by Jordi Mondéjar López, Antonio Cayuela Gil and Eduardo Aguilar Fernández-Hontoria, respectively; also, the resignation of the director Rafael of Mena Arenas, from Banco Popular, whose place was taken by Jaime Rodríguez Andrade.

All the candidates were elected for a five-year term following the principles established to that effect in applicable legislation, in the Articles of Association and in the Board Regulations. To that end a prior evaluation was made of the abilities, knowledge and experience required on the Board,

and also the dedication necessary for performing their duties, availability and existence of any possible incompatibility in the candidates.

On 1 January 2018 Lucía Calvo resigned as Proprietary Director of the FROB.

Profile of Sareb Board of directors

First appointment	Director	Nature	Committees to which they belong	Profile and competences
05/03/14	Jaime Echegoyen Enríquez de la Orden	Executive	E (Chairman)	Finance, Real Estate Sector, Business management, Legal, International
27/11/13	José Poveda Díaz	Independent	A, R	Real Estate Sector, Legal, Public Authorities
27/11/13	Isidoro Lora-Tamayo Rodríguez	Independent	E, A, R (Chairman)	Real Estate Sector, Legal, Public Authorities, International
14/04/15	FROB (Representado por Jaime Ponce Huerta)	(D) FROB	E	Finance, Legal, Public Authorities, International
10/06/15	Francisca Ortega Hernández-Agero	(D) Banco Santander	A	Finance, Real Estate Sector, Business management, International
10/06/15	Pedro Antonio Merino García	Independent	E, A (Chairman), R	Finance, Business management, Public Authorities, International
25/11/15	Enric Rovira Masachs	(D) Banco Sabadell	R	Finance, Real Estate Sector, Business management
05/05/16	Javier García-Carranza Benjumea	(D) Banco Santander	E	Finance, Real Estate Sector, Business management, International
28/11/16	Iñaki Goikoetxeta González	Independent	A, R	Real Estate Sector, Legal, Public Authorities, International
28/11/16	Javier Bartolomé Delicado	Independent	A, R	Finance, Business management, Legal, International
13/12/17	Jaime Rodríguez Andrade	(D) Banco Popular*	R	Finance, Business management, International
13/12/17	Jordi Mondéjar López	(D) Caixabank	E	Finance, Real Estate Sector, Business management
13/12/17	Eduardo Aguilar Fernández-Hontoria	(D) FROB	A, R	Finance, Business management, Public Authorities, International
13/12/17	Antonio Cayuela Gil	(D) Caixabank	A	Finance, Real Estate Sector, Business management

E Executive committee
A Auditing Committee
R Remuneration and Appointments Committee
Chairman of the committee

Finance
Real Estate Sector
Business management
Legal
Public Authorities
International

* Banco Popular is wholly owned by Banco Santander.

More information on Board of Directors
https://www.sareb.es/en_US/about-us/corporate-governance/board-of-directors

The functions of the governing bodies and their responsibilities

Sareb has two governing bodies, namely the Shareholders General Meeting and the Board of Directors. In addition, the Board of Directors has three Committees set up from amongst its members –the Auditing Committee, the Remuneration and Appointments Committee and, since March 2017, the Executive Committee.

Lastly, Sareb has what are known as Support committees, formed by representatives of the management team and the shareholders of the company.

Responsibilities and functions of the governing bodies and their Committees[38]

SHAREHOLDERS GENERAL MEETING		Composed of Sareb shareholders, it discusses and makes decisions on matters within its competence, according to the Articles of Association and the Capital Companies Act
BOARD OF DIRECTORS The body holding the representation, administration, management and control of the company	**Auditing Committee**	Responsibility for internal control systems, requisite financial information, and associated non-financial information, auditors or auditing firm, and conflicts of interests and related transactions.
	Remuneration and Appointments Committee	Amongst its functions are the duty to inform, propose and assess the suitability of the Sareb directors, and to inform on the general policy on remunerations and incentives, amongst others.
	Executive Committee	Created in March 2017, its activity focusses on the approval of business transactions and other powers delegated by the Board of Directors.

In addition to drawing up the programmes and setting the objectives for the carrying out all the activities included in its corporate object, the Board of Directors is also responsible, amongst other things, for approving the Corporate Social Responsibility Policy and the Medium-Term Social Housing Programme, for assigning properties to be used as affordable rented social housing through autonomous regions and town councils.

[38] The nature, composition, functions and scope of action of the Board, the Auditing Committee and the Remuneration and Appointments Committee is implemented within its own Regulations, which are available on the Sareb corporate website: https://www.sareb.es/en_US/

Evaluation of the performance of the Board of Directors

Article 6 of the Regulations of the Sareb Board of Directors establishes the obligation to prepare and approve a report on the performance of the members while carrying out their duties.

The Board of Directors and its Committees are subject to an annual evaluation of the activities carried out in the performance of their duties, as well as the degree of compliance with the provisions of the Board Regulations.

The results of the evaluation carried out in 2017 were satisfactory, and no improvement opportunities were identified with regards to the functioning of the Board. There was therefore no need to define a work plan.

The effectiveness of the Board of Directors

The exceptional conditions and circumstances that led to the creation of Sareb mean that special care must be taken in the administration and management of the company. For this reason, the members of the Sareb Board of Directors perform their duties in strict compliance with ethical and behavioural standards relating to possible conflicts of interest and related operations.

The Conflicts of Interests and Related Operations policy, approved by the Board of Directors in 2013, with its procedures for identifying such situations, applies more restrictive criteria than those required by applicable legislation. Not only are the affected directors prohibited from deliberating and voting on resolutions and decisions relating to transactions in which there is a potential conflict[39], but they are also denied information on these matters, and must be absent from the Board or Executive Committee while the matter is being discussed. This policy was applied on 45 occasions during 2017, with three of those applying to members of the Executive Committee.

In 2017, both the policy and the procedure were modified to incorporate new factors deriving from the company's exposure and its unique position with regards to the Capital Companies Act.

Remuneration for members of the Board of Directors

There is a policy that defines the remuneration framework for the members of the Sareb Board of Directors.

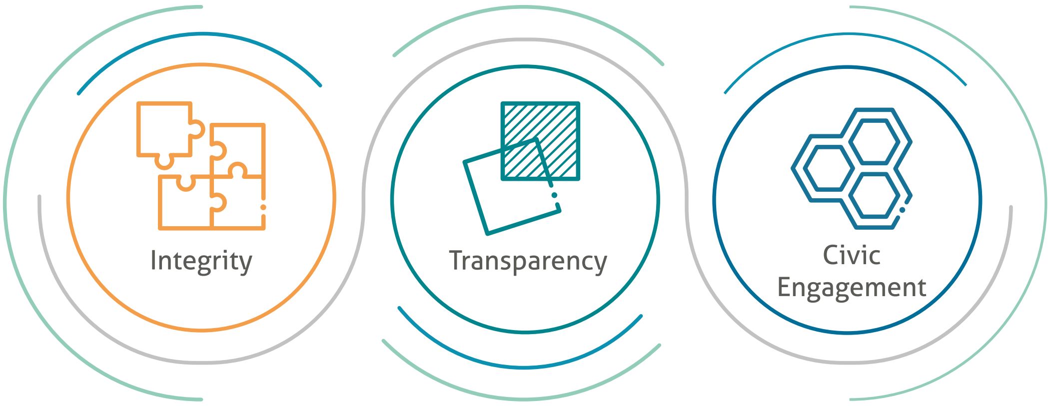
Each year sees the publication of a report on the manner in which the company has applied the policy in the last closed financial year. This is available for consultation on the Sareb website.

[39] According to the provisions of the Capital Companies Act.

More information in the Remunerations Policy Report
https://www.sareb.es/es_ES/conoce-sareb/gobierno-corporativo/informes

Internal Control Systems

Sareb is committed to carrying out its work according to the principles of Integrity, Transparency and Civic Engagement



The Internal Control System on Ethical Standards[40] includes all policies, manuals and procedures that contribute to the performance of the company's activity, not only in accordance with current legislation, but also in a full and integrated manner so as to safeguard its reputation and consolidate a corporate culture based on ethics.

The Compliance, Internal Control and Institutional Relations department is in charge of monitoring compliance with ethical standards aimed at crime prevention, data protection and the detection of other risks.

Central to this model is the Code of Conduct, which is complemented by a broad set of policies that cover areas that include, among others, criminal liability, the prevention of money laundering and financing of terrorism, data protection and relations with third parties. These also apply to servicers.

The Code of Conduct

Inspired by the 10 principles contained in the United Nations Global Compact, the Code of Conduct is the ultimate expression of Sareb's corporate culture. It expressly includes the commitments and behaviour guidelines that must be observed by the people included in its scope of application, and determines the framework to which policies and procedures must adhere.

[40] SCISNE

It was approved by the Board of Directors in 2013, and last updated on 21 December 2017.

New additions to the Code of Conduct

Code of Conduct Monitoring Committee	Further development of the competences of the Monitoring Committee, which is responsible for the assessment and monitoring of compliance with the Code of Conduct by Sareb staff.
Failure to comply with the policies shall be considered an infraction	It includes the Policy for the Prevention of Fraud, Bribery and Corruption, with non-compliance treated in the same way as non-compliance with the Code of Conduct.
What to do with gifts, giveaways and invitations?	The Code contains a new appendix that regulates the procedure that employees must follow with regards to gifts, thus adding to the regulations governing the acceptance of gifts that are already in existence.
Updates to prohibited conduct	Guidelines for the behaviour of employees when carrying out their professional activities have been updated.
Modifications to the Criminal Risk Prevention Model	The changes made to the Criminal Risk Prevention Model have been incorporated into the Code of Conduct.

The Code of Conduct should form the basis for the behaviour of employees from the moment they start working for Sareb. For this reason, new employees receive a copy of the Code of Conduct along with their employment contract, and express and signed acceptance of the Code of Conduct is requested as a contractual obligation.

In addition, a training plan is approved every year, relating to the internal regulations -the Code of Conduct and the rest of the policies- and the external legislation that is applicable at all times. All Sareb employees must complete this training. In 2017, 100% of Sareb employees took the courses on ethical regulations and compliance.

Compliance with the Code also extended its scope of influence to the relationship with servicers -all of them must adhere to the Sareb Code of Conduct- and the main suppliers, through the inclusion of a specific clause in contracts that requires express acceptance of the Code prior to the provision of services.

The Code of Conduct and its implementation

CODE OF CONDUCT	**Money Laundering Prevention**	• Sareb's Money Laundering Prevention Policy and Manual was approved by the Board of Directors in 2013, and last amended in 2016 in order to adapt them to organisational changes and amendments to the criteria employed in the legislation.
	Criminal Risk Prevention	• The Policy for Detection and Prevention of Criminal Risks and its Prevention Model guarantee that third parties duly comply with what is legally required of Sareb, and reinforce the entity's commitment to ethics and honesty.
	Data Protection	• Sareb ensures compliance with regulations regarding data protection, taking into account current legislation and applicable regulatory changes. 2017 therefore saw the company analysing the implications of the new European General Data Protection Regulation (GDPR) in order to identify and anticipate foreseeable changes. • In addition, the Law on Information Society Services and E-Commerce and other issues relate to consumption and advertising were taken into consideration.
	Relations with third parties	• The public nature of Sareb, and its unique social purpose, make it essential that the company acts in a totally exemplary manner in its operations. • The Policy on Relations with Third Parties was approved by the Board of Directors in 2014.

Certification of the compliance system

Sareb has become the first company with public capital to certify its commitment to criminal and anti-bribery compliance.

In line with the strict compliance with ethical and integrity standards that characterises Sareb, 2017 saw AENOR grant the company documentation that certifies and authenticates that the organisation has implemented the appropriate mechanisms to prevent, detect and manage both criminal risks and possible bribery behaviour, in accordance with UNE 19601/2017 and UNE-ISO 37001/2017, respectively.

In 2017, Sareb also strengthened its internal compliance system, with approval of the Policy for the Prevention of Fraud, Bribery and Corruption by the Board of Directors.

The Whistleblowing Channel

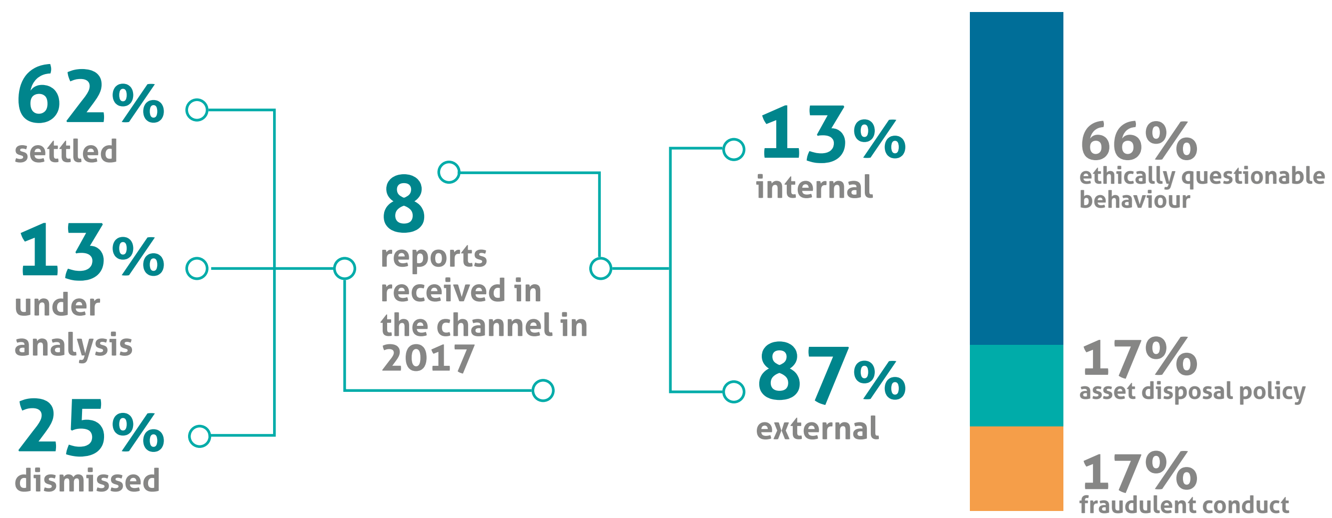
Sareb provides its employees and third parties related to the company –specifically servicers and suppliers– with a channel to facilitate the communication of irregularities and other ethically questionable behaviour.

The management of the channel is outsourced to a third party, with the aim of protecting the confidentiality of the complainant and thus avoiding fear of possible reprisals when it comes to reporting these issues.

In addition, the channel has been the subject of a publicity campaign to ensure that employees and servicers are aware of its existence, with information sessions, posters in areas where staff that manage Sareb's assets work, and intranet news content. In this way, the company sought to raise awareness of the importance of using the whistleblowing channel if any questionable behaviour is detected.

During the year, Sareb received a total of eight complaints, of which only one remains in the process of analysis or investigation at 31 December 2017. Five of them were resolved in accordance with internally established processing procedures, and two have been dismissed because they do not comply with the requirements governing acceptance for processing.

50. The Sareb Whistleblowing Channel[41]



[41] The breakdown of reports by category does not include dismissed ones.

Identification and management of risk

Risk management is fundamental for the achievement of established objectives

In 2017, Sareb defined a new risk management and control model based on recommendations issued by an independent expert. This will be implemented in 2018, and will allow the company to further improve the identification of potential situations that lead to the materialisation of risks, as well as the associated procedures that must be carried out to mitigate such risk.

To this end, a comprehensive risk assessment was carried out throughout the entire organisation, and a risk tolerance framework was incorporated –financial and non-financial– which includes specific metrics for each type of identified risk and minimum thresholds that trigger the action plans.

Risk Champions

In 2017, Sareb created a newly defined role in each business area, responsible for the management and control of risks.

In order to implement these changes in the structure of risk management and control, the company created the role of Risk Champions: a designated person in each business area responsible for leading the management of the risks pertaining to their area, as well as maintaining the reporting line and the hierarchical dependencies of their functional area.

Risks to which it is exposed

In line with the above, the company undertook a review of risk taxonomy and evolution from the inception of Sareb in 2012 to the current state of identified risks, approved in 2017.

	DEFINITION OF RISK	HOW IS IT MANAGED?
INTEGRITY	Non-compliance with ethical standards or generally accepted principles that result from deficiencies in the standards of conduct established by the Company or the procedures associated with them or improper personal behaviour. This includes risks deriving from legal, criminal and fiscal issues when due to wilful intent.	The Code of Conduct and its developments ensure the safekeeping of the company's integrity and its proper management.
FINANCIAL INFORMATION	The consequences of errors in financial information attributable to inadequate accounting policies or failures in the establishment of accounting treatment criteria for transactions or deficiencies in how they are implemented.	Management comprises a set of controls that provide reasonable assurance about the reliability of the financial information included in the financial statements.
OPERATIONAL	Failures in the processing of transactions attributable to unintentional human error or inadequate or defective processes or system failures, or as a consequence of external events.	Management encompasses an exhaustive and complete set of policies, manuals and procedures that ensure the minimisation of operational errors. As far as possible, Sareb automates those risks that are considered critical.
CREDIT	Possibility of loss arising from the total or partial failure of our customers or counterparties to meet their financial obligations to the Group, or a deterioration in their credit-worthiness.	Management establishes specific procedures based on the different characteristics of the financial asset units and operations.
REAL-ESTATE	The evolution of the price of property assets, whether owned by Sareb or not, indirectly affects this credit exposure and directly affects the portfolio of awarded property assets.	Active risk management covers the analysis of all the variables that affect the evolution of the real estate market, in order to optimise valuation and implement palliative strategies[42].

[42] Including guarantees.

	DEFINITION OF RISK	HOW IS IT MANAGED?
INTEREST RATE	The magnitude of the interest rate risk is directly linked to the size of the portfolio received in relation to the bonds issued for the acquisition of the company's assets and the payment of a floating interest rate linked to Euribor and the Spanish Treasury spread with respect to market swaps.	Management is carried out through the daily monitoring of the evolution of interest rate curves and monthly monitoring of the impact on Sareb's financial costs, raising awareness of extreme scenarios.
LIQUIDITY	Impossibility of dealing with debts acquired in respect of third parties and counterparties as a result of not having the necessary resources.	Management includes continuous analysis and definition of contingency plans, as well as the management of surpluses in accordance with the prudence principle, and an investment policy with counterparty risk limits, established and approved by the Board of Directors.
REPUTATIONAL	This is derived from the set of perceptions that the stakeholders have about Sareb as a result of its behaviour and actions over time. There is reputational risk when Sareb projects a message/image to its internal and external stakeholders that does not conform to its values.	Sareb has a Policy on Reputation Risk "by contagion", which allows the ordering of different risk situations the company may face, such as those derived from the parties involvement in criminal procedures related to assets received by Sareb. The company also has Communication and Institutional Relations Policies, which ensure transparency, and a Corporate Social Responsibility Policy, which details the company's commitments to carry out its mandate in a sustainable manner.
STRATEGIC	Consequence of policies, assumption of risks or strategy inconsistent with company mission or the context in which its business and activities would have to be developed. This applies to all areas of Sareb, including those directly involved in the activity of divestment of company assets and those involved in activities of internal organisation, given their capacity to influence compliance with the company mandate.	Management is carried out through the monitoring and annual update of the Sareb Business Plan.

10 ANNEX

Materiality Assessment 102-46

Within the framework of the preliminary work for drafting this Annual Report 2017, Sareb carried out a materiality study for the first time. This assessment follows the guidelines defined by the International Integrated Reporting Framework[43] and also takes into account the new GRI Standards[44] for the preparation of sustainability reports –another new initiative– which takes into account economic, social and environmental impacts.

In addition, the company continuously analyses the evolution of the context and trends of the market in which it operates in order to identify those issues that may have a potential impact on the business and the achievement of its results, and specifically, on the fulfilment of its mandate.

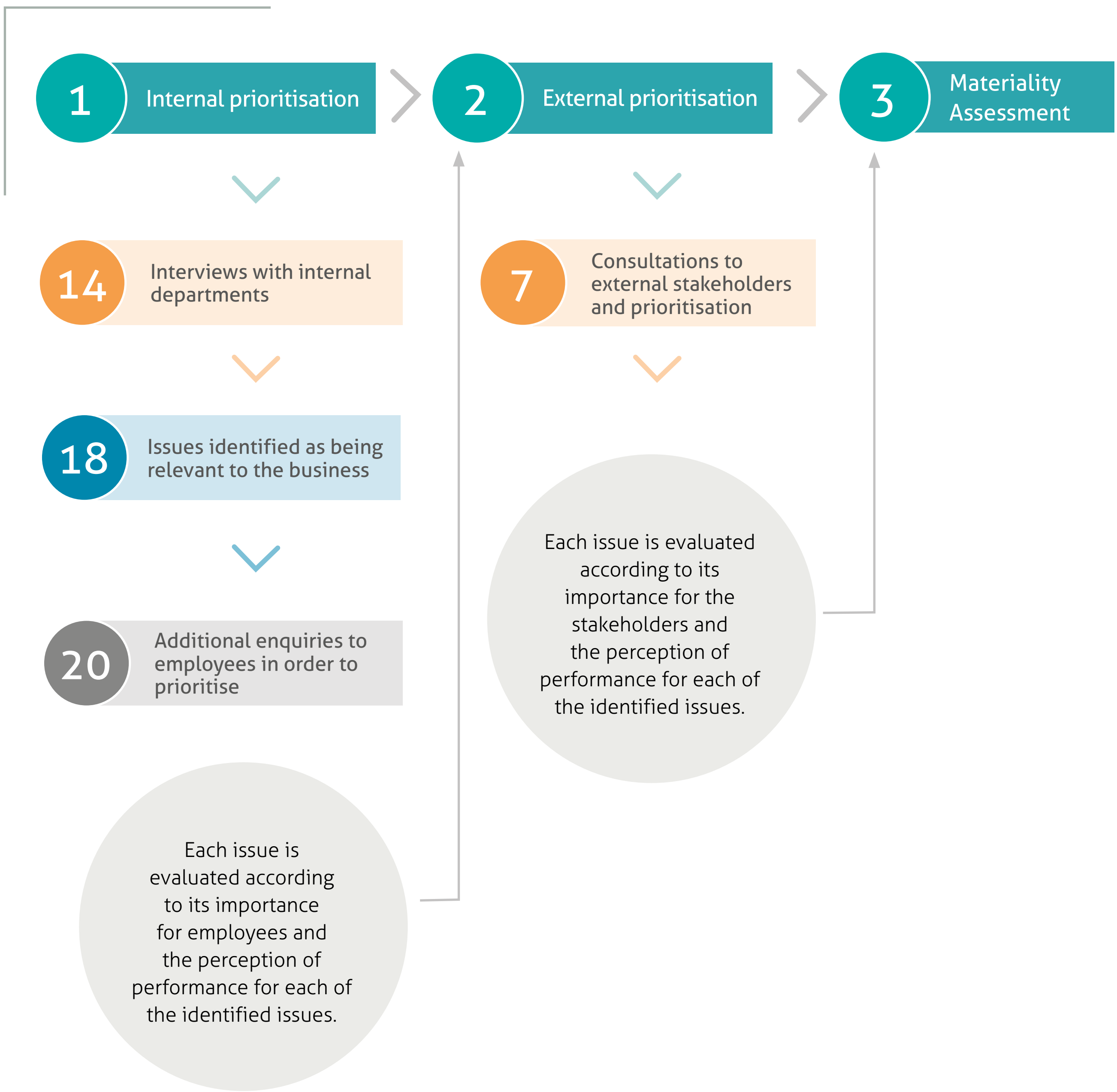
Methodological development

The identification of these issues and their prioritisation was addressed from two perspectives: internal, as a starting point to define and prioritise those issues relevant to the business; and external, which allows Sareb to know which of these issues concern its stakeholders, and their perception of the activity carried out by the Company.

A total of 14 interviews and 13 internal enquiries were conducted with Sareb employees; and seven interviews with representatives of external stakeholders. The result is 18 prioritised issues based on the above, which determine, among other things, the focus of the report for the organisation. From now on, Sareb will continue to work on gaining a deeper understanding of the identified issues and the results obtained, in order to refine and develop the basis for its knowledge in this regard.

[43] IIRC standing for international integrated reporting framework.
[44] Carried out in accordance with the 'Materiality Disclosures Service'.

Assessment methodology 102-46



Sareb stakeholders 102-40 102-44

List of issues

102-44 102-47

Below is a list of the identified issues, prioritised according to their internal and external relevance; and their equivalence to specific material indicators in economic, social and environmental spheres, in accordance with the requirements for the preparation of sustainability reports contained in the Global Reporting Initiative (GRI).

	HIGH PRIORITY	GRI Standards
1	Transparency in the activity carried out	
2	Efficient and responsible management of the asset portfolio received	201 – [201-1]
3	Payment of the debt without cost to the taxpayer	203 – [203-1]
4	Integrity, prevention of corruption and conflicts of interest	205 – [205-2] 102 – [102-16]; [102-17]
5	Creation of value to improve the commercial viability of the portfolio	

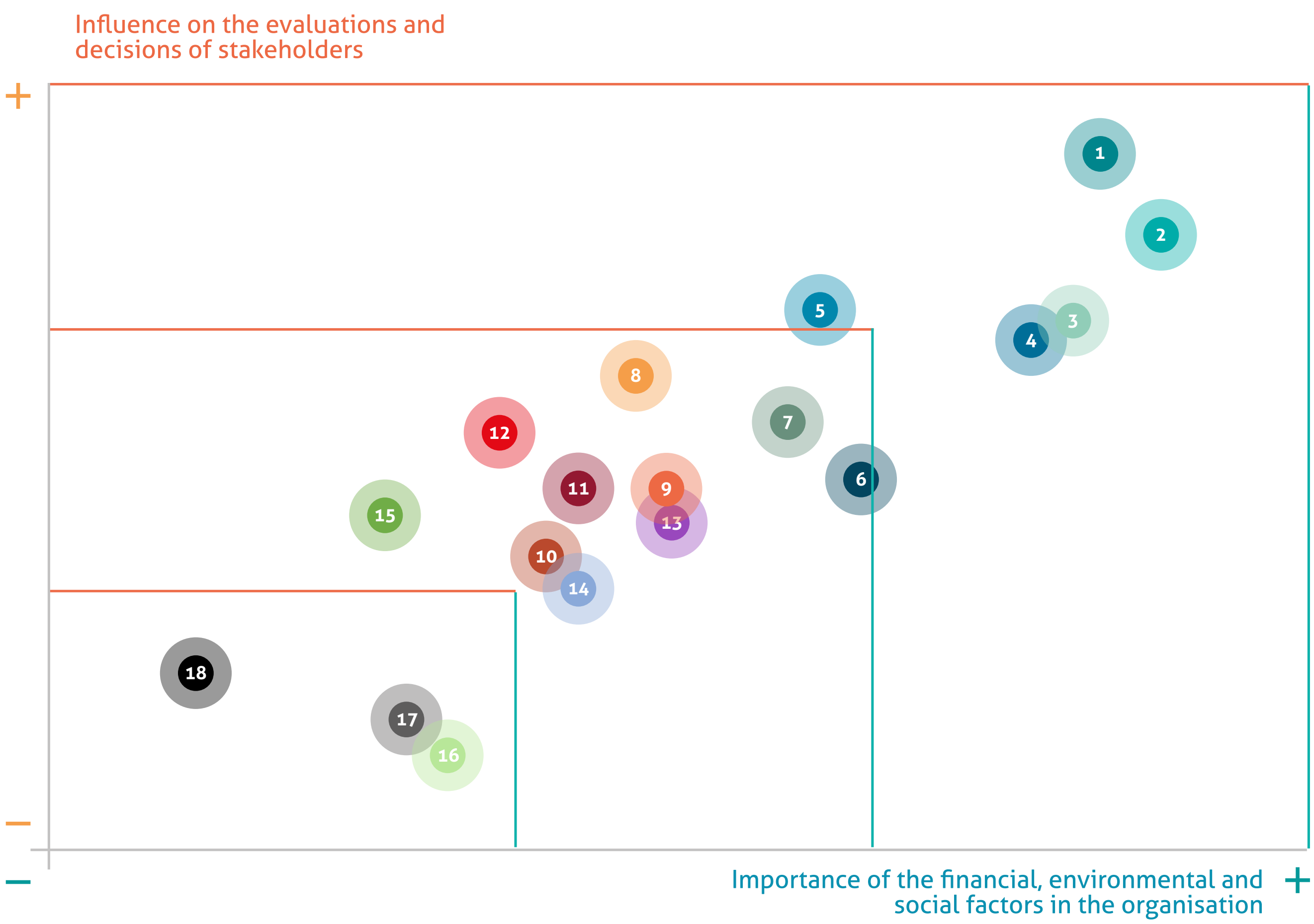
	MEDIUM PRIORITY	GRI Standards
6	Systems for the control, supervision and monitoring of activity	102 – [102-18]; [102-21] a [102-28]; [102-35]
7	The company's role in providing impetus to the real estate sector	203 – [203-1]
8	Respect for free competition and the free market	206 – [206-1]
9	Social action initiatives related to housing	201 – [201-1]
10	Flexibility to adapt to the market	
11	Closeness and communication with stakeholders	102 – [102-40] a [102-44]
12	Relationship with counterparties: public authorities, suppliers, etc.	204 – [204-1] 414 – [414-1]
13	Commercial viability of real estate assets	
14	Applied innovation: efficiencies and development of new products and services	
15	Impact of construction work on the environment	307 – [307-1]

	LOW PRIORITY	GRI Standards
16	Talent management and the professional development of employees	401 – [401-1] 404 – [404-1]; [404-2]; [404-3]
17	Respect for equality, diversity and non-discrimination	405 – [405-1] 406 – [406-1]
18	Expected return for shareholders	201 – [201-1]

In addition, and in order to make further progress in terms of transparency and corporate reporting, additional indicators to the material ones for the organisation are included in the GRI Content Index.

MATERIALITY MATRIX

The prioritisation of the issues was carried out while taking into consideration the assessment of the internal and external stakeholders consulted.



Prioritisation of issues on the basis of internal and external assessments

GRI CONTENT INDEX

GRI Code	Description of the indicator	Reference / Response
GRI 101: Foundation 2016		
GRI 102: General Disclosures 2016		
Profile of the organisation		
102-1	Name of the organisation	Sareb, Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A.
102-2	Activities, brands, products and services	14-15; 26-27
102-3	Location of headquarters	Paseo de la Castellana, 89, Madrid 28046
102-4	Location of operations	Spain
102-5	Ownership and legal form	Public Limited Company
102-6	Markets served	Spain
102-7	Scale of the organisation	23-24; 26; 73
102-8	Information on employees and other workers	75-76
102-9	Supply chain	85
102-10	Significant changes to the organisation and its supply chain	85
102-11	Precautionary Principle or approach	Not applicable
102-12	External initiatives	United Nations Global Compact
102-13	Membership of associations	Association of Professionals in Regulatory Compliance (Cumplen)
Strategy		
102-14	Statement from senior decision-maker	8-11
102-15	Key impacts, risks and opportunities	20-21; 35-36; 99-101

GRI Code	Description of the indicator	Reference / Response
Ethics and integrity		
102-16	Values, principles, standards and norms of behaviour	13; 95-97
102-17	Mechanisms for advice and concerns about ethics	98
Governance		
102-18	Governance structure	88-89; 93
102-21	Consulting stakeholders on economic, environmental, and social topics	103-104
102-22	Composition of the highest governance body and its committees	92
102-23	Chair of the highest governance body	92
102-24	Nominating and selecting the highest governance body	91, 93
102-25	Conflicts of interest	94
102-26	Role of highest governance body in setting purpose, values, and strategy	35
102-27	Collective knowledge of the highest governance body	92
102-28	Evaluating the highest governance body's performance	94
102-35	Remuneration policies	94
Stakeholder engagement		
102-40	List of stakeholder groups	105
102-41	Collective bargaining agreements	100% employees are covered by collective bargaining agreements
102-42	Identifying and selecting stakeholders	Stakeholders are selected on the basis of their influence and impact on the company's activity
102-43	Approach to stakeholder engagement	Active listening to the needs and expectations of the stakeholders, with specific channels depending on the stakeholder
102-44	Key topics and concerns raised	105-106
102-45	Entities included in the consolidated financial statements	2017 Financial Statements: 147-148; 171-172; 175

GRI Code	Description of the indicator	Reference / Response
Reporting practice		
102-46	Defining report content and content Boundaries	103-104
102-47	List of material topics	106
102-48	Restatements of information	There have been no restatements of information
102-49	Changes in reporting	The content of the report has been established according to a materiality assessment on the basis of IIRC guidelines and GRI Standards.
102-50	Reporting period	2017
102-51	Date of most recent report	2017
102-52	Reporting cycle	Anual
102-53	Contact point for questions regarding the report	Tel.: 915 563 700 www.sareb.es
102-54	Claims of reporting in accordance with the GRI standards	7
102-55	GRI content index	108
102-56	External assurance	Not applicable

MATERIAL TOPICS

GRI Code	Description of the indicator	Reference / Response
Economic performance		
GRI 103: Management Approach		
103-1	Explanation of the material topic and its boundary	66-73
103-2	The management approach and its components	66-73
103-3	Evaluation of the management approach	66-73
GRI 201: Economic performance 2016		
201-1	Direct economic value generated and distributed	19; 23-24; 26-27
Indirect economic impacts		
GRI 103: Management Approach 2016		
103-1	Explanation of the material topic and its boundary	20-21
103-2	The management approach and its components	20-21
103-3	Evaluation of the management approach	20-21
GRI 203: Indirect economic impacts 2016		
203-2	Significant indirect economic impacts	20-21
Procurement practices		
GRI 103: Management Approach 2016		
103-1	Explanation of the material topic and its boundary	85
103-2	The management approach and its components	85
103-3	Evaluation of the management approach	85
GRI 204: Procurement practices 2016		
204-1	Proportion of spending on local suppliers	85
Anti-corruption		
GRI 103: Management Approach 2016		
103-1	Explanation of the material topic and its boundary	95-96
103-2	The management approach and its components	95-96
103-3	Evaluation of the management approach	95-96
GRI 205: Anti-corruption 2016		
205-2	Communication and training about anti-corruption policies and procedures	96

GRI Code	Description of the indicator	Reference / Response
Anti-competitive behaviour		
GRI 103: Management Approach		
103-1	Explanation of the material topic and its boundary	Medium-priority issue
103-2	The management approach and its components	Medium-priority issue
103-3	Evaluation of the management approach	Medium-priority issue
GRI 206: Anti-competitive behaviour 2016		
206-1	Legal action related to unfair competition and monopolistic practices and against free competition.	No cases have been notified of non-compliance related to unfair competition and other similar practices in the reporting period.
Energy		
GRI 103: Management Approach		
103-1	Explanation of the material topic and its boundary	84
103-2	The management approach and its components	84
103-3	Evaluation of the management approach	84
GRI 302: Energy 2016		
302-1	Energy consumption within the organisation	84
302-3	Energy intensity	84
Environmental compliance		
GRI 103: Management Approach 2016		
103-1	Explanation of the material topic and its boundary	84
103-2	The management approach and its components	84
103-3	Evaluation of the management approach	84
GRI 307: Environmental compliance 2016		
307-1	Non-compliance with environmental laws and regulations	No cases have been notified of non-compliance of environmental legislation during the reporting period.
Employment		
GRI 103: Management Approach		
103-1	Explanation of the material topic and its boundary	77-78
103-2	The management approach and its components	77-78
103-3	Evaluation of the management approach	77-78
GRI 401: Employment 2016		
401-1	New employee hires and employee turnover	75-76

GRI Code	Description of the indicator	Reference / Response
Training and education		
GRI 103: Management Approach		
103-1	Explanation of the material topic and its boundary	79-80
103-2	The management approach and its components	79-80
103-3	Evaluation of the management approach	79-80
GRI 404: Training and education 2016		
401-1	Average hours of training per year per employee	79
401-2	Programmes for upgrading employee skills and transition assistance programmes	80
401-3	Percentage of employees receiving regular performance and career development reviews	80
Diversity and equal opportunity		
GRI 103: Management Approach 2016		
103-1	Explanation of the material topic and its boundary	78
103-2	The management approach and its components	78
103-3	Evaluation of the management approach	78
GRI 405: Diversity and equal opportunity 2016		
405-1	Diversity of governance bodies and employees	75-76; 78; 92
Non-discrimination		
GRI 103: Management Approach 2016		
103-1	Explanation of the material topic and its boundary	78
103-2	The management approach and its components	78
103-3	Evaluation of the management approach	78
GRI 406: Non-discrimination 2016		
406-1	Incidents of discrimination and corrective actions taken	No incidents of discrimination have been identified during the reporting period
Supplier Social Assessment		
GRI 103: Management Approach 2016		
103-1	Explanation of the material topic and its boundary	85
103-2	The management approach and its components	85
103-3	Evaluation of the management approach	85
GRI 414: Supplier Social Assessment 2016		
414-1	New suppliers that were screened using social criteria	85

11 FINANCIAL STATEMENTS

Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A.

Annual accounts and Directors' report at 31 December 2017

* [N.B.: Translation of annual accounts originally issued in Spanish and prepared in accordance with the regulatory financial reporting framework applicable to the Company in Spain (see Note 2). In the event of a discrepancy, the Spanish-language version prevails.]

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This version of our report is a free translation of the original, which was prepared in Spanish. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views and opinions, the original language version of our report takes precedence over this translation.

Independent auditor's report on the annual accounts

To the Shareholders of Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A.:

Report on the annual accounts

Opinion

We have audited the annual accounts of Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A. (the Company), which comprise the balance sheet as at December 31, 2017, the income statement, the statement of changes in equity, the cash flow statement and the related notes for the year then ended.

In our opinion, the accompanying annual accounts present fairly, in all material respects, the equity and financial position of the Company as at December 31, 2017, as well as its financial performance and cash flows for the year then ended, in accordance with the applicable financial reporting framework (as identified in Note 2 of the notes to the annual accounts), and, in particular, with the accounting principles and criteria included therein.

Basis for opinion

We conducted our audit in accordance with legislation governing the audit practice in Spain. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the annual accounts* section of our report.

We are independent of the Company in accordance with the ethical requirements, including those relating to independence, that are relevant to our audit of the annual accounts in Spain, in accordance with legislation governing the audit practice. In this regard, we have not rendered services other than those relating to the audit of the accounts, and situations or circumstances have not arisen that, in accordance with the provisions of the aforementioned legislation, have affected our necessary independence such that it has been compromised.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the annual accounts of the current period. These matters were addressed in the context of our audit of the annual accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

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Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A.

Key audit matters	How our audit addressed the key audit matter
Valuation of the units of financial assets and real estate assets At the year end, the Company assesses the need to execute valuation adjustments relating to financial and property assets impairment. This evaluation was carried out on individual basis, offsetting gains against losses for assets within the same "assets unit", in accordance with the Bank of Spain Circular 5/2015, of September 30. The valuation adjustments relating to financial assets and real estate assets impairment, is one of the most significant and complex estimation for the accompanying annual accounts, therefore was consider a key audit matter. According to the Bank of Spain Circular 5/2015, the Company has classified its assets in two different assets units as follows: • Financial assets unit: credit rights transferred to the Company, mortgage foreclosures and acquired in payment after the transfer date. • Real estate asset unit: properties with that nature at the transfer date. In accordance with the regulation set by the Circular as well as based on the criteria established in it, the Company has developed a assets' methodology for estimating the impairment adjustments. The process to estimate the possible impairment adjustments of the assets carried out by the Company is as follows: • As regards to the property assets unit, the evaluation was carried out individually, according to the Bank of Spain Circular 5/2015, taking into account the following criteria: - Generally, the Company estimates the value of property assets based on their mortgage value, calculated from valuation reports (full individual appraisals) made in accordance with the criteria set out in Order ECO/805/2013, of 27 March. Appraisal companies registered in the Official Registry of Appraisal Companies of the Bank of Spain made these valuation reports.	Our audit work regarding the estimation of the impairment adjustments to financial assets and real estte assets value has focused, among others, on the analysis, evaluation and verification of the internal control system, as well as the performance of detailed tests on the estimates made by the Company. With respect to the internal control environment, we have evaluated the design and tested the controls operational effectiveness in the following areas: • Verifying the IT general controls of the systems used to produce the financial information. Verification of the main aspects of the security environment of the information systems that include the calculation of impairment adjustments. • Verifying the adequacy of the policies and procedures, internal methodology approval to the relevant regulatory requirements applied, as well as obtaining, understanding and analyzing the interpretations of the Company in relation to the specific applicable rules. • Understanding of the internal control environment regarding the internal valuation methodology, identifying and validating the main key controls. In addition, we have carried out, among others, the following substantive procedures: • Reviewing the sample of the operations for the data quality testing purposes of the information contained in the systems, which was used as a basis for the assets' value estimation as well as for the calculation of possible impairment adjustment of the asset units' value. • We evaluated the competence, independence and integrity of the appraisal companies whose reports had been used for the valuation of the financial and property assets of the Company.

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Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A.

Key audit matters	How our audit addressed the key audit matter
- The company has the possibility to choose to perform full individual valuations, valuations based on sampling statistical procedures or making valuation by using automatic valuations, with the objective to estimate the value of finished houses and annexes to them as well as commercial premises located in towns where there is a representative market for comparable properties, and if exists a valuation report prepared in accordance with regulation mentioned above and which seniority is less than three years. Appraisal companies registered in the Official Registry of Appraisal Companies of the Bank of Spain made these valuation reports. - For those assets of the property assets unit, different from categories mentioned in the previous paragraph, the Company uses its best estimate based on an internal valuation model evaluated by an independent expert. Additionally to the valuation obtained according to the criteria described in the previous paragraphs, the methodology developed by the Company mainly considers the following aspects in the final valuation of the assets: - Adjustments to reflect the evolution of market prices and the horizons of the Company's business plan. - Estimation of maintenance and marketing costs, which were deducted from the result applying the criteria described above. - Discount or update rate. The valuation obtained after the application of the above adjustments was update to present value by applying an estimated discount rate taking into account the cost of financing the Company and the inherent risks in the assets. As indicated in notes 4.7, 4.7.1 and 4.7.2., in estimating the value of the assets, a series of assumptions based on the business plan of the Company had been apply. Therefore, the evolution of the valuation was linked to compliance with the key assumptions of the business plan. In notes 4.7.1 and 4.7.2, the Company had included a sensitivity analysis on the key assumptions considered more volatile.	• For a selected sample of valuation reports, we have verified, in collaboration with our experts in this matter, the assumptions used by the appraisal companies in the realization of their valuations in order to evaluate the reasonableness of them, as well as comparing with market data relevant and attending to the current situation of the buildings. • In cases of use of automatic valuation models, we have verified, in collaboration with our experts in this matter, the adequacy of the valuation methodologies applied by the appraisal companies and communicated to the Company. • We have carried out verifications regarding to the adjustments applied by the Company on the values of the appraisals received from third parties in relation to: i) the reflection of the evolution of market prices and the horizons of the Company's business plan; ii) the estimated maintenance and marketing costs and iii) the update to present value of the values obtained after applying the above mentioned adjustments. • We have obtained and analyzed the assessment made by the Company regarding the contrast between the evolution of the appraisals (revaluations made in the year) and the evolution of the price curves used by type of assets (land, residential, other assets). • Re-performance of the impairment adjustments calculation of each assets unit basing on the estimation of assets' value. • Sensitivity analysis and assumptions verifications used in the valuation of the asset units. • We have verified the correct accounting registration of the impairment adjustments estimated by the Company in accordance with the Bank of Spain Circular 5/2015. As a result of the procedures described above, we consider that the methodology used by the Company and the impairment estimated of its unit assets result consistent with the applicable accounting framework.

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Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A.

Key audit matters	How our audit addressed the key audit matter
• Regarding to the financial assets, the evaluation was carried out on individual basis, according to the capacity of payment of theirs debtors, taking into account the existence of guarantors with demonstrated payment capacity. For those financial assets for which it was estimated that the recovery of the amounts owed would be make through the foreclosure of the guarantees, the valuation of the financial assets are made by taking into account the property valuation of the guarantees. The evaluation was carried out in a similar way as the real estate assets described above, including in the estimation of costs not only those of maintenance and commercialization until the subsequent sale of the collateral, but also those necessary for the execution of the guarantees (procedural, legal and fiscal). Financial assets without property asset collateral that presents delays in contractual obligations exceeding eighteen months from the date of transfer of the assets to the Company, or from the date of the first default if this is later, are considered, except for evidence against, with null value. According to the criteria described above and the value of each asset calculated, the Company estimates the value of each asset, compensating for losses and gains of assets within the same assets unit. In accordance with the RD 4/2016, of December 2, on urgent financial measures, which modifies Act 9/2012, of November 14, on restructuring and resolution of credit institutions, the Company recognizes the valuation adjustments of the unit asset in the balance sheet, net of their tax effect, charged to "Value Change Adjustments - Impairment of financial assets", within equity. As established in the aforementioned RD 4/2016, the aforementioned adjustments would not be consider equity for the purposes of the distribution of profits, the mandatory reduction of share capital and the mandatory dissolution for losses established in the Capital Companies Act (LSC). See note 11.5. See notes 2.4. Critical aspects of the valuation and estimation of the uncertainty, 4.7 Impairment of financial assets, property investments and other accounts receivable, 4.7.1. Impairment of the property assets unit, 4.7.2. Impairment of loans and credits receivable and property assets received in payment of debts, 5. 5. Property Investments, 7.1.1. Long and short term third party loans, 8. Inventories, 11.4. Value change adjustments and 11.5 Equity Situation of the Company.	

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Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A.

Key audit matters	How our audit addressed the key audit matter
Recoverability of deferred tax assets	
The Company carries out an evaluation of the probable recoverability of deferred tax assets, taking into account the estimates made in its business plan. The evaluation of the recoverability of deferred tax assets involves a high degree of judgment and estimation, which is why they were considered as one of the most relevant issues in the audit. See notes 2.4 Critical aspects of the assessment and estimation of uncertainty and 15 Public administrations and tax position.	As part of our audit, we have verified the estimation process of the future recoverability of the deferred taxes assets recognized. The mainly the following audit procedures were carried out: • Understanding the area's control environment and verification of the criteria and assumptions considered by the Company in estimating the probable recoverability of the deferred taxes assets. • Obtaining and evaluating the information used by the Company for the estimation and subsequent evaluation of the recoverability of deferred tax assets. We have obtained the business plan developed by the Company and approved by its Board of Directors, as the most relevant information for estimating the recoverability of deferred tax assets, and we had evaluate the reasonableness of the most relevant hypotheses and assumptions included therein, through the following audit procedures, among others: • Verification of the consistency of the business plan with the budgets of the Company for the next fiscal years. • Evaluation of the reasonableness of the hypothesis and assumptions on which the business plan was based. • Evaluation of the reasonableness of the projections made by the Company, through retrospective analysis of the past projections. In relation to the deductibility of losses due to the impairment of the financial assets, we have verified their reasonableness, in collaboration with our experts in tax matters, executing the following audit procedures: • We had carried out an analysis on the content and scope of the inquiries issued by the General Directorate of Taxes in this regard.

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Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A.

Key audit matters	How our audit addressed the key audit matter
	• We have confirmed with our internal tax experts the conclusions obtained by the Company's tax advisors, based on the query, and we have verified the consideration of the content by the Company when establishing the impairment losses that they qualify as deductible at each moment of time. As a result of the above procedures, we consider that the estimates made by the Company regarding to the recoverability of deferred tax assets are reasonable, in accordance with the applicable fiscal and accounting framework.
Aspects associated with the generation of financial information	
The Company has four external managing companies (hereinafter, servicers) who manage the portfolios of financial and property assets assigned to them. Within its functions, each servicer registers and prepares the financial and accounting information of their own portfolios, reporting this information to the Company on a monthly basis. Based on this information, the Company carries out a process of accounting aggregation and generation of the financial information as a whole. Among the accounting entries that are recorded by each servicer as part of the Company's accounting records, the most important are those that originate in the operation of sales of financial and property assets, mortgage foreclosures and dations in payment, leases of real estate, maintenance expenses of real estate and ordinary management of loans, among others. For an adequate control of the operations managed in each servicer, the Company has a communication platform. This platform was use in order to gather information and documentation about the operations and verify that they are within the framework of functions delegated to each servicer or, in its case, to be able to authorize the transaction before its formalization and its subsequent accounting registration.	The following describes the main procedures carried out at the headquarters of each servicer, regarding the generation of the Company's financial and accounting information: • Verifying the IT general controls of the applications where the information on the managed financial and real estate assets is gathered. In the framework of our work, certain aspects of improvement were detect in relation to access controls in some applications. This aspect has led to an increase in the work to be done by our side over the mitigating controls identified by the Company and an increase in the work done regarding certain substantive testing. • Identifying automatic controls and key manual controls established by each servicer, on the financial and accounting information sent to the Company, and verification. • Reviewing the sample of the operations, executed by each servicer with supporting documentation, verifying the proper accounting treatment and classification. Likewise, we have verified whether the framework of delegated functions was fulfill or, where appropriate, the existence of authorization of the operation by the Company when it is required.

pwc

Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A.

Key audit matters	How our audit addressed the key audit matter
Consequently, the financial and accounting information associated with the operations managed at the headquarters of each servicer, resides in the computer systems of each of them, this way each and one of them is responsible for monthly and year end information submission to the Company. Therefore, an adequate control over the information systems in the main offices of each servicer is fundamental to guarantee the correct processing of the accounting information. In this context, the knowledge, evaluation and verification of controls established by the Company to ensure the integrity of financial information, as well as the execution of certain substantive verification tests at the servicers' headquarters, were consider a key audit matter. See note 1 Company Activity of the report of the attached annual accounts.	• Reviewing the sample of the operations for the data quality testing purposes, verifying the information accounted in the servicers' systems with the supporting documentation, this way verifying the coherence between the information reflected in the servicers' systems and the systems of the Company. • Verifying the reconciliation of accounting inventories generated by each servicer with the financial information sent to the Company. • Understanding and analysis, on a sample basis, of entries introduced manually in the financial information systems. Additionally, we have identified the automatic controls and key manual controls established by the Company, regarding the integrity of the financial and accounting data submitted by the servicers and we have evaluated their effectiveness. Our procedures allow us to obtain sufficient and adequate audit evidence in relation to the accounting aggregation process and the generation of financial information by the Company, without having identified relevant aspects that could significantly affect the financial information included in the financial statements in the accompanying annual accounts.

Other information: Management report

Other information comprises only the management report for the 2017 financial year, the formulation of which is the responsibility of the Company's directors, and does not form an integral part of the annual accounts.

Our audit opinion on the annual accounts does not cover the management report. Our responsibility regarding the management report, in accordance with legislation governing the audit practice, is to evaluate and report on the consistency between the management report and the annual accounts as a result of our knowledge of the Company obtained during the audit of the aforementioned financial statements, and does not include information different to that obtained as evidence during our audit. Likewise, our responsibility is to evaluate and report on whether the content and presentation of the management report is in accordance with applicable regulations. If, based on the work we have performed, we conclude that material misstatements exist, we are required to report that fact.

On the basis of the work performed, as described in the previous paragraph, the information contained in the management report is consistent with that contained in the annual accounts for the 2017 financial year, and its content and presentation are in accordance with the applicable regulations.

pwc

Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A.

Responsibility of the directors and the audit committee for the annual accounts

The Company's directors are responsible for the preparation of the accompanying annual accounts, such that they fairly present the equity, financial position and financial performance of the Company, in accordance with the financial reporting framework applicable to the entity in Spain, and for such internal control as the directors determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

In preparing the annual accounts, the Company's directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The audit committee is responsible for overseeing the process of preparation and presentation of the annual accounts.

Auditor's responsibilities for the audit of the annual accounts

Our objectives are to obtain reasonable assurance about whether the annual accounts as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with legislation governing the audit practice in Spain will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these annual accounts.

As part of an audit in accordance with legislation governing the audit practice in Spain, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the annual accounts, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Company's directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor´s report to the related disclosures in the annual accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor´s report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the annual accounts, including the disclosures, and whether the annual accounts represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Company's audit committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Company's audit committee with a statement that we have complied with relevant ethical requirements, including those relating to independence, and we communicate with the audit committee those matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Company's audit committee, we determine those matters that were of most significance in the audit of the annual accounts of the current period and are therefore the key audit matters.

We describe these matters in our auditor´s report unless law or regulation precludes public disclosure about the matter.

Report on other legal and regulatory requirements

Additional report to the audit committee

The opinion expressed in this report is consistent with the content of our additional report to the Company's audit committee dated on March 22, 2018.

Appointment period

The General Ordinary Shareholders' Meeting held on May 9, 2017 appointed us as auditors for a period of two years, corresponding to the years ended on December 31, 2017 and December 31, 2018.

Previously, we were appointed by resolution of the General Shareholders' Meeting for a period of three years and we have audited the annual accounts continuously since the year ended on December 31, 2012.

Services provided

PricewaterhouseCoopers Auditores, S.L. provided to the Company non-audit services during the period ended December 31, 2017. See details in the note 16.4 of the accompanying annual accounts.

PricewaterhouseCoopers Auditores, S.L. (S0242)

Original in Spanish signed by:

Amagoia Delgado Rodríguez (22009)

March 22, 2018

Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A. (Sareb)

Balance sheets at 31 December 2017 and 31 December 2016
(Thousand of euros)

ASSETS	Notes in Report	31/12/17	31/12/16
NON-CURRENT ASSETS		**31,934,374**	**36,612,166**
Intangible fixed assets	**Note 4.1**	**17,982**	**16,294**
Industrial property		46	52
Computer software		17,936	16,242
Property, plant and equipment	**Note 4.2**	**5,081**	**3,949**
Fixtures		212	187
Technical installations and other property, plant and equipment		4,695	3,356
IT Equipment		174	406
Property Investments	**Note 5**	**11,699,278**	**11,986,731**
Land		5,072,450	5,019,864
Properties completed		6,486,782	6,966,867
Advances on Property Investments		140,046	-
Long term investments in group companies and associates		**186,034**	**31,667**
Equity instruments	Note 7.2.1	182,867	9,702
Loans to companies	Note 7.2.2	3,167	21,965
Long term financial investments	**Note 7.1**	**19,414,953**	**23,679,348**
Loans to third and related parties		17,207,323	20,902,659
Other financial assets		2,207,630	2,776,689
Deferred tax assets	**Note 15.3**	**611,046**	**894,177**
CURRENT ASSETS		**8,210,490**	**7,479,907**
Inventories	**Note 8**	**268,359**	**150,765**
Products in progress		217,790	95,085
Finished products		17,327	21,764
Advances to suppliers		33,242	33,916
Trade debtors and other accounts receivable	**Note 9**	**196,236**	**252,032**
Customer receivables from sales and services rendered		180,970	218,448
Sundry debtors		7,938	26,437
Staff		8	7
Current tax assets	Note 15.1	1,949	5,899
Other receivables from the Public Administrations	Note 15.1	5,371	1,241
Short term financial investments	**Note 7.1**	**3,608,270**	**3,584,025**
Loans to companies		3,600,337	3,558,690
Other financial assets		7,933	25,335
Cash and other cash equivalents	**Note 10**	**4,137,625**	**3,493,085**
Cash and Banks		2,751,862	1,726,822
Other cash equivalents		1,385,763	1,766,263
TOTAL ASSETS		**40,144,864**	**44,092,073**

Notes 1 to 19 described in the attached report form an integral part of the Balance Sheet at 31 December 2017.

Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A. (Sareb)

Balance sheets at 31 December 2017 and 31 December 2016

(Thousand of euros)

LIABILITIES	Notes in Report	31/12/17	31/12/16
EQUITY	**Note 11**	**(3,707,230)**	**(2,657,271)**
SHAREHOLDERS' EQUITY-		**2,055,367**	**2,619,943**
Capital			
Subscribed capital		303,862	303,862
Issue Premium		-	-
Legal Reserve		**19,174**	**19,174**
Other reserves		**2,296,907**	**2,959,698**
Income/(Loss) for the year		**(564,576)**	**(662,791)**
VALUE CHANGE ADJUSTMENTS-	**Note 13,3**	**(5,762,597)**	**(5,277,214)**
- Hedging operations		**(1,533,045)**	**(1,987,672)**
- Impairment of Financial Assets		**(4,229,552)**	**(3,289,542)**
NON-CURRENT LIABILITIES		**39,383,208**	**42,267,482**
Long term provisions	**Note 12**	**9,530**	**10,947**
Long term debts	**Note 13**	**39,373,678**	**42,256,535**
Debentures and other negotiable securities		36,891,090	39,068,660
Derivatives		2,057,320	2,686,801
Other financial liabilities		425,268	501,074
CURRENT LIABILITIES		**4,468,886**	**4,481,862**
Short term provisions		**2,397**	**2,533**
Short term debts	**Note 13**	**3,968,991**	**4,021,772**
Amounts owed to credit institutions		22,947	61,430
Debentures and other negotiable securities		3,907,378	3,959,509
Other financial liabilities		38,666	833
Trade accounts and other accounts payable	**Note 14**	**490,511**	**457,557**
Suppliers		380,069	341,029
Staff		8,545	11,989
Current tax liabilities		-	-
Other payables to the Public Administrations	**Note 15,1**	50,586	75,258
Customer advances		51,311	29,281
Income collected in advance		**6,987**	-
TOTAL EQUITY AND LIABILITIES		**40,144,864**	**44,092,073**

Notes 1 to 19 described in the attached report form an integral part of the Balance Sheet at 31 December 2017.

Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A. (Sareb)

Income statement for the years 2017 and 2016

(Thousand of euros)

	Notes in Reports	2017	2016
ONGOING OPERATIONS			
Net Turnover	**Note 16.1**	**2,143,800**	**2,134,149**
Sales of inventories		22,769	23,659
Income from sales of Property Investments		1,109,609	986,238
Income from leases		49,443	42,135
Income from sales of loans and credits		452,427	474,285
Income from loans and credits		723,818	890,563
Margin of recovery of loans and credits		(220,844)	(283,634)
Income from remuneration FABs		1,778	903
Income from sale and liquidation of FABs	Note 7.2.1	4,800	-
Changes in inventories of finished products and work in progress	**Note 16.2**	**(15,841)**	**(17,483)**
Sales costs	**Note 16.2**	**(1,378,013)**	**(1,479,361)**
Cost of Property Investments		(962,234)	(886,246)
Sales costs of Financial Assets		(413,165)	(593,115)
Cost of sales of FABs		(2,614)	-
Other operating income		**17,058**	**26,523**
Non-core and other current operating revenues		17,058	26,523
Staff expenses	**Note 16.3**	**(40,787)**	**(39,401)**
Salaries, wages and similar		(34,890)	(34,606)
Social Security		(5,897)	(4,795)
Other operating expenses		**(659,617)**	**(658,769)**
External Services	Note 16.4	(460,564)	(445,375)
Taxes	Note 16.4	(177,766)	(197,205)
Loss, impairment and variation in provisions for trade operations	Notes 9 y 12	(17,331)	(14,795)
Other current operating expenses		(3,956)	(1,394)
Amortisation/Depreciation of fixed assets	**Notes 4.1, 4.2 y 4.3**	**(61,444)**	**(67,775)**
Overprovisions	**Note 12**	**3,053**	**-**
Impairment and gain/(loss) from sales of property, plant and equipment		**(94)**	**-**
- Gain/(loss) from sales and others		(94)	-
Impairment and gain/(loss) from sales of financial instruments		**(1,169)**	**(2,427)**
Impairment and losses		(1,047)	(2,427)
Gain/(loss) from sales and others		(122)	-
OPERATING INCOME/(LOSS)		**6,946**	**(104,544)**
Financial revenue	**Note 16.6**	**7,640**	**19,174**
From negotiable securities and other financial instruments			
- In third parties		7,640	19,174
Financial Expenses	**Note 16.5**	**(548,494)**	**(577,465)**
For debts with third parties		(530,894)	(560,132)
Other financial expenses		(17,600)	(17,333)
Exchange rate differences	**Note 4.12**	**3**	**187**
FINANCIAL INCOME/(LOSS)		**(540,851)**	**(560,531)**
PRE-TAX INCOME/(LOSS)		**(533,905)**	**(662,648)**
Income tax	Note 15	(30,671)	(143)
INCOME/(LOSS) FOR THE YEAR FROM ONGOING OPERATIONS		**(564,576)**	**(662,791)**
INCOME/(LOSS) FOR THE YEAR		**(564,576)**	**(662,791)**

Notes 1 to 19 described in the attached report form an integral part of the Income Statement for 2017.

Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A. (Sareb)

Statement of changes in equity for the years 2017 and 2016
Statement of recognised income and expense
(Thousands of euros)

	Notes in the Report	Year 2017	Year 2016
BALANCE FROM THE INCOME STATEMENT (I)	**Note 3**	**(564,576)**	**(662,791)**
Income and expenses attributed directly to equity			
- For cash flow hedges	Note 15.2	80,746	(564,763)
- For Impairment of Financial Assets	Note 7.1	(840,196)	(376,938)
- Tax effect	Note 15.2	(20,186)	(441,144)
TOTAL INCOME AND EXPENSES ATTRIBUTED DIRECTLY TO EQUITY (II)		**(779,636)**	**(1,382,845)**
Income and expense charged against the income statement			
- For cash flow hedges	Note 13.3	525,424	505,607
- Tax effect		(231,170)	(126,402)
TOTAL TRANSFERS TO THE INCOME STATEMENT (III)		**294,254**	**379,205**
TOTAL RECOGNISED INCOME AND EXPENSES (I+II+III)		**(1,049,958)**	**(1,666,431)**

Notes 1 to 19 in the attached report form an integral part of the recognised income and expenditure statement at 31st December 2017.

Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A. (Sareb)

Statement of changes in equity for the years 2017 and 2016
Total statement of changes in equity
(Thousands of euros)

	Capital	Issue Premium	Legal Reserve	Restricted reserved
OPENING BALANCE 2016	**300,060**	**900,000**	**-**	**-**
Total recognised income and expenses	**-**	**-**	**-**	**-**
Transactions with shareholders				
Distribution of profit/(loss) 2015	-	-	33	-
Other changes in equity (Note 2.5)	-	-	-	-
Capital reduction to offset losses	(300,060)	(900,000)	(33)	-
Capital increase for conversion of financial liabilities	2,170,440	-	-	-
Capital reduction to offset losses and allocation to legal reserves	(1,237,151)	-	19,174	-
Capital reduction for allocation to restricted reserve	(629,428)	-	-	629,428
CLOSING BALANCE 2016 (Note 11)	**303,862**	**-**	**19,174**	**629,428**
Total recognised income and expenses	**-**	**-**	**-**	**-**
Transactions with shareholders				
Other changes in equity - Distribution of profit((loss)	-	-	-	-
CLOSING BALANCE 2017 (Note 11)	**303,862**	**-**	**19,174**	**629,428**

Notes 1 to 19 of the attached report form an integral part of the statement of total changes in equity for 2017.

Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A. (Sareb)

Statement of changes in equity for the years 2017 and 2016

Total statement of changes in equity

(Thousands of euros)

Voluntary Reserves for application RD 4/2016	Accumulated loss from previous years	Income/(Loss) for the year	Adjustements for changes in value - Finantial Derivatives	Adjustements for changes in value - Impairment FA	TOTAL
2,433,163	**(2,418,370)**	**(102,561)**	**(1,943,305)**	**(2,330,270)**	**(3,161,282)**
-	**-**	**(662,791)**	**(44,367)**	**(959,272)**	**(1,666,430)**
-	299	(332)	-	-	-
(102,893)	-	102,893	-	-	-
-	1,200,093	-	-	-	-
-	-	-	-	-	2,170,440
-	1,217,977	-	-	-	-
-	-	-	-	-	-
2,330,270	**-**	**(662,791)**	**(1,987,672)**	**(3,289,542)**	**(2,657,272)**
-	**-**	**(564,576)**	**454,627**	**(940,010)**	**(1,049,958)**
(662,791)	-	662,791	-	-	-
1,667,479	**-**	**(564,576)**	**(1,533,045)**	**(4,229,552)**	**(3,707,230)**

Notes 1 to 19 of the attached report form an integral part of the statement of total changes in equity for 2017.

Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A. (Sareb)

Cash flow statement for the years 2017 and 2016

(Thousands of euros)

		Year 2017	Year 2016
A)	**CASH FLOWS FROM OPERATING ACTIVITIES (1 + 2 + 3 + 4)**	**2,327,498**	**2,298,928**
1.	**Pre-tax income/(loss)**	**(533,905)**	**(662,648)**
2.	**Adjustments to income/(loss):**	**(106,195)**	**(247,275)**
(+/-)	Amortisation/Depreciation of fixed assets	61,444	67,775
(+/-)	Financial Expenses	548,494	577,465
(+/-)	Financial revenue	(7,640)	(19,174)
(+/-)	Financial revenue from interest on loans and credits	(723,818)	(890,563)
(+/-)	Other adjustments to income/(loss)	(3,053)	-
(+/-)	Loss, impairment and variation in provisions for trade operations	17,331	14,795
(+/-)	Impairment of financial instruments	1,047	2,427
2.a	**Tax payments (-)**	**(1,949)**	**(1,935)**
3.	**Increase / (Decrease) of assets and liabilities**	**3,095,218**	**3,295,844**
	Increase / (Decrease) of inventories (+/-)	(15,659)	(1,156)
	Increase / (Decrease) of accounts receivable (+/-)	34,568	(13,393)
	Increase / (Decrease) of other current financial assets (+/-)	17,402	(17,925)
	Increase / (Decrease) of accounts payable (+/-)	32,954	31,902
	Increase / (Decrease) of other current financial liabilities (+/-)	(461)	(22,165)
	Increase / (Decrease) of loans and credits to third parties	2,076,708	2,450,297
	Increase / (Decrease) of Property Investments	949,706	868,284
4.	**Other cash flows from operating activities:**	**(125,671)**	**(85,057)**
(-)	Interest payments	(574,803)	(557,092)
(+)	Dividends receivable	-	-
(+)	Interest receivable	3,751	4
(+/-)	Interest received from loans and credits	445,381	472,031
(+/-)	Other receivables/(payments) from operating activities	-	-
B)	**CASH FLOWS FROM INVESTMENT ACTIVITIES (1 + 2)**	**577,693**	**(117,491)**

Notes 1 to 19 described in the attached report form an integral part of the cash flow statement for 2017.

Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A. (Sareb)
Estados de flujos de efectivo de los ejercicios de 2017 y de 2016
(Miles de euros)

		Year 2017	Year 2016
1.	**Payments on investments**	**(8,898)**	**(117,491)**
(-)	Tangible and Intangible Fixed Assets	(8,074)	(10,258)
(-)	Credit and holdings in associates	(824)	(2,365)
(-)	Other financial assets	-	(104,868)
2.	**Receivable from divestments:**	**586,591**	**-**
(+)	Credit and holdings in associates	17,532	-
(+)	Other financial assets	569,059	
C)	**CASH FLOWS FROM FINANCING ACTIVITIES (1 + 2 + 3)**	**(2,260,651)**	**(1,922,585)**
1.	**Receivables/(payments) from equity instruments:**	**-**	**-**
(+)	Issue	-	-
(-)	Amortisation/Depreciation	-	-
(-)	Acquisition	-	-
(+)	Sale of own shares	-	-
2.	**Net obtained from new financing with third parties**	**(2,260,651)**	**(1,922,585)**
(+)	Other non-current financial liabilities	(71,288)	(84,094)
(-)	Drawdowns / (Amortisations) credit accounts	8,737	3,609
(-)	Refund and amortisation	(2,198,100)	(1,842,100)
3.	**Net receivables for issue own securities**	**-**	**-**
D)	**EFFECT OF FLUCTUATIONS IN EXCHANGE RATES**	**-**	**-**
E)	**INCREASE/(DECREASE) NET OF CASH AND CASH EQUIVALENTS (A + B + C + D)**	**644,540**	**258,852**
F)	**CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR**	**3,493,085**	**3,234,233**
G)	**CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR (E + F)**	**4,137,625**	**3,493,085**
	COMPONENTS OF CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR		
(+)	Cash and banks	2,751,862	1,726,822
(+)	Other financial assets	1,385,763	1,766,263
(-)	Less: Bank overdrafts repayable on demand		
	TOTAL CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	**4,137,625**	**3,493,085**

Notes 1 to 19 described in the attached report form an integral part of the cash flow statement for 2017.

Notes to the annual accounts for the year ended 31 December 2017

1. Company Activity

The company Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A. (hereinafter, the "Company" or "Sareb") was incorporated for an indefinite term in Madrid, on 28 November 2012, in accordance with the provisions of Act 9/2012, of 14 November, on the restructuring and winding-up of credit institutions, with the name Sociedad Promotora de la Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A., as a single-member public limited company; its purpose is to carry out all the preparatory measures necessary for putting Sareb into operation. Registered in the Companies Registry for Madrid in volume 30,521, Sheet 1, Section 8, Page M-549,293, 1st entry.

On 12 December 2012 it changed its term and name under the deed which places on public record the company resolutions adopted on that date in the presence of the Madrid Notary Mr. José María García Collantes under number 1624 of his official record, limiting its duration until 28 November 2027 and assuming its current name.

On 31 December 2017 the Company has its registered and tax address in Paseo de la Castellana number 89, in Madrid.

The Company is governed by its Articles of Association and by legislation in force that is applicable to it, i.e. the current Capital Companies Act, except for the provisions of articles 537 and 348 bis thereof, in accordance with the terms of Act 9/2012, of 14 November, on the restructuring and winding-up of credit institutions, with the specific terms necessary for ensuring that the accounting principles applicable to it are consistent with the mandate and general objectives of the company as established in the Act of reference and which are set out by law (see Note 2.1).

Its corporate object consists of holding, managing and directly or indirectly administering, buying and selling the assets and, where appropriate, liabilities, transferred to it by the credit institutions referred to in the Ninth Additional Provision of the Act 9/2012, (or any legislation that replaces, implements or supplements it) which appear in their balance sheets or in those of any company over which it exercises control in the sense of article 42 of the Code of Commerce (and also any others that it might acquire in the future as a result of the mentioned activity involving the management and administration of such assets).

Notwithstanding the above-described corporate object, in accordance with the legislation regulating it, the Company has to contribute to the correct implementation of the processes for the restructuring or winding up of credit institutions, making it possible to meet the objectives set out in article 3 of Royal Decree 1559/2012 in accordance with the general principles of transparency and professional management, namely:

a) Contribute to the clean-up of the financial system by acquiring the related assets in such a manner that the risk associated with these assets are effectively transferred from the time of their transfer.

b) Minimise public funding.

c) Settle debts and meet obligations it assumes in the course of its operations.

d) Minimise any possible distortions in the markets that might arise from its actions.

e) Sell the assets received, enhancing their value within the time period established and for which the company was set up.

Background to the incorporation of the Company and transfer of assets

In 2012: Acquisition of assets from banks in Group 1

On 21 December 2012, Sareb and the banks making up the mentioned Group 1 concluded the corresponding asset transfer contracts which, in accordance with the terms thereof, did not come into full effect until 31 December 2012. Those assets were transferred free of any charges by the assigning banks as a whole and at a fixed price which was for the amount of 36,695,308 thousand euros, and were acquired by Sareb through the issue of senior bonds for a total of 36,694,100 thousand euros, which were subscribed by the assigning banks, deferring the payment of the difference between the transfer price and the value of the bonds issued for a period of 36 months, which may be offset by the Company with any amount owed to it by the assigning banks under the terms set out in the asset transfer contracts. At 31 December 2013 that amount had been settled, with no amounts appearing for that item on the attached balance sheet at that date.

Below is the breakdown of the assets that were transferred by the banks in Group 1 according to their nature on that date:

	Thousands of euros
Financial assets	28,298,902
Real estate assets	8,396,406
Total	**36,695,308**

The breakdown of the financial assets that were transferred by the Group 1 banks, according to the type of guarantee on each, was as follows:

Amounts in Thousands of euros	No. of Assets	Total Transfer Price
Loans	**62,435**	**26,493,181**
Normal	28,047	8,368,902
Sub-standard	11,877	6,646,904
Doubtful	22,511	11,477,375
Credits	**5,714**	**1,805,721**
Normal	1,810	537,427
Sub-standard	870	495,392
Doubtful	3,029	557,025
Others	5	215,877
Total	**68,149**	**28,298,902**

For its part, the breakdown of the property assets that were transferred by the banks in Group 1 was as follows:

Amounts in Thousands of euros	No. of Assets	Total Transfer Price
Land	10,322	2,812,430
Properties completed and for sale	30,158	2,426,138
Properties for rental	5,822	927,620
Total Property Investments	**46,302**	**6.166,188**
Works in progress	3,050	470,124
Properties completed	27,682	1,760,094
Total inventories	**30,732**	**2,230,218**
Total	**77,034**	**8,396,406**

Below is a summary of the main features of the senior bonds issued by the Company and subscribed by the Group 1 banks on 21 December 2012 in payment of the mentioned assets:

ISIN Code	Description	Date of issue	Maturity date (**)	Applicable rate in force	Nominal (Thousands of euros) (*)
ES0352506002	SAREB/VAR BO 20131231 2012-1	31/12/2012	31/12/2013	2.374%	11,008,100
ES0352506010	SAREB/VAR BO 20141231 2012-2	31/12/2012	31/12/2014	2.747%	16,512,500
ES0352506028	SAREB/VAR BO 20151231 2012-3	31/12/2012	31/12/2015	3.149%	9,173,500
					36,694,100

(*) Those bonds carry an irrevocable guarantee from the Kingdom of Spain (see Note 13.2).
(**) There is an option to renew at the Company's discretion, as described in Note 13.

Those bonds were subscribed by the assigning banks in accordance with the following distribution:

	Thousands of euros
Bankia, S.A./Banco Financiero y de Ahorros, S.A.	22,317,600
Catalunya Banc, S.A.	6,708,300
Banco Gallego, S.A.	609,700
NovaGalicia Banco, S.A.	5,096,800
Banco de Valencia, S.A.	1,961,700
Total	**36,694,100**

In 2013: Acquisition of assets from banks in Group 2

On 20 December 2012, the European Commission approved the plans for the restructuring of the financial institutions falling under Group 2 (Banco Grupo Cajatres, S.A., Banco Mare Nostrum, S.A., Banco Caja España de Inversiones, Salamanca y Soria, S.A. -CEISS- and Liberbank,S.A.) after they had been approved by the Bank of Spain.

On 28 February 2013 Sareb and the entities making up Group 2 formalised the corresponding asset transfer contracts; the assets were transferred free of charges by the assigning banks of Group 2 to Sareb as a whole and at a fixed price for the amount of 14,087,157 thousand euros, and were acquired by Sareb through the issue of senior bonds at a face value of 100 thousand euros, for a total of 14,086,700 thousand euros, that were subscribed by the assigning banks, deferring the payment of the difference between the transfer price and the value of the bonds issued for a period of 36 months, which may be offset by the Company for any amount owed to it by the assigning banks under the terms set out in the asset transfer contracts. At 31 December 2013 that amount had been settled, with no amounts appearing for that item on the attached balance sheet at that date.

The breakdown of those assets that were transferred by the Group 2 banks, according to their nature, was as follows on that date:

	Thousands of euros
Financial assets	11,139,891
Real estate assets	2,947,266
Total	**14,087,157**

The breakdown of the financial assets that were transferred by the Group 2 banks, according to the type of guarantee on each, was as follows:

Amounts in Thousands of euros	No. of Assets	Total Transfer Price
Loans	**21,889**	**10,855,331**
Normal	9,337	4,642,163
Sub-standard	1,800	1,872,775
Dudoso	10,752	4,340,393
Créditos	**727**	**284,560**
Normal	270	125,758
Sub-standard	137	44,161
Doubtful	230	110,643
Others	90	3,998
Total	**22,616**	**11,139,891**

For its part, the breakdown of the real-estate assets that were transferred by the Group 2 banks was as follows on that date:

Amounts in Thousands of euros	No. of Assets	Total Transfer Price
Land	4,630	1,062,531
Work stopped	1,445	163,505
Properties completed and for sale	23,404	1,619,800
Properties for rental	906	98,140
Total Property Investments	**30,385**	**2,943,976**
Works in progress	27	3,290
Total inventories	**27**	**3,290**
Total	**30,412**	**2,947,266**

Below is a summary of the main features of the senior bonds subscribed on 28 February 2013 in payment of the mentioned assets:

ISIN Code	Description	Date of issue	Maturity date (**)	Applicable rate in force	Nominal (Thousands of euros) (*)
ES0352506036	SAREB/VAR BO 20140228 2013-1	28/02/2013	28/02/2014	1.451%	4,225,900
ES0352506044	SAREB/VAR BO 20150228 2013-2	28/02/2013	28/02/2015	2.233%	6,339,200
ES0352506051	SAREB/VAR BO 20160228 2013-3	28/02/2013	28/02/2016	2.674%	3,521,600
					14,086,700

(*) Those bonds carry an irrevocable guarantee from the Kingdom of Spain (see Note 13.2).

(**) There is an option to renew at the Company's discretion, as described in Note 13.

Those bonds were subscribed by the assigning banks in accordance with the following distribution:

	Thousands of euros
Banco Mare Nostrum, S.A.	5,819,600
Banco Caja España de Inversiones, Salamanca y Soria, S.A.	3,137,300
Liberbank, S.A.	2,917,800
Banco Grupo Cajatres, S.A.	2,212,000
Total	**14,086,700**

Rectification of the deeds for asset purchases formalised in 2017 and 2016

In 2017 and 2016, and in application of the provisions of the mentioned Royal Decree 1559/2012 and in the asset transfer contracts themselves, the loan and credit portfolios and the portfolios of real-estate assets acquired from the entities in Groups 1 and 2 were reviewed in order to identify any inappropriate classification of assets, changes in perimeter and errors or variations in the valuation estimated on the date of transfer.

In 2017 and 2016, and as a result of the analysis made by the Company as described above for each financial period, rectifications were made for the overall amounts of 44 and 69 million euros, respectively, by returning assets to the assigning banks of Group 1 and 2 for the amounts of 5 and 64 million euros and by making price adjustments of 17 and 5 million euros, respectively, in each year reducing the amount of the real-estate assets initially transferred by 10 and 33 million euros and the amount of loans and credits by 12 and 35 million euros, respectively. Furthermore, in 2017 and 2016 rectifications of 22 and 1 million euros were made, respectively, corresponding to amounts pending offsetting arising from changes in the portfolio transferred, between the signing and the transfer.

In return, the assigning banks have handed Sareb part of the bonds issued in payment of the above-mentioned portfolios of transferred property for an amount equivalent to the assets returned, and also the cash equivalent of the coupons received by the banks corresponding to the bonds handed over. Furthermore, according to the transfer contract, the banks have applied a compensatory interest rate of 1% per year on the total amount of coupons paid by the Company, which were for 44 and to 10 thousand euros in 2017 and 2016, respectively, in relation to the bonds returned.

The summary of the rectifications made in 2017 and 2016 is as follows:

2017

Amounts in Thousands of euros	Real-Estate Assets Rectified (Note 5) **	Financial Assets Rectified (Note 7) **	Differences between signing and transfer (***)	Total Rectification	Amounts pending offsetting (****)	Balances after offsetting	Bonds returned (Note 13.2) (*****)	Cash adjustment (*)
Banco Mare Nostrum, S.A. (****)	9,558	12,101	22,270	43,929	(36,290)	7,639	(30,500)	315
Total	9,558	12,101	22,270	43,929	(36,290)	7,639	(30,500)	315

(*) Corresponds to the difference, paid in cash, between the total amount of the rectification and the amount of the bonds returned.

(**) Out of the amount of Real-Estate Assets rectified, 865 thousand euros corresponded to properties sold by the Company prior to rectification and 2,906 thousand euros to loans sold prior to rectification.

(***) Referring to changes produced in the assets transferred since the close of the perimeter until the transfer deeds from Banco Mare Nostrum, S.A. were notarised.

(****) That amount includes the price of a number of assets which, by error, were included in the perimeter but not in the calculation of the transfer price.

(*****) This figure includes the return of 23,177 thousand euros in bonds corresponding to rectifications formalised in 2016 which were pending return.

2016

Amounts in Thousands of euros	Real-Estate Assets Rectified (Note 5) **	Financial Assets Rectified (Note 7) **	Differences between signing and transfer (***)	Total Rectification	Exchange (*****)	Bonds returned (Note 13.2)	Cash adjustment (*)
Banco Grupo Cajatres, S.A.	10,087	2,687	(24)	12,750	-	(12,600)	150
Liberbank, S.A.	382	22,510	1,421	24,313	-	(24,100)	213
Banco Caja España de Inversiones Salamanca y Soria, S.A.	100	645	-	745	57	(500)	188
Bankia, S.A.	4,886	3,599	-	8,485	8,485	-	-
Banco Mare Nostrum, S.A. (****)	17,900	5,277	-	23,177	-	-	-
Total	**33,355**	**34,718**	**1,397**	**69,470**	**8,542**	**(37,200)**	**551**

(*) Corresponds to the difference, paid in cash, between the total amount of the rectification and the amount of the bonds returned.

(**) Out of the amount of Real-Estate Assets rectified, 1,020 thousand euros corresponded to properties sold by the Company prior to rectification and 497 thousand euros to loans sold prior to rectification. The cash obtained by the Company in those sales was returned to the corresponding banks.

(***) Referring to changes produced in the assets transferred since the close of the perimeter until the transfer deeds from the banks in Group 1 and Group 2 have been notarised.

(****) In the case of the rectification with Banco Mare Nostrum, S.A. the return of bonds for the amount of 23,177 thousand euros will not take place until the final settlement with that bank which will foreseeably happen within the first four months of 2017. Until that settlement takes place, the Company shows the amount owed by that bank under the heading of "Trade and other accounts receivable" (see Note 9).

(*****) Furthermore in 2016 the banks Banco Caja España de Inversiones Salamanca y Soria, S.A. and Bankia, S.A. handed over to the Company various real-estate assets for the amount of 8,485 and financial assets for the amount of 57 thousand euros to compensate the assets rectified.

Furthermore, during the years 2017 to 2014 the Company formalised different settlement agreements with all of the assigning banks under which the parties have agreed to waive demanding further price adjustments and also the 36 month period granted in the asset transfer contract for making claims. This does not apply to the Company exercising any rights and actions to which it is entitled by law or contract, whether for hidden defects, damages or losses. That agreement does not prevent making future perimeter adjustments with those entities for assets incorrectly transferred due to not meeting the specifications of art. 48 of RD 1559/2012 or of the FROB Resolution [Fund for Orderly Bank Restructuring] on transfer conditions dated 14 December 2012 as it has done during the past years.

Ibero Project

In 2014 the Company launched what was known as the "Ibero" project. The project consisted of substituting the management and administration contracts formalised on the date of transferring the assets, by way of a bidding process in which it sought:

- To group together the servicers of the nine portfolios initially provided by the banks in Group 1 and 2 into new servicers, in order to simplify and facilitate the management of the assets transferred.

- To achieve professionalisation and improvement in the quality of the service at market prices which would enable the Company to fulfil its commitments and the tasks with which it is entrusted, that is, to be able to achieve the divestment of the assets acquired within the period established and maximise their value.

During the months of November and December of 2014 the new administration and management contracts were formally allocated and signed, with the following being appointed as new servicers:

- Solvia Servicios Inmobiliarios, S.L. was allocated the real-estate portfolio of Bankia, S.A. and the entire portfolios of Banco Gallego, S.A. and Banco Caja España de Inversiones Salamanca y Soria, S.A.

- Altamira Asset Management, S.L. was allocated all of the portfolios up until then managed by Catalunya Caixa, S.A., Banco Mare Nostrum, S.A. and Banco Caja 3, S.A.

- Haya Real Estate, S.L.U. was allocated the loans portfolio originally transferred by Bankia, S.A. and Banco Financiero de Ahorros, S.A.

- Lastly, Servihabitat Servicios Inmobiliarios, S.L. was allocated the portfolios initially transferred by NovaGalicia Banco, S.A. (Abanca, S.A.) Liberbank, S.A. and Banco de Valencia, S.A.

The term established under the contracts ranges from 5 to 7 years from when each one comes into force, and can be automatically renewed for a further year unless any of the parties informs the other giving 6 months advance notice that it does not wish to renew. Furthermore the contract provides for the possibility of early cancellation by Sareb at any time by giving a minimum of 3 months advance notice and paying compensation to the servicers calculated in accordance with the terms of the contract.

In any case, the contracts for the services to be provided by the new servicers include:

- Migration: services necessary for developing, implementing and concluding the migration of the asset management and administration. In 2015 the technological and administrative migration of all the property portfolios was carried out in stages. With regard to the financial assets portfolios at 31 December 2016, they are fully migrated except for the portfolio initially transferred by Bankia, S.A. which was migrated in its technological aspect in the first quarter of 2017.

- Administration and management of the portfolios allocated. Management is performed by the four servicers listed above, who handle and manage the portfolios of financial assets and real-estate assets assigned to them. As part of their functions, each servicer records and prepares the financial and accounting information for their portfolios, reporting to the Company.

- Legal advice in relation to the administration and management of the assets migrated.

In consideration for the above services the contract establishes the fees due to them for management and administration, which are calculated on the basis of the volume of assets held for management by each of the servicers, and for sales, which are calculated on the basis of the revenue and cash generated in the divestment of the assets managed. In 2017 and 2016 management fees were due for the amount of 96,171 and 105,491 thousand euros, and for sales commissions 146,755 and 131,471 thousand euros respectively (see Note 16.4).

Furthermore, and with the aim of guaranteeing a certain level of service and performance in the tasks entrusted, and also to bring their objectives in line with those of the Company, in 2014 the awardees set up performance guarantees for an initial amount of 588,600 thousand euros, of which 414,349 thousand euros of face value are currently pending return, this being recorded under the heading "Other financial liabilities" in non-current liabilities on the attached balance sheet (see Note 13.4).

Regarding the above guarantees, it is worth pointing out that they were calculated based on an estimation of the assets that will be managed, adjusted to the final figure once the various migrations of the portfolios have been completed. In 2016 the Company returned guarantees for this item for the amount of 6,091 thousand euros (see Note 13.4).

The return of those guarantees is considered a contingent item and is associated to the adequate trading performance of the new servicers. The Company considers it likely that, according to current estimations, those guarantees will be returned and that the return will take place as the fees arranged between the Company and its new servicers become due and are paid. This contract provides for measuring the degree of the servicers' fulfilment of the various performance indicators applicable to the services agreed upon, establishing a scale of penalties to be applied and also the circumstances for early termination (for example if the servicers' failure to fulfil extends over a period of 12 months with the highest level of materiality and degree of divergence from the target value established in the contract). On the basis of the fees due in 2017 and 2016, the Company has returned 71,178 and 61,051 thousand euros of guarantees provided by the new servicers respectively (see Note 13.4).

Other information

At 31 December 2017, the Annual accounts of the Company were not included in the consolidated Annual accounts of any of the Shareholders using the full integration method due to not holding a percentage higher than 50% in the capital of the Company and as it is considered that none of them controls the Company nor has the power to govern its financial and operating policies so as to obtain benefits from its activities, nor holds majority voting rights nor has the power to appoint or remove a majority of the Directors (see Note 11).

In turn, at 31 December 2017 the Company had no majority holdings in the capital of any subsidiaries with the exception of the interest in Tempore Properties Socimi, S.A. However, the Directors consider that, given the figures for assets, equity and net turnover of that subsidiary, it is not of any relevant size in terms of the Group and therefore it is released from filing consolidated accounts under the terms of article 43 of the Code of Commerce (see Note 7.2.1).

Furthermore, the participation in Bank Assets Funds ("FABs") (Note 4.6.1) which does not require the deconsolidation of the assets and liabilities involved, does not have any significant effect on the true and fair view of the equity, the financial situation and the results of the Company. In consequence, according to the provisions of article 9 of Royal Decree 1159/2010, of 17 September, which approves the Regulations for Formulating Consolidated Annual accounts and amends the General Chart of Accounts approved under Royal Decree 1514/2007, of 16 November, and the General Chart of Accounts for Small and Medium Businesses approved under Royal Decree 1515/2007, of 16 November and also under article 43 of the Code of Commerce, the Company is not required to file consolidated Annual accounts.

2. Bases for the presentation of the Annual Accounts

2.1 Legislation Framework for financial information applicable to the company

These Annual accounts have been drawn up by the Directors in accordance with legislation framework for financial information applicable to the company which is that set out in:

a) Code of Commerce and other commercial legislation, with the specific aspects set out in sub-section 10 of the Seventh Additional Provision of Act 9/2012 which, where appropriate, were implemented in 2015 through a Bank of Spain Circular and amended under article 2 of RD 4/2016 (see point c).

b) The Spanish General Chart of Accounts approved by Royal Decree 1514/2007 and its subsequent amendments, except for the specific aspects included under Act 9/2012 and amendments thereto included in article 2 of RD 4/2016.

   Similarly, due to its activity, the preparation of these Annual accounts has taken into consideration the provisions of the Ministry of Finance Order of 28 December 1994 which approved the adaptation of the 1990 General Chart of Accounts to Estate Agencies, being applicable wherever it does not contradict the provisions of the Code of Commerce, the Capital Companies Act, Act 9/2012 and the General Chart of Accounts approved under Royal Decree 1514/2007.

   Furthermore, the Company has to comply with the general obligations of transparency, and for the filing of Financial Statements established in RD 1559/2012.

c) In accordance with the provisions of sub-section 10 of the 7th Additional Provision of the mentioned Act 9/2012, in 2015 the Bank of Spain issued Circular 5/2015, of 30 September, under which it put into effect the specific accounting aspects for Sareb (hereinafter "Circular 5/2015"). Subsequently, on 3 December 2016 an amendment was made to letter c) of sub-section 10 of that 7th Additional Provision by way of article 2 of RD 4/2016 of 2 December, on urgent financial measures, later included in the Circular 5/2015 by publication of Circular 2/2017.

d) The mandatory rules approved by the Spanish Accounting and Audit Institute in order to implement the General Chart of Accounts and relevant secondary legislation.

e) All other Spanish accounting regulations that are applicable.

2.2 Faithful Image

The attached Annual accounts have been obtained from the Company's accounting records and are presented in accordance with the legislation framework for financial information applicable to the Company and in particular the principles and criteria contained therein, in such a way as to show the true reflection of the equity, the financial situation of the Company at 31 December 2017, the earnings or losses and the cash flows during the financial year closed on that date.

The Annual accounts of Sareb for 2016 were approved by its Shareholders Annual General Meeting held on 9 May 2017 and those corresponding to 2017, which were drawn up by the Board of Directors of Sareb in its meeting on 22 March 2018, will be submitted for approval by the Shareholders Annual General Meeting. They are expected to be approved without amendment.

2.3 Non-obligatory accounting principles applied

No non-obligatory accounting principles have been applied in preparation of these Annual accounts. In addition, the Directors have drawn up these Annual accounts taking into consideration the whole set of accounting principles and standards of compulsory obligation that have any significant effect on those Annual accounts (see Note 4). There is no accounting principle that is obligatory and has a significant effect on these Annual accounts which has not been applied.

2.4 Critical aspects of the assessment and estimation of uncertainty

In preparing the attached Annual accounts, estimates were made by the Company's Directors to evaluate some of the assets, liabilities, income, expenses and obligations reported therein. Basically these estimations refer to:

- The assessment of impairment of certain assets (see Notes 4.7, 5, 7, 8).
- The useful life of intangible assets and property, plant and equipment and property investments (Notes 4.1, 4.2, 4.3 and 5).
- The market value of certain financial instruments (see Note 7).
- The recoverability of prepaid tax and tax credits and tax loss carryforwards due to impairment of the Financial Assets unit (see Note 15).
- The calculation of provisions (see Note 12).
- The estimation of the bonds and other short-term marketable securities (see Note 13.2).
- The classification of the balance sheet amounts between the long term and the short term based on the estimated future cash flows (see Note 7 and 13).

In 2014 the Company concluded a process of review (Due Diligence) of the assets transferred. That analysis was intended to establish that the estimations and mechanism for calculating prices (correct application of the transfer pricing, confirmation of the features of the assets acquired and the accuracy of the information provided by the assigning banks) are reasonable.

Based on the outcome obtained from that analysis, in 2017 and 2016 the Company formalised the rectifications specified in Note 1. Except for those rectifications, with the current information, the estimation of any possible differences that might come to light regarding the transfer pricing are not relevant for the purposes of these Annual accounts..

Although, in accordance with applicable legislation, these estimations have been made on the basis of the best information available at the year end 2017 and at the date of preparing these Annual accounts., it is possible that events that might take place in the future could mean modifying them (increasing or decreasing) in the coming years, which would, if the case arises, be carried out prospectively, with a balancing entry in the profit and loss of the years affected in the future.

Going concern principle

At 31 December 2017 the situation of the equity of the Company is as follows:

	Thousands of euros
Equity in the Annual accounts of Sareb, S.A. at 31/12/2017	(3,707,230)
Less:	
Value change adjustments for cash flow hedges	1,533,045
Value change adjustments for impairment of Financial Assets	4,229,552
Equity for the purposes of reduction and dissolution 31/12/2017	**2,055,367**

It should be mentioned that under prevailing accounting legislation, any changes in the value of derivative hedging instruments are recognised in equity until they are allocated to profit or loss in the corresponding year. The total fair value of this interest rate risk derivative, net of its tax effect, is recognised under the heading "Value change adjustments – Hedging Transactions". However, from a business perspective and according to the provisions of article 36 of the Code of Commerce, these value changes in the hedging derivative yet to be charged to the income statement are not considered as equity for the purposes of profit distribution, compulsory reduction of share capital and compulsory dissolution for losses.

In turn, as established by article 2 of RD 4/2016, the Company has recorded the value adjustments of the units of assets established in Circular 5/2015 allocating them to the heading "Value change adjustments – Impairment of financial assets" net of taxes. As established in that RD the adjustments referred to above will not be considered as equity for the purposes of profit distribution, compulsory reduction of share capital and compulsory dissolution for losses (see Note 11.5).

At 31 December 2017, the Company shows positive working capital for the amount of 3,741,604 thousand euros as a result of classifying the senior debt as long term, because although 31,828,100 thousand euros of senior debt contractually matures in 2018, the Company has the option of unilaterally novating the maturity term of those bonds, meaning that a good part of the debt has been classified as long term taking the current estimates of the Company into consideration.

Furthermore, the Company has considered that the financial assets classified as doubtful will be recovered in a time horizon generally longer than twelve months, and that those which are up-to-date with payments will be recovered according to their original contracted schedule of payments (Note 7). Taking the above into account, and considering the financial projections made by the Company which include the generation of sufficient cash flows to realise its assets and settle its liabilities. Based on the above, the Directors of the Company have drawn up these Annual accounts on the principle of the company as a going concern.

2.5 Changes in accounting principles

In 2017 there have been no significant additional changes in accounting policies with regard to the policies applied in 2016.

2.6 Comparison of the Information

The information contained in this report referring to the 2016 financial year is presented solely for comparison with the information for the 2017 year, in accordance with the provisions of current legislation.

2.7 Grouping of items

To facilitate comprehension of the balance sheet, income statement, statement of changes in equity and cash flow statement, certain items are presented in grouped form, and the necessary breakdown is given in the corresponding notes, wherever it is relevant.

2.8 Correction of errors and changes in estimations

No significant errors have been identified in the preparation of the accompanying Annual accounts that would involve the re-statement of the amounts included in the Annual accounts for 2016.

2.9 Environmental Impact

Given the business in which the Sareb is engaged, it has no responsibilities, expenses, assets, provisions or contingencies of an environmental nature which could be significant in respect of its equity, financial position and profit or loss.

For this reason, in the Annual accounts of the Company for 2017, there is no itemisation of any information on this subject.

2.10 Presentation of the Annual accounts

Unless stated otherwise, the figures in these Annual accounts are expressed in thousands of Euro.

3. Distribution of profit or loss

The proposals put forward by the Board of Directors for the distribution of the profit obtained in 2017, to be submitted for the approval of the Shareholders General Meeting and the proposal for 2016 which was approved by the Shareholders General Meeting held on 9 May 2017 are as shown below:

Amounts in Thousands of euros	2017	2016
Balance from the Income Statement:	**(564,576)**	**(662,791)**
Distribution:		
To Legal Reserve	-	-
To Voluntary Reserves	(564,576)	(662,791)
To Accumulated Loss from previous years	-	-

4. Principles for recording and measurement

The main recording and valuation principles used by the Company in the preparation of its 2017 Annual accounts, according to those established by the applicable regulatory framework, were the following:

4.1 Intangible assets

Intangible fixed assets are initially valued for their acquisition price or production cost. Subsequently, they are valued at cost decreased by the relevant accumulated amortisation and, where appropriate, by any impairment losses they may have undergone. These assets are amortised over their useful life.

Industrial property

The amounts recognised by the Company under the heading Industrial Property correspond to the expenses capitalised by obtaining the corresponding patents, or similar, including costs for registering and formalising the industrial property, notwithstanding any amounts that can also be included in the accounts for purchasing the corresponding rights from third parties. The Company amortises the amounts capitalised under the heading of "Industrial Property" on a straight line basis over 10 years.

Computer software

Computer software acquired or designed by the Company is recognised at acquisition or production cost, as the case may be, amortised on a straight line basis over 5 years. The costs for maintaining computer software are recognised in profit or loss in the year incurred. At 31 December 2017 and 2016 that heading mainly includes the gross cost of the computer software acquired by the Company, for the amount of 29,137 and 22,348 thousand euros, respectively.

The provision for the amortisation of the intangible assets in 2017 and 2016 was 5,100 and 3,473 thousand euros, respectively, having been recognised with a charge to the heading "Amortisation of fixed assets" on the attached income statement. The figures for cumulative amortisation at 31 December 2017 and 2016 were 11,201 and 6,106 thousand euros, respectively.

The developments that the Company performs on its own fixed assets are reflected at the accumulated cost resulting from adding the internal costs, determined according to the actual consumption of materials and general manufacturing expenses applied using the same principles as those used for valuing inventories. In 2017 and 2016 the Company had not capitalised any cost for these items in its intangible assets.

Impairment of the value of intangible assets

Whenever there are indications of impairment in the value of intangible assets with a finite useful life, that classification being applicable to all of the Company's intangible assets, it performs "impairment testing" to assess whether there is any indication of impairment that reduces the recoverable amount of such assets to below their carrying amount.

When an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years. That reversal of an impairment loss is recognised as income.

In 2017 and 2016 the Company had not recognised impairment for its intangible assets.

Furthermore, at the year end of 2017 and 2016 the Company has no firm commitments for the purchase and/or sale of any items of intangible assets for any significant amount.

4.2 Property, plant and equipment

Initial valuation

Property, plant and equipment is initially valued at acquisition price or production cost, to which are added the amounts of additional or complementary investments made, and subsequently reduced by the relevant accumulated depreciation and the impairment losses if any, pursuant to the criteria mentioned in this Note.

Costs of expanding, upgrading or improving property, plant and equipment that increase its productivity, capacity or efficiency, or prolong its useful life are capitalised as an increase in the cost of the asset.

Repair and maintenance costs for the year are recognised as "External Services" in the attached Income Statement.

In 2017 and 2016 the Company has not capitalised any financial interest as an increase in the value of its property, plant and equipment.

The developments that the Company performs on its own fixed assets are reflected at the accumulated cost resulting from adding the internal costs determined according to the actual consumption of materials and manufacturing expenses to the external costs, applied using the same principles as those used for valuing inventories. In 2017 and 2016 the Company had not capitalised any cost for these items in its property, plant and equipment.

Depreciation

The depreciation of property, plant and equipment is calculated on a straight-line basis over the estimated useful life of the assets. The annual depreciation percentages for the respective current cost value, where relevant, and the estimated years of useful life are the following:

Heading	Annual Percentage	Years of Estimated Useful Life
Straight-line depreciation method:		
Other facilities	10	10
Fixtures	10	10
Data processing equipment	20	5
Other property, plant and equipment	12.5	8

The depreciation of property, plant and equipment in 2017 and 2016 was 328 and 281 thousand euros, respectively, having been recognised with a charge to the heading "Depreciation of fixed assets" on the attached income statement. The accumulated depreciation on the balance sheet at 31 December 2017 and 2016 was 995 and 847 thousand euros, respectively.

The assets under construction in progress do not begin to depreciate until they are brought into use or are operating, which is when they are transferred to their corresponding account in property, plant and equipment, depending on their nature.

Impairment of property, plant and equipment

Whenever there are indications of impairment in the value of property, plant and equipment, that classification being applicable to all of the Company's tangible assets, it performs "impairment testing" to assess whether there is any indication of impairment that reduces the recoverable amount of such assets to below their carrying amount.

When an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years. That reversal of an impairment loss is recognised as income.

In 2017 and 2016 the Company had not recognised impairment for its property, plant and equipment.

Furthermore, at the year end 2017 and 2016 the Company has no firm commitments for the purchase and/or sale of any items of property, plant and equipment for any significant amount.

4.3 Property Investments

The heading property investments on the balance sheet includes the values for land, buildings and other constructions that are held, either to earn rentals or for capital appreciation when sold as a result of future increases on the respective market prices.

Initial valuation

Property Investments are initially valued at acquisition price or production cost, to which are added the amounts of additional or complementary investments made, and subsequently reduced by the relevant accumulated depreciation and the impairment losses if any, pursuant to the criteria mentioned in this Note.

According to the provisions of letter a) of sub-section 10 of the 7th Additional Provision of Act 9/2012, the acquisition cost of the assets received from the assigning banks in Group 1 and Group 2 was established applying the transfer prices for each type of assets that were fixed by resolution of the Bank of Spain according to the principles established in RD 1559/2012.

Under the provisions of Regulation three of Circular 5/2015, in the case of real-estate assets allocated or acquired in payment of debts, the amount for which they are initially recognised is the carrying amount of the financial assets cancelled on the date of foreclosure or lieu of payment. The legal and registry expenses, and taxes paid are added to the initial value provided that by doing so the estimated fair value of that initial value is not exceeded.

Costs of expanding, upgrading or improving the assets which increase their productivity, capacity or efficiency, or prolong their useful life are capitalised as an increase in the cost of the corresponding asset.

The Company recognises any properties acquired under mortgage foreclosure proceedings having a court ruling under the heading "Advances on property investments". Those properties are transferred to the heading of "land" or "completed properties" once that ruling becomes final.

Repair and maintenance costs for the year are recognised as "External Services" in the attached Income Statement.

The work the Company performs on its own fixed assets is reflected at the accumulated cost resulting from adding the internal costs determined according to the actual consumption of materials and manufacturing expenses to the external costs, applied using the same principles as those used for valuing inventories. In 2017 and 2016 the Company had not capitalised any cost for these items in its Property Investments.

In 2017 and 2016 the Company had not capitalised any financial interest or charges as an increase in the value of Property Investments.

Subsequent measurement and evaluation of impairment

The impairment of those assets is assessed as described in Note 4.7.

Depreciation

The depreciation of property investments is calculated on a straight-line basis over the estimated useful life of the assets. The annual depreciation percentages for the respective cost values, where relevant, and the estimated years of useful life are the following:

	Annual Percentage	Years of Estimated Useful Life
Straight-line depreciation method:		
Constructions	2	50
Other facilities	10	10
Fixtures	10	10
Data processing equipment	20	5
Other property, plant and equipment	12.5	8

The provision for the amortisation of property investments in 2017 and 2016 was 56,016 and 64,021 thousand euros, respectively, having been recognised with a charge to the heading "Depreciation of fixed assets" on the attached income statement.

4.4 Asset exchanges and foreclosures

"Asset exchanges" are taken to be the acquisition of tangible or intangible assets in exchange for other non-monetary assets or for a combination of these and monetary assets.

As a general rule, the asset received in an asset exchange transaction with commercial substance is recognised at the fair value of the asset given up, plus, where appropriate, any monetary consideration paid. The valuation differences that arise on derecognition of the asset given up in the exchange are recognised in the income statement.

Assets received in an exchange that lacks commercial substance are measured at the carrying amount of the asset given up plus, where appropriate, any monetary consideration paid, up to the limit of the fair value of the asset received if this is lower.

In the specific case of assets foreclosed as payment of debt, depending on their nature and the purpose for which they are to be used, they are classified as property investments and inventories and recognised in accordance with the terms of Notes 4.3. and 4.11, respectively.

4.5 Leases

The Company considers as operating leases those originating from an agreement under which the lessor arranges with the lessee the right to use an asset for a certain period of time, in in return for a one-off payment or a series of payments, without involving a lease which, under the provisions of current legislation, could be considered as a financial lease.

The Company charges to the income statement the revenue and expenses arising from the operating leases agreements in which it acts as lessor in the year to which they relate. Likewise, the acquisition cost of the asset is presented on the balance sheet according to its nature, increased by the amount of the costs of the contract directly attributable, which are recognised as an expense during the term of the contract, applying the same method used to report revenue from the lease.

The Company treats any amount collected or paid that could be made through an operational lease agreement as an advance collection or payment and takes it to profit or loss throughout the term of the lease, according to how the profits from the leased assets are transferred or received.

In 2017 and 2016, the Company has not entered into any financial lease agreement.

4.6 Investments in subsidiaries and associates - Categories of financial assets

4.6.1 Investments in subsidiaries companies and associates

Associates are entities over which significant influence can be exercised. Significant influence is understood to be when the Company has a holding in another company and has the power to participate in the financial and operating policy decisions of the investee, but without having control or joint control over them. Usually, this influence is evidenced by a direct or indirect holding of 20% or more of the investee's voting rights.

Holdings in associates are entered under the heading "Long term investments in group companies and associates – Equity instruments" on the balance sheet and measured for their acquisition cost, net of any impairments that might have been sustained by those holdings (see Note 4.7.3).

When the remuneration arising from these holdings does not originate unequivocally from earnings generated before the acquisition date, they are recognised under the caption "Turnover" on the income statement (see Note 16.1).

Bank Assets Funds (FABs)

Article 20 of Royal Decree 1559/2012, of 15 November, authorises the Company to create separate equity compartments in what are known as "Bank Assets Funds" (hereinafter, FABs).

The corporate object of the FABs, fund-based entities without legal personality, will be to liquidate the portfolio of assets and liabilities provided by Sareb, for which their duration will be the term for which they were created.

In its accounting of the investments in FABs the Company distinguishes between:

- FABs whose creation does not transfer substantially all the risks and rewards incidental to ownership of the assets and liabilities transferred to third party investors. As a general rule, such funds are those in which the Company has control and holds over 50% of the sum of the liabilities and equity of the Fund. In those cases, the Company does not derecognise the assets and liabilities (that is, it does not recognise any sales revenue nor the corresponding costs) and it measures them using the same criteria applicable before the transfer; it does however recognise a liability for an amount equal to the consideration received which it measures at amortised cost, where appropriate netting and recognising both the income from the assets transferred and not derecognised as costs of the new financial liability when it is effectively sold to third parties. At 31 December 2017 the only FAB set up that has not been deconsolidated is the FAB 2013 Bull. Those FABs have their own accounting and taxation rules.
- FABs whose creation does transfer substantially all the risks and rewards incidental to ownership of the assets and liabilities transferred to third party investors. As a general rule, such funds are those in which the Company does not hold more than 50% of the total liabilities and equity of the Fund. In these cases, and given that control of the assets sold has usually been transferred to the investor, the Company records the cost of the amounts equivalent to the share capital subscribed by the Company under the heading of "Long term investments in associates – Equity instruments". Those equity instruments are measured in accordance with the terms of Note 4.7.3 (Impairment of equity instruments issued by FABs). Furthermore, if any financing has been granted by the Company, it is recognised under the heading of "Long term investments in associates - Credit for companies". At 31 December 2017 the only FAB set up that has been deconsolidated is the FAB Teide 2013.

Below is a summary of the main transactions carried out with FABs in 2017 and 2016:

2017:

On 19 September 2017 an agreement was reached with the investment partner of the FAB May in order to liquidate that fund. The agreement reached provided for assigning 5% of the equity corresponding to Sareb to the investment partner in exchange for monetary compensation of 4,800 thousand euros. That amount is recorded under "Turnover" of the attached income statement.

2016:

On 30 June 2016 the FAB Crossover I and of the FAB Corona were liquidated after having realised its assets and settled all of its liabilities. Those liquidations had no impact on the Annual accounts of the Company.

4.6.2 Loans and receivables

This category of financial instruments includes debt instruments originating in the services provided by the Company and those which, while not originating in those services, represent fixed or determinable collection rights and are not traded in an active market.

Loans and items receivable are recognised on the balance sheet at 31 December 2017 under the headings of "Long term investments in group companies and in associates – Loans to companies", Long and short term financial investments corresponding to "Loans to third parties and related parties", "Loans to companies" and "Other financial assets" and the headings of "Trade debtors and other accounts receivable" and "Cash and other cash equivalents" on the asset side of the balance sheet on those dates.

The Company follows the policy of transferring to the heading of doubtful assets any loans and credits having interest and/or capital payments due and outstanding for more than 90 days.

Initial valuation

In general, loans and items receivable are initially measured at fair value, which is the transaction/acquisition price, which is equivalent to the fair value of the consideration paid plus the transaction costs directly attributable to them. In 2013 the Company capitalised the costs incurred as necessary for taking control of the assets as their increased value, which amounted to 17,561 thousand euros. At 31 December 2017 and 2016 the amount capitalised for those expenses amounted to 12,417 and 13,397 thousand euros, respectively (Note 7.1.1.).

According to the provisions of letter a) of sub-section 10 of the 7th Additional Provision of Act 9/2012, the acquisition cost of the assets received from the assigning banks in Group 1 and Group 2 was established applying the transfer prices for each type of assets that were fixed by resolution of the Bank of Spain according to the principles established in RD 1559/2012.

Subsequent valuation

The assets included in this category are measured at their amortised cost, net of any impairment loss. The interest generated by these assets is recorded in the income statement, applying the effective interest rate method. According to the reply to the consultation made to the Bank of Spain and to the earlier pronouncements from the Institute of Accounting and Account Audits (ICAC), the estimation of the future cash flows for the purposes of establishing the effective interest rate takes into account, where appropriate, the value of the collateral on transactions.

Notwithstanding the above, certain items established in applicable legislation, maturing in less than one year, are booked initially at their face value, if the effect of not restating their cash flows is insignificant, and are later measured for the same amount.

Any impairment losses existing on these assets are booked in accordance with the terms of Note 4.7.2.

At 31 December 2017 and 2016 Sareb did not hold or have any financial assets of the type provided for in applicable legislation, other than those outlined in this note.

4.7 Impairment of financial assets, property investments and other accounts receivable

As stated in Note 2.1, pursuant to the provisions set out in sub-section 10 of the 7th Additional Provision of Act 9/2012, in 2015 the Bank of Spain published Accounting Circular 5/2015 which implemented the specific accounting aspects of the Company.

The publication of that Circular 5/2015 regulated the principles which were to be the basis of the method that the Company was to use for estimating the value of the assets transferred by the banks in Group 1 and 2. According to the terms set out in the Circular, the calculation of that value has to be carried out in a way that is consistent with the one originally used for establishing the prices for transfer to the Company taking into account the evolution of market prices and the time horizons forecast in the Company's business plan.

To comply with the provisions of the Circular, the Company has implemented and approved the method for estimating the valuation adjustments for impairment based on the criteria established in the Circular.

The recognition of the impairment arising as a result of measuring the assets should be made per asset unit. The Circular establishes the offsetting of losses with gains on assets within the same «asset unit». The asset units defined in the Circular are as follows:

a) Properties foreclosed or acquired in payment of debt, regardless of their origin, provided that they appear on the individual balance sheets of the assigning banks or in their consolidated balance sheets at the time of the transfer.

b) The following credit rights:

  i. Loans or credits for financing land for development in Spain or for financing property construction or promotion in Spain, whether in progress or completed, regardless of their age and accounting classification.

  ii. Participating loans granted to companies in the real-estate sector or to companies related to them, regardless of their age and accounting classification.

  iii. Other loans or credits granted to the holders of credits or loans included in sub-section 1 above, if the Fund for Orderly Bank Restructuring (FROB) considers the transfer to be suitable, so that the Sareb can properly manage the assets transferred.

c) The properties and credit rights that meet the requirements set out in the foregoing letter coming from companies in the real-estate sector, or from companies related to them, over which the bank exercises control within the meaning of article 42 of the Code of Commerce.

d) Instruments representing the capital of companies in the property sector or of companies related to them which directly or indirectly enable the bank or any other company in its group to exercise joint control or significant influence over them, if the Fund for Orderly Bank Restructuring (FROB) considers the transfer to be suitable due to their holding a considerable volume of assets referred to under letter a), or to serving as an effective channel for the company to engage in property construction or promotion in Spain.

e) Consumer loans or credits or loans to small and medium businesses, loans or credits guaranteed by mortgage or by any other assets not included in those sub-sections, whenever those assets are especially impaired or if their continuation on the balance sheet would be considered detrimental to the viability of the company. The consideration of the presence of these circumstances will require a prior report from the Bank of Spain.

Notwithstanding the definition given in Circular 5/2015 for 5 asset units, only the first two are applicable to Sareb: the one relating to the properties allocated originally transferred to Sareb; and the one created by the original credit rights.

It is worth mentioning that the Circular establishes that the assets allocated or received in payment of debts subsequent to the transfer dates will remain in the asset unit in which they were initially included.

At the year end, or whenever the Company publicly provides information on its financial position, it should assess the need to make valuation adjustments for impairment of each of the asset units. To this end, with the best information available at all times, it will assess whether the carrying amount of the asset unit is higher than the value estimated for the asset unit as a whole using the method implemented by the Company, according to the criteria established in rule four of Circular 5/2015. If that is so, an impairment loss will be recognised net of taxes, with a charge to the heading "Value change adjustments" within the Company Equity, in compliance with the provisions of article 2 of RD 4/2016 (see Note 2.1).

The debit balance of that account will be taken to the income statement only in those years in which the Company shows a profit. For this purpose the pre-tax profit will be taken into account without considering any possible accrual of interest on the subordinated loan.

The impairment of value of each «asset unit» can be reversed when there is evidence that the value of the assets in the «asset unit» has been recovered using the method implemented by the Company and regulated under Circular 5/2015, with the limit being the value that the «asset unit» would have had if no impairment had been recognised.

In each «asset unit», the amount of the losses in the impaired assets can be offset against the gains on the unimpaired assets included in the same «asset unit», estimated according to the criteria of rule four of Circular 5/2015.

Assets shall remain in their corresponding «asset unit» as long as they meet the requirements set out in letter a) of sub-section 1 of article 36 of the Code of Commerce, namely that there are sufficient objective factors confirming that the likelihood of recovering the value of the asset recognised is not remote.

In compliance with the Bank of Spain Circular 5/2015, the Company made a valuation of its entire portfolio of Financial and Property Assets. However, considering the large volume of assets and collateral subject to being valued, and the complexity of that process, there is a small percentage of the portfolio that has not obtained an eligible valuation in accordance with Rule 4 of the Circular.

In relation to 1.8% of the portfolio, -0.7% in terms of the carrying amount (6% and 3.5% respectively in 2016) of the assets recognised under the headings of "Financial Investments - Credit for third parties and related parties", "Property Investments" and "Inventories"- (on which there are no eligible valuations in accordance with Rule 4 of the Circular), the Company, the same as in 2016, has updated the latest valuations available using correction indices calculated on the basis of information obtained from the updating carried out on the 98.2% of the portfolio that does meet the eligibility requirements described in the mentioned Rule 4. The calculation of this estimation takes into consideration the type of asset, its location and the age of the valuations available. According to the Directors, the criteria followed provide the best estimation of the value of the assets in this portfolio, and will not differ significantly from the values that would result from an updated valuation that is eligible under Rule 4 of the Circular.

Furthermore, it is worth mentioning that for the case of valuations in which the appraiser has indicated conditioning factors, the Company has applied correction indices according to each type, whether due to being unable to have access to the property, due to checking the town planning issues, or checking with registries. Those correction indices range from 7% to 30% and have been drawn up internally on the basis of the best understanding and professional judgement of the Company.

Assets will be derecognised from the balance sheet for their carrying amount, without taking into consideration any valuation adjustments for impairment estimated per «asset unit» as a result of applying the provisions of Rule Four.

Below are the principles applied by the Company for establishing the existence of impairment losses in each of the different asset units identified, and also the method employed for calculating the hedges accounted and recognised for that impairment.

4.7.1. Impairment of the property assets unit

This asset unit includes the amounts booked under the headings of "Property Investments" and "Inventories" except for 4,228 and 4,115 million euros in 2017 and 2016 respectively of property assets received by the Company in payment of debts subsequent to the date of transferring the financial assets and which have been measured within the asset unit itemised in Note 4.7.2.

To determine the value of its real-estate assets the Company takes into account the features that a properly informed buyer would use for deciding to buy it, such as its geographical location, available infrastructure, legal status, terms of sale or operation, demand and offer for similar properties, its most likely use, as well as aspects related to town planning, demographical evolution and prices of utility supplies. For the purposes of considering the legal situation of the property and its town planning status, for the valuation of the land the Company has used the planning levels defined in article 4 of Order ECO/805/2003, of 27 March on the rules for valuing property assets and defining the fees for certain financial purposes.

Estimation of the value of Property Investments for rental

In those property investments that the Company keeps for rental, the value has been calculated on the basis of discounting future cash flows, considering the level of occupation corresponding to the date when valued, the likelihood of future occupation of the properties and current market rents.

Estimation of the value by making individual appraisals

The Company has estimated the individual value of its real-estate assets according to valuation reports from independent experts with proven experience in the area and type of properties being valued. The valuation of the assets has been specifically carried out by appraisal companies registered in the Registry of Licensed Appraisal Companies held by the Bank of Spain, in accordance with the criteria established in Order ECO/805/2003, of 27 March, on the rules for property valuation. In accordance with the provisions of Rule 4 of the Bank of Spain Circular 5/2015, those valuations were performed by independent experts who took into account the following methods depending on the type of assets:

- Residual dynamic method for land.
- Discounting future cash flows for assets used for obtaining income, considering the expected occupation levels and current market rents.

At least every three years, the Company shall review the mortgage valuations made on its property assets by changing the independent expert. If the market conditions and circumstances demonstrate the need to perform valuations more frequently, the Company will reduce that period.

Estimation of the value of completed properties, annexes and commercial premises

In the case of completed properties, annexes (such as garages or storerooms) as set out in Rule 4 of Bank of Spain Circular 5/2015, they may be valued using automated valuation methods by independent experts (appraisal companies registered in the Registry of Licensed Appraisal Companies held by the Bank of Spain). Those methods can be used to determine the value of commercial premises in towns where there is a market that is representative of comparable properties in the sense that, at almost any time, it is possible to find operators willing to negotiate a sale or rental. However, it is Company policy to have an ECO valuation carried out, as it considers that with this, the situation of the asset and its market value can be more accurately represented. Assets valued using those statistics-based methods account for 2.8% in the case of mortgage guarantees, and 9% for real-estate assets.

Those valuations using statistics-based or automated valuation methods are recalculated every year and are performed taking into account the statistics from the National Institute of Statistics in respect of the evolution of prices for new and second-hand property.

Estimation of value of other assets using internal estimations or methods

In the case of property assets other than those described in the previous sub-sections and with a combined carrying amount per batch of less than one million euros, the company has used its best estimate to establish their current value, at least once a year. Those estimates were made using valuation models for which an external independent expert has recognised the method, and solely for those assets for which sufficiently tested data was available. Otherwise, those assets would be valued using the ECO valuations.

In addition to the valuations carried out according to the above methods, the method developed by Sareb, based on the criteria established in Circular 5/2015 applicable to both property and financial assets, includes a number of assumptions, of which the following are worthy of special mention:

- Adjustments for reflecting the evolution of market prices and the horizons of the Company's business plan. In order to apply those adjustments, the Directors have employed their best estimate depending on the type and location of the different properties, as well as the estimated sales for the different years contained in the business plan. To this end, and on the basis of the provisions of Circular 5/2015, they have considered an estimated evolution of average market prices ranging from between 2.1% and 6.3% in 2017 (3.8% and 5% in 2016), and an average time horizon, depending on the different types of assets, ranging from between 4 and 6.5 years in 2017 (5.5 and 8 years in 2016).
- Estimation of the costs for maintenance and marketing, which are deducted from the estimated valuations. In order to calculate that cost estimate, the average estimate of the asset's permanency has been taken into consideration, taken from the Business Plan as reflected in the previous paragraph. To this end, according to the different types of asset, the average costs associated to them range between 1.1% and 9.0% in 2017 (1.1% and 8% in 2016) depending on the nature of the assets and costs.
- Discount rate or actualization The valuation obtained after applying the above adjustments is updated to the current value using an estimated discount rate taking into consideration the Company's financing costs and the risks inherent to the assets. Average rates have been considered ranging between (1.4% and 3.0% in 2017 (1.7% and 3% in 2016), which include an aggregate figure for the finance costs estimated for the Company according to the Business Plan. Moreover, the capital asset pricing model includes a measure that is in addition to the finance costs related to the Business Plan and the property risk contained in the methods under the ECO Order, which varies between 8% and 30%.
- Also, and in application of the Circular, any valuation that is seen to be 15% higher than the mortgage value or the value obtained using sample statistical procedures or automated valuation models must be evidenced with more than one market transaction involving similar assets. However the Company has made no adjustments higher than 15% above the mortgage value or the value obtained using sample statistical procedures or automated valuation models.

At 31 December 2017 and 2016 the Company shows no net losses in this asset unit.

The Company has carried out a sensitivity analysis on the key assumptions considered to be more volatile in the capital asset pricing model. The results obtained are summarised below:

Figures in millions of Euro	+ 100 p.b./ + 1 year	- 100 p.b./ -1 year
Appraisal values	76	(76)
Prices of real-estate assets	339	(355)
Time Horizon of the Business Plan	220	(209)
Total	**651**	**(624)**

In 2016 those sensitivities brought about effects ranging between 653 thousand euros of increased value and 563 thousand euros of decreased value.

None of these fluctuations has had any impact on the Company's equity as that asset unit has increased value for a greater amount.

4.7.2. Impairment of loans and credits receivable and property assets received in payment of debts

Trade accounts receivable

At least at year end, the Company carries out impairment testing to bring the trade accounts receivable into line with their recoverable value. Objective evidence of impairment is considered to exist if the recoverable value of the financial asset is lower than its carrying value. If this happens, this impairment is recognised in profit or loss. At 31 December 2017 and 2016 the Company has a provision for impairment of trade accounts receivable for the amount of 54,981 and 41,212 thousand euros, respectively (see Note 9).

Loans and credits and other real-estate assets received in payment of debts

The value of financial assets representing debt transferred to the Company is estimated on an individual basis according to the payment capacity of the main debtors liable for payment, where appropriate, considering the possible existence of guarantors or surety with proven payment capacity.

Estimating the payment capacity of debtors takes place either individually depending on the payment capacity of the debtor if this can be verified and evidenced with documents in respect of fulfilment of contractual obligations with no significant delays or hold-ups in payments. In the case of loans without collateral, the valuation is made collectively, considering that the expected loss of the portfolio in question is reflected, except for financial assets without collateral that have not been paid or payment that has been delayed for over 18 months and which are considered to be of zero value, unless demonstrated otherwise. That principle is applied to the residual value of assets with security guarantee other than a first ranking guarantee, after deducting all of the liability insured with the first ranking guarantees, including interest on arrears. Only when the Company is the sole best-ranking creditor, the current value of the debt is used when this is less than the mortgage liability and the value of the guarantee could cover both senior ranking and junior ranking loans, whether fully or partially.

For any financial assets (or property assets received by the Company in payment of debts) in respect of which it is estimated that the amounts owed will be recovered by enforcing the guarantees and those guarantees represent a first-ranking property right to the assets, or a lesser ranking right if the requirements set out in the previous paragraph are met, the valuation of the financial asset will be made taking into consideration the property valuation of the guarantees. That valuation is made according to the terms set out in Note 4.7.1 on Real-Estate Assets (including in the estimation of costs not only those for maintenance and marketing up until the subsequent sale of the collateral, but also those necessary for the enforcement of the guarantees (court costs, legal costs and taxes).

In the case where the loans and items receivable with collateral other than properties, such as pledging debt securities or capital, the Company calculates their market value on the valuation date if it is a financial instrument traded on an active market or, where appropriate, it uses generally accepted valuation methods.

For the estimation of the value of these assets a number of assumptions have been applied, based on the Company's business plan, which are listed in Note 4.7.1. With regard to the costs and deadlines for enforcement and collateral given in lieu of payment, these have been estimated on the basis of the type of assets and the Company's business plan, fluctuating between 1% and 18% of the debt.

Following the impairment test carried out, in 2017 and 2016 the Company has provisions which have been funded with a charge to the heading "Value change adjustments – Impairment of financial assets" (see Note 2.1) for the amount of 4,229,552 and 3,389,356 thousand euros respectively for the impairment of debt securities classified as loans and items receivable and assets received in payment of debt (see Note 7.1.1.). That provision is recognised under the heading "Long term financial investments – Credit for third parties and related parties".

The same as for the unit of real-estate assets, the Company has carried out a sensitivity analysis on the key assumptions considered to be more volatile in the pricing model, obtaining the following results:

Figures in millions of Euro	Effect on Equity	
	+ 100 p.b./ + 1 year	- 100 p.b./ -1 year
Appraisal values	210	(211)
Prices of real-estate assets	1,011	(976)
Time Horizon of the Business Plan	853	(855)
Total	**2,074**	**(2,042)**

4.7.3 Investments in subsidiaries and associates

Impairment losses on the Investments in subsidiaries and associates are estimated and booked by the Company whenever, according to the provisions of applicable legislation, there is objective evidence that the carrying value of an investment in those companies may not be recovered.

When estimating the existence of evidence of the impairment of those investments, amongst other factors, the Company considers any drop in its underlying book value adjusted for any non-recorded unrealised gains of the companies or the evolution of its share price (in the case of those that are publicly traded), inactivity of the investee, its financial position, etc.

The amount of the impairment loss to be recognised is estimated as the difference between the carrying value of the holdings and their recoverable amount, this being understood as the higher amount between the fair value less the sales costs and the actual value of future cash flows arising from the investment.

In any cases in which it is not possible to estimate the recoverable amount of an investment as described in the previous paragraph or in any insignificant investments, the estimation of their impairment is based on the equity of the investee company, adjusted by the amount of the unrealised gains existing at the date of valuation.

In application of the 2nd consultation of the Official Bulletin of the Institute for Accounting and Auditing (BOICAC) 79, valuation adjustments for impairment and, where applicable, their reversal, are recognised as revenue or an expense, respectively, under the heading "Impairment of financial instruments – Equity instruments, loans and credit for associates" forming part operating income/(loss) on the income statement. The reversal of a previously recorded impairment is limited to the book value of the investment that would have been recorded on the date of reversal if the value impairment had not been recorded.

In 2017 and 2016 the impairment recorded by the Company for this item was 1,047 and 2,427 thousand euros, respectively (see Note 7.2).

4.8 Categories of classification of financial liabilities

This category includes the classification of trade accounts payable originating in the purchase of assets and services under the Company's trading operations, the funding received (see Note 1) and any non-trade accounts payable which, as they are not derivatives, are not of trade origin.

Debits and items payable are initially valued at the fair value of the consideration received, adjusted by the transaction costs directly assignable to them. Subsequently those liabilities are valued for their amortised cost.

Notwithstanding the above, certain items established in applicable legislation, maturing in less than one year, are booked initially at their face value if the effect of not restating their cash flows is insignificant, and are later measured for the same amount.

Liability derivatives are valued at their fair value, following the same criteria as those used for financial assets held for trading described in Note 4.9.

The interest accruing on those liabilities, calculated using the effective interest rate method, is recorded under the heading "Financial Expenses" on the income statement.

4.9 Hedging Derivatives

The Company uses financial derivatives to hedge its equity positions as part of its strategy for reducing its exposure to interest rate risks.

When the Company designates a transaction as a hedge it does so from the inception of the transactions or instruments included in the hedge, and the hedging transaction is documented appropriately. The hedge accounting documentation identifies the hedged instrument or instruments and the hedging instrument or instruments, the nature of the risk to be hedged, and the criteria or methods used by Sareb to assess the effectiveness of the hedge over its entire life, taking into account the risk intended to be hedged.

Sareb only classifies as hedge transactions those considered to be highly effective during their expected life. A hedge is considered to be highly effective if, during its expected life, the changes in fair value or in the cash flows that are attributed to the risk hedged under the hedging transaction for the financial instrument or instruments hedged are almost entirely offset by changes in the fair value or in the cash flows, as appropriate, of the hedge instrument or instruments.

To measure the effectiveness of hedge transactions defined as such, the Company analyses whether, from the beginning to the end of the term defined for the hedge, it may be expected, prospectively, that the changes in fair value or in the cash flows of the hedged item that are attributable to the hedged risk will be almost entirely offset by changes in the fair value or in the cash flows, as appropriate, of the hedging instrument or instruments and, retrospectively, that the results of the hedge will vary within a range of 80% to 125% of the results of the hedged item.

In order to establish that fair value, the Company takes into account its credit risk in the event of the valuation being negative, or the counterparty risk in the event of the valuation being positive.

The hedge accounting ceases to take place when the hedging instrument matures or is sold, expires or is exercised, or if it no longer meets the criteria for hedge accounting. At that time any cumulative gain or loss corresponding to the hedge instrument that has been recorded in equity is held there until the anticipated transaction has occurred. If the hedging transaction is no longer expected to *occur*, any cumulative gains or losses recognised in Equity are transferred to profit or loss.

Cash flow hedges

The hedge transactions held by the Company at 31 December 2017 are in line with the definition of "Cash flow hedges", that is, hedges to cover exposure to cash flow fluctuations associated to the interest rate risk for a highly probable forecast transaction and for the financing received at a floating interest rate, respectively, which affect the Company's income statement. The portion of the gain or loss on the hedge instruments qualifying as effective hedges is recognised temporarily in equity, net of tax, under the heading "Value change adjustments - Hedge transactions", and the corresponding portion is taken to the income statement in the year or years in which the planned hedged transaction affects income.

In 2017, the derivatives hedging the 1-year bonds and part of the 2-year bonds have conserved their effectiveness within the thresholds required under the International Standards of Accounting but, due to the decline in the interest rates to which the hedged risks are indexed and to Sareb's application of a "floor" by which the interest rate may in no case be lower than 0%, they have lost part of that effectiveness. At 31 December 2017 and 2016 the valuation of the ineffective portion of the hedges was 13,260 and 36,572 thousand euros, respectively. That amount was recognised with a charge to the heading "Financial Expenses" on the attached income statement (see Note 16.5). The variation in the ineffectiveness has been reduced as a result of the novation of part of the senior debt, which is no longer limited by the mentioned "floor".

Certain information is provided in Note 13.3 on the cash flow hedging transactions carried out by the Company.

4.10 Derecognition of financial instruments

Financial assets are derecognised when any of the following circumstances arises:

1. The contractual rights on the cash flows generated by the asset have expired; or
2. The contractual rights to the cash flows from the financial asset are transferred and substantially all its risks and rewards are transferred or, although these are not substantially transferred or retained, control over the financial asset is transferred.

   Also, a financial liability is derecognised when the obligations it generates have been extinguished or when it is repurchased by the Company, with the intention either to re-sell or to cancel it.

4.11 Inventories

These mainly correspond to property developments in progress and to the value of the associated land intended for sale in the normal course of the Company's business. Sareb recognises under the heading of "Inventories" all assets on which it is going to take any kind of action, construction and/or development for subsequent sale through marketing.

The costs incurred in uncompleted property developments still to be completed are considered as works in progress. Those costs include any corresponding to the land, urbanising and construction, as well as the capitalisation of the finance expenses incurred during the construction stage and any other direct and indirect costs attributable to them. Moreover, the Company does not capitalise marketing costs, which are taken directly to profit or loss.

All property assets for which the Company's governing bodies have approved an investment and development plan for their subsequent retail sale are transferred from "Property Investments" to the heading of "Inventories".

The expense corresponding to any property developments for which construction has concluded during the year and are still to be sold is transferred from "Works in progress" to "Completed Buildings".

The principles applicable to the impairment testing of inventories are similar to those applicable to Property Investments (see Note 4.7.1.).

4.12 Foreign Currency Transactions

The functional currency used by the Company is the Euro. Therefore, transactions in currencies other than the Euro are considered to be denominated in foreign currency and are recorded according to the exchange rates in force at the transaction dates.

At the year end, the Company neither had balances nor had carried out transactions in foreign currencies for any significant amount. The amount of revenue recognised in 2017 and 2016 for this item was 3 and 187 thousand euros, respectively.

4.13 Income and expenses

Income and expenses are recorded according to the principle of accrual, that is, at the moment when the goods or services represented by them are provided, regardless of when actual payment or collection occurs. This revenue is measured at the fair value of the consideration received, after deducting discounts and taxes.

Reporting in the income statement:

In line with the provisions set out in sub-section 10 of the Seventh Additional Provision of Act 9/2012, of 14 December, and its amendment included in the Ninth Additional Provision of Act 26/2013, of 27 December, and also the provisions of Bank of Spain Circular 5/2015, the Company has recognised the revenue generated as a result of the process for orderly management and liquidation of all the transferred assets in the income statement forming part of its "Net Turnover" (see Notes 2.1 and 16.1).

Income from interest

Notwithstanding the principles provided in the Accounting and Measurement Rule 9 of the General Chart of Accounts (PGC), under which the subsequent measurement of the financial assets should follow the amortised cost principle and also that "interest paid is entered into the accounts in the income statement, applying the effective interest rate method", the general application of the accrual principle and the amortised cost principle can have specific practical applications depending on the type of asset to which they are to be applied, the terms under which they were acquired and even the sector applying that principle, to the extent that it responds to the true and fair view of the annual accounts.

Considering the characteristics of the assets received and the high degree of uncertainty in their recovery through regular channels as already described in Note 4.6.2, the accrual model applied by Sareb provides that interest will only accrue on transactions in which they are estimated to be effectively recovered, backed up by the recoverable value of the guarantees for those transactions. That recoverable value is estimated on the basis of the principles set out in Note 4.7.2.

As part of the effective interest rate, the Company records under the heading "Net Turnover – Margin of recovery of Loans and Credits", the difference between the recovered value and the net carrying value of the loans and credits that have been cancelled or partially repaid.

Income from sales of loans and credits

Income from sales of loans are recognised under the heading of "Net Turnover – Sales of Loans and Credits". That sale takes place once all the risks and benefits related to the financial assets transferred have been passed on to the buyer, which usually coincides with signing the sales deeds and collecting payment on the sale.

Income from property sales (Property Investments and Inventories)

Revenue from property sales (both for Property Investments and Inventories) is recognised when the significant risks and rewards of ownership of the goods sold have been transferred to the buyer, and the Company neither continues to manage the goods nor retains effective control over them. That moment usually coincides with signing the sales deeds for the property being sold. The amount of property sales is recorded under the heading "Net Turnover" on the attached income statement.

The Company includes in the attached Income Statement the charge for the amounts corresponding to the expenses yet to be incurred for liquidating the promotion, as a provision for finishing building work.

Amounts paid in advance in the form of cash or notes receivable corresponding to reservations and sales contracts for promotions when they have not yet been handed over to the buyer and therefore the sale has not been recognised, are booked under the heading "Customer Advances" on the liability side of the attached Balance Sheet, and are classified as current regardless of the date planned for recognition of the sale of the developments.

The Company recognises sales of plots and land when the risks and benefits inherent to them are transferred, which normally takes place when the sales deeds are signed.

Income from leases

Rental revenue is recognised on an accrual basis, and incentive-related income and the initial costs of lease agreements are allocated on a straight-line basis.

4.14 Income tax

The Income Tax expense or income includes the portion relative to the current tax expense or income and the portion corresponding to the deferred tax asset or liability. Corporate Income Tax for the year is calculated based on the economic or accounting profit or loss determined by applying generally accepted accounting principles, which does not necessarily coincide with taxable profit, this being taken as the taxable amount for this tax.

Current tax is the amount that the Company pays as a result of paying income tax relating to one year. Any deductions and other tax benefits in the tax charge, excluding any withholdings and payments made on account, and the tax losses that can be offset from previous years and applied effectively in this year, give rise to a lower amount of current tax.

Any deferred tax expense or income corresponds to the recognition and derecognition of the deferred tax assets and liabilities. These include any temporary differences which are identified as those amounts that are foreseen to be payable or recoverable, arising from the differences between the book values of the assets and liabilities and the taxable basis value, and the negative tax bases still to be offset and the credits for tax deductions that have not been applied. Those amounts are recorded by applying to the corresponding temporary difference or credit the charge at the rate at which it is expected to be recovered or paid.

Deferred tax assets are only recognised to the extent that it is considered probable that the Company will have sufficient future taxable profits against which they can be offset. In this case, the deferred taxes are measured on the basis of the current tax rate expected at the time of recovery.

Deferred tax liabilities are recognized for all taxable temporary differences, except those arising from the initial recognition of the goodwill or other assets and liabilities in a transaction that has no effect on the taxable profit or loss or on the accounting profit or loss, and is not a business combination, and also those associated to investments in subsidiaries, associates and joint ventures in which the Company is able to control the timing of the reversal of the temporary difference and it is probable that they will not reverse in the foreseeable future.

Deferred tax assets and liabilities originating in transactions with charges or payments directly made in equity accounts are also entered with a balancing entry in equity.

At each year end of the accounts the recorded deferred tax assets are reviewed, and appropriate adjustments are made to the extent that there are doubts as to their future recovery. Also, at each accounts closure date, the deferred tax assets not recorded on the balance sheet are assessed and recognised to the extent that it has become probable that future taxable profit will enable them to be recovered.

4.15 Provisions and contingencies

In the drawing up of these Annual accounts the Directors differentiate between:

a) Provisions: credit balances that cover current obligations arising from past events, the cancellation of which is likely to originate an outgoing of resources, but that is undefined as to the amount and/or moment of cancellation.

b) Contingent liabilities: possible obligations arising as a consequence of past events, the materialization of which is conditioned to one or several future events occurring beyond the control of the Company.

The Annual accounts contain all the provisions with respect of which it is anticipated that the probability of having to attend to the obligation is greater than not having to. The contingent liabilities are not recognised in the Annual accounts, but information is provided on them in the Notes in the Report, to the extent that they are not considered to be remote.

Provisions are valued at the current value of the best calculation possible of the amount necessary for cancelling or transferring the obligation taking into account the information available on the event and its consequences, and recording the adjustments that arise from updating those provisions as a financial expense as they become due.

The compensation to be received from a third party at the moment of liquidating the obligation, as long as there are no doubts that said reimbursement will be received, is recorded as an asset, except in the case of there being a legal relation through which part of the risk has been externalised, and by virtue of which the Company is not bound to respond; in that circumstance, the compensation shall be taken into account to estimate the amount for which, if appropriate, the relevant provision shall be recorded.

At 31 December 2017 and 2016 the Company had set up the provisions described in Note 12.

4.16 Transactions with related parties

A related party is deemed to be any individual or legal entity having control or significant influence over a company, or who is a key member of its Management. According to the Directors, no other company exercises sole or joint control of the Company there is no association with key members of Management, other than their employment relationship.

Significant influence is understood to be the power to participate in the financial and operating policy decisions of the Company, but without having control over them. In this respect the Company considers that the FROB is the only shareholder having any significant influence on the Company.

In general, transactions with related parties are recognised according to the general rules for measurement contained in the General Chart of Accounts, namely that the items involved in the transaction are initially recorded for their fair value and subsequently according to the relevant accounting standards.

Note 17 gives information on transactions with related parties concluded in 2017 and 2016 and on the balances held at 31 December of those years with related parties.

4.17 Termination indemnities

In accordance with current legislation, the Company is required to pay indemnities to any employees who, in certain conditions, have had their employment relationships terminated. Therefore, indemnities for dismissal that can be reasonably quantified are recorded as an expense in the financial year in which the decision to dismiss them is taken. At 31 December 2017 the Company had no liabilities for this item, however in 2017 and 2016, the Company recognised indemnities for dismissal for the amount of 216 and 515 thousand euros, respectively, which were recorded under the heading "Staff Expenses – Salaries, wages and similar" on the attached income statement.

4.18 Statements of cash flows

In the cash flow statements, prepared using the indirect method, the following expressions are used with the following meanings:

1. Cash flows: Inflows and outflows of cash and cash equivalents, which are short-term, highly liquid investments that are subject to an immaterial risk of changes in value.
2. Operating activities: The principal activities of the Company and other activities that are not classified as investment or financing activities. The Company classifies these activities as described in Note 4.13.
3. Investing activities: The acquisition and disposal of non-current assets and other investments not included in cash and cash equivalents.
4. Financing activities: Activities that result in changes in the size and composition of equity and liabilities that are not amongst the Company's operating activities, as well as any others which cannot be classified as for investment or operating.

5. Property Investments

The composition of this heading at 31 December 2017 and 2016, is as follows:

	Thousands of euros	
	31/12/2017	31/12/2016
Land and plots	**5,072,450**	**5,019,864**
Buildings completed		
Residential - Main Residence	4,766,283	5,148,449
Offices, commercial premises and multiple use facilities	1,212,669	1,255,626
Other properties	457,135	508,092
Residential - Other than main residence	50,695	54,700
Total buildings completed	**6,486,782**	**6,966,867**
Of which: Buildings rented (Note 6)	763,954	854,864
Of which: Land	3,852,914	4,089,235
Advances on Property Investments	140,046	-
Total Property Investments	**11,699,278**	**11,986,731**

The changes under the heading of Property Investments in 2017 and 2016 are as follows:

2017

	Thousands of euros			
	Buildings completed	Land and plots	Advances	Total
Cost:				
Balance at 1 January 2017	**7,155,094**	**5,019,864**	-	**12,174,958**
Additions from awards and given in lieu	485,487	379,746	137,888	1,003,121
Other additions	7,490	10,245	8	17,743
Sales and retirements	(824,387)	(340,739)	-	(1,165,126)
Transfers	(15,386)	13,236	2,150	-
Transfers to Inventories (Note 8)	(102,404)	469	-	(101,935)
Retirements due to rectifications (Note 1)	724	(10,371)	-	(9,647)
Balance at 31 December 2017	**6,706,618**	**5,072,450**	**140,046**	**11,919,114**
Depreciation				
Balance at 1 January 2017	**(188,227)**	-	-	**(188,227)**
Allocations charged against profit or loss	(56,014)	-		(56,014)
Sales, retirements and other changes	24,405	-		24,405
Balance at 31 December 2017	**(219,836)**	-		**(219,836)**
Net balances at 31 December 2017	**6,486,782**	**5,072,450**	**140,046**	**11,699,278**

2016

	Thousands of euros		
	Buildings completed	Land and plots	Total
Coste:			
Balance at 1 January 2016	**6,898,945**	**4,884,955**	**11,783,900**
Additions from awards and given in lieu	834,429	489,238	1,323,667
Other additions	7,006	10,665	17,671
Sales and retirements	(558,859)	(327,096)	(885,955)
Transfers to Inventories (Note 8)	(24,785)	(7,205)	(31,990)
Retirements due to rectifications (Note 1)	(1,642)	(30,693)	(32,335)
Balance at 31 December 2016	**7,155,094**	**5,019,864**	**12,174,958**
Depreciation			
Balance at 01 January 2016	**(137,871)**	-	**(137,871)**
Allocations charged against profit or loss	(64,021)	-	(64,021)
Sales, retirements and other changes	13,665	-	13,665
Balance at 31 December 2016	**(188,227)**	-	**(188,227)**
Net balances at 31 December 2016	**6,966,867**	**5,019,864**	**11,986,731**

The most relevant changes produced in 2017 and 2016 under this heading are itemised as follows:

Other additions

In 2017 and 2016 the Company capitalised 17,743 and 9, 186 thousand euros, respectively, as the higher cost of property investments corresponding to improvements and developments it carried out on the items of its Property Investments. Those improvements were mainly related to infrastructure works carried out on land and sites.

In addition, in 2016 that heading included 8,485 thousand euros corresponding to the Company's acquisition of certain property assets through a swap operation carried out with Bankia, S.A. (see Note 1).

Transfers between items

In 2017 and 2016 the Company reclassified 101,935 and 31,990 thousand euros from the heading of property investments to Inventories corresponding to various plots of land and construction work in progress that had been halted and regarding which the Company has decided to begin or resume the construction and promotion of properties (see Note 8).

Advances on Property Investments

In 2017 the Company recognised under the heading of "Advances on Property Investments" all properties acquired through mortgage foreclosure proceedings which have an enforcement order but are still pending a final ruling. The Company adopted that principle in 2017 in order to standardise the accounting and tax treatment of the operation.

Mortgage foreclosures and dations in payment

2017

On 19 July of 2017 the Company formalised the foreclosures on various sites and finished products that the debtor "Liderazgo Inmobiliario de Aragón, S.L." had mortgaged in guarantee of various loans held by the Company. The acquisition cost of the land and finished products acquired was 43,677 thousand euros, this being the net carrying amount of the loans and credits cancelled following the method of transfer in lieu of payment.

In August of 2017 various mortgage foreclosure procedures were concluded in respect of various loans secured by mortgage guarantee on finished product and land belonging to the agency "Martinsa-Fadesa S.A.". The acquisition cost of the land and finished products acquired was 18,235 thousand euros.

On 29 September 2017 formalised the transfer in lieu of payment of 6 plots of land that the debtor "Promociones Montegancedo 2013" had mortgaged in guarantee of various bilateral loans held by the Company. The acquisition cost of the land acquired was 22,760 thousand euros.

2016

On 31 May 2016 the Company formalised the transfer in lieu of payment of various sites and finished products that the debtor "Inmobiliaria Osuna, S.L." had mortgaged in guarantee of various bilateral loans held by the Company. The acquisition cost of the land and finished products acquired was 27,075 thousand euros, this being the net carrying amount of the loans and credits cancelled following the method of transfer in lieu of payment.

On 22 June 2016 the Company formalised the transfer in lieu of payment of part of the finished product and plots of land that the debtor "Levalta S.L" had mortgaged in guarantee of various bilateral loans held by the Company. The acquisition cost of the land and finished products acquired was 20,774 thousand euros.

On 4 August 2016 the Company formalised the transfer in lieu of payment of finished product that the debtor "Imberti Viviendas, S.A." had mortgaged in guarantee of various bilateral loans held by the Company. The acquisition cost of the land and finished products acquired was 22,076 thousand euros.

Sales and retirements

2017

On 25 May 2017 the deeds were signed for the sale of a plot of land for urban development located in Sotogrande, in the municipality of San Roque (Cadiz), for a total price of 8,000 thousand euros, which was received in full upon notarising the deed.

On 19 July 2017 the deeds were signed for the sale of the Hotel Senator Parque Central and the garages located on the basement floor, situated in Valencia, for a total price of 16,462 thousand euros, which was received in full upon notarising the deed.

On 5 December 2017 the sale took place of a plot of land located in the municipality of Rivas-Vaciamadrid (Madrid) for the price of 15,100 thousand euros, of which 8,325 were received by year-end, and the rest was deferred.

On 14 December 2017 the deeds were signed for the sale of a plot of land in Benahavis (Malaga) for the price of 10,500 thousand euros, of which 5.775 thousand euros were received by year-end, and the rest was deferred.

On 7 July the Company incorporated Tempore Properties Socimi, S.A. through a non-monetary contribution of a complex of residential buildings and properties for rental located in the main city centres in Spain. The net carrying amount of those assets transferred was 172,055 thousand euros (see Note 7.2.1).

On 29 December 2017 the deeds were signed for the sale of land on Plot D Son Ferragut (Palma de Mallorca), for the price of 8,353 thousand euros which was received in full at the close of 2017.

2016

The main sales in 2016 are described below:

On 31 August 2016 the deeds were signed for the sale of 4 plots located in the "El Cañaveral" sector in Vicalvaro (Madrid) for a total price of 7,722 thousand euros, which was received in full upon notarising the deed.

On 28 October 2016 the deeds were signed for the sale of a single building located in Calle de la Protectora in Palma de Mallorca (Balearic Islands) for the price of 5,000 thousand euros which was received in full by the close of 2016.

On 29 November 2016 the deeds were signed for the sale of a plot of land located in the Paseo de los Melancólicos (Madrid) for the price of 20,000 thousand euros, having deferred 9,000 thousand euros until 30 September 2017. The sales deed provides that in case of non-payment, the Company will recover the asset transferred plus compensation.

On 2 December 2016 the sales deed was notarised for an office block in calle Gobelas nº 29 (Aravaca – Madrid) for the price of 9,200 thousand euros which was received in full by the year end 2016.

Sales Commitments:

At 31 December 2017 and 2016 the Company had the following sales commitment regarding items of its Property Investments:

- FAB Bull: In 2013 the Company transferred the amount of 100,000 thousand euros to the FAB 2013 Bull for a package of Property Investments whose net cost at 31 December 2013 was 97,896 thousand euros. The Company has not recorded the corresponding sale as it considered that the risks and benefits inherent to those assets have not been transferred. At 31 December 2017 and 2016, the amount of outstanding properties belonging to the FAB Bull, was 13,686 and 17,777 thousand euros, respectively.
- Eloise Portfolio: In December 2016 the Company sold what was known as the Eloise portfolio which included a sales commitment on a package of Property Investments for the total price of 17,864 thousand euros. During the first quarter of 2017 that operation was formalised and notarised.

At 31 December the Company signed sales commitments on various properties and plots of land whose carrying amount is 62,915 thousand euros, to which a sales price of 85,767 thousand euros has been assigned; of this amount, 4,666 thousand euros was advanced and has been recognised under the heading "Customer Advances" on the attached balance sheet.

Other information

At the end of 2017 and 2016:

- All the Company's property investments are unencumbered and free from security rights.
- The Company has no fully depreciated items of property investments on its balance sheet.
- There are no dismantling or retirement costs capitalised as a higher cost of the property investments for any significant amount.
- The assets foreclosed by Sareb forming part of the Financial Assets Unit have not generated any profit/(loss) upon being entered on the balance sheet of property assets.
- In this respect the application of the rules for measurement established by Circular 5/2015 for the Property Assets Unit, consisting of the assets transferred by the assigning banks when Sareb was set up, which are classified under the heading of Property Investments and Inventories (see Note 8), at the end of 2017 and 2016 showed a capital gain ion the net carrying value net of 689 and 1,491 million euros respectively.
- The valuation of assets allocated or received in payment of debt subsequent to the date of transfer, carried out according to the principles of Bank of Spain Circular 5/2015, has brought a gain to in the financial assets unit (see Note 7.1) of 400 and 551 million euros in 2017 and 2016 respectively which reduces the need for reorganising the credit transactions of that Unit.
- The Company had no provisions for impairment of its portfolio of property investments.

The Company's policy is to take out all insurance deemed necessary to cover the risks that could affect the property investments. The insurance cover taken out by the Company in respect of its property investments is higher than the net carrying amount of the investments, and is updated annually.

6. Operating leases

At the end of 2017 and 2016, the Company acts as the lessor in certain operating lease agreements whose minimum lease payments, according to the contracts currently in force, without taking into account the repercussion of common expenses, future increases in the Consumer Price Index, nor future contractually agreed rent updates, are as follows:

	Thousands of euros	
Minimum rents	2017	2016
Less than one year	45,652	36,025
From one to five years	72,831	62,838
Over five years	46,780	82,558
Total	**165,263**	**181,421**

Also, the amount of rent from the operating leases and sub-leases corresponding to 2017 and 2016 were recorded under the heading "Turnover" with the following breakdown:

	Thousands of euros	
	2017	2016
Minimum payments per lease (Note 16.1)	49,433	42,135
Repercussion on general expenses	2,627	2,412
Total	**52,060**	**44,547**

The most significant lease agreements are those itemised below:

Location	Contract date	Type of Property	Gross annual amounts (thousands of euros)	Expiry date
C/ Ajalvir (Torrejón de Ardoz)	01/03/2012	Shopping Centre	706	21/05/2023
C/ Cronos (Madrid)	26/06/2006	Office block	753	30/06/2018
C/ Italia (Franqueses del Vallés)	01/01/2013	Industrial warehouse	724	01/01/2023
C/ Doctor Trueta (Sant Celoni)	01/11/2016	Commercial premises	531	03/12/2034
C/ Gaiteira (La Coruña)	04/10/2013	Office block	394	03/10/2018
C/ Manfredonia (Zaragoza)	01/03/2009	Industrial warehouse	393	27/04/2024
C/ Amplaries (Oropesa del Mar)	13/07/2017	Holiday apartments	363	13/07/2022

The net cost of the Company properties being rented at 31 December 2017 and 2016 was 763,954 and 854,864 thousand euros, respectively (see Note 5).

Also, the amount of contingent rents, i.e. variable lease payments, corresponding to those leases recorded in 2017 and 2016 under the heading "Turnover" are insignificant.

Lastly, the lease agreements in which the Company acts as lessee mainly refer to the lease for the offices where it has its head office, and to the leasing of various items of computer software. The lease payments to which the Company is committed for these items are insignificant at the close of 2017 and 2016.

7. Long and Short term financial investments

The carrying value of each category of financial asset held by the Company at 31 December 2017 and 2016 is shown below:

7.1 Breakdown of short and long term financial investments

Below is the breakdown of financial assets belonging to Sareb at 31 December 2017 and 2016, classified according to the breakdown required under applicable legislation:

2017

Thousands of euros

Categories	Long term financial instruments		Short term financial instruments		Total
	Equity instruments	Credits, derivatives and others	Debt Securities	Credits, derivatives and others	
Other financial assets	-	2,207,630	-	7,933	2,215,563
Loans and receivables - Third party loans	-	17,207,323	-	3,600,337	20,807,660
Assets available for sale	-	-	-	-	-
Total	**-**	**19,414,953**	**-**	**3,608,270**	**23,023,223**

2016

Thousands of euros

Classes / Categories	Long term financial instruments		Short term financial instruments		Total
	Equity instruments	Credits, derivatives and others	Debt Securities	Credits, derivatives and others	
Other financial assets	-	2,776,689	-	25,335	2,802,024
Loans and receivables - Third party loans	-	20,902,659	-	3,558,690	24,461,349
Assets available for sale	-	-	-	-	-
Total	**-**	**23,679,348**	**-**	**3,584,025**	**27,263,373**

7.1.1 Long and short term third party loans

The breakdown of the financial instruments - long and short term third party loans, per counterparty and per instrument type, at 31 December 2017 and 2016, is as follows:

Thousands of euros

	31/12/2017	31/12/2016
Public Authorities	**12,962**	**4,523**
Other resident sectors	**1,285,374**	**1,673,384**
Trade credit	-	-
Borrowing secured by property	1,228,989	1,473,549
with mortgage guarantee	1,228,989	1.473,529
with other property-based security	-	20
Other term receivables	30,453	141,175
Overdrafts and others	25,932	58,660
Non-resident private sector	**-**	**35**
Doubtful debts and credit	**22,996,278**	**25,604,185**
Valuation adjustments	**(3,486,954)**	**(2,820,778)**
Impairment losses on assets	(4,229,552)	(3,389,356)
Other valuation adjustments –*accrued interest pending collection*	730,181	555,181
Others– Capitalised expenses – (Note 4.6.2)	12,417	13,397
Total	**20,807,660**	**24,461,349**

In 2017 and 2016 the Company has granted no new loans or credit to third parties for any significant amount, except for the drawdowns that the beneficiaries have made on the unused funds available to them.

Rectifications formalised

As stated in Note 1, in 2017 and 2016 the Company formalised the rectifications made on financial assets for the amount of 12,101 and 34,718 thousand euros, respectively, following the process of reviewing the portfolio of loans and credits transferred by the banks in Group 1 and 2.

Financial revenue

At 31 December 2017 88.70% of the loan and credit portfolio is indexed to Euribor plus a market spread (89.4% of the total loans and credits at 31 December 2016). Conversely, 11.3% is indexed to fixed interest rates (10.6% at 31 December 2015) - see Note 7.3.3.

In 2017 and 2016, the Company recognised interest arising from its loan and credit portfolio for the amount of 723.818 and 890,563 thousand euros under the heading "Turnover" on the attached income statement (see Notes 4.13 and 16.1). That amount includes 384,089 thousand euros (296,095 thousand euros in 2016) corresponding to amounts received in operations cancelled or partially repaid which were applied to interest following the company's order of priority according to which it gives priority to the cancellation of interest and then to capital; and also 61,292 thousand euros (95,174 thousand euros in 2016) for receiving contractual interest.

Sales of loans and credits

In 2017 and 2016, the Company has carried out wholesale lending sales for the amount of 452,427 thousand euros, recording a gross positive margin of 39,262 thousand euros (474,285 thousand euros of revenue and a negative margin of 118,830 thousand euros in 2016) (see Note 16.1).

The most significant sales transactions of portfolios in 2017 and 2016 are described below:

2017

Operation "Amanda": On 28 June 2017 the Company formalised the transfer of 49 loans with first-ranking mortgage. The price fixed for this portfolio was 63,035 thousand euros, which has been received in full and is recorded under the heading "Net Turnover" on the attached income statement.

Operation "Inés": On 19 December 2017 the sale was concluded for a portfolio of mortgage loans on various properties for the total price of 140,125 thousand euros which is recorded under the heading of "Net Turnover". At 31 December 2017 the price was received in full. This portfolio included a package of "Property Investments" at a sales price of 2,988 thousand euros.

Operation "Tambo": On 29 December 2017 the sale was concluded for a portfolio of 109 mortgage loans on various properties for the total price of 62,770 thousand euros which is recorded under the heading of "Net Turnover". At 31 December 2017 the price was received in full.

On 29 December 2017 the Company sold 321 mortgage loans. The sales price for this portfolio was 50,192 thousand euros, which has been received in full and is recorded under the heading "Net Turnover" on the attached income statement.

2016

On 19 February 2016 the Company sold 16 mortgage loans. The sales price for this portfolio was 45,500 thousand euros, which has been received in full and is recorded under the heading "Net Turnover" on the attached income statement.

On 14 September 2016 the Company sold 241 loans with a first-ranking mortgage. The sales price for the portfolio was 70,500 thousand euros, which has been received in full. The amount of the sale is recognised under the heading of "Net Turnover" on the attached income statement.

Operation "Antares": On 23 December 2016 the sale was concluded for a portfolio of 123 mortgage loans on various properties for the total price of 49,367 thousand euros which is recorded under the heading of "Net Turnover". At 31 December 2016 the price was received in full.

Operation "Sevilla": On 29 December 2016 the Company formalised the transfer of 41 loans with first-ranking mortgage. The price established for this portfolio was 33,278 thousand euros, which have been received in full and are recorded under the heading "Net Turnover" on the attached income statement.

Operation "Eloise": On 29 December 2016 the sale was concluded for a portfolio of mortgage loans for various properties for the total price of 240,601 thousand euros which is recorded under the heading of "Net Revenue". At 31 December 2016 the price was received in full. This portfolio includes a "Property Investment" package for which the signing of the deeds for part of the package has been postponed until the first quarter of 2017 (see Note 5).

Margin of recovery of loans and credits

Under this heading the Company records the difference between the amount recovered from loans that have been repaid and/or fully or partially cancelled, and their carrying amount (see Notes 4.13 and 16.1). The order of precedence adopted by the Company means that the amounts recovered are firstly applied to the cancellation of interest and then to capital. This has resulted in the recovery of loans and credits in 2017 being a negative figure of 220,844 thousand euros. In 2016 that heading showed a negative figure of 283,634 thousand euros.

Adjustments related to impairment of credit risk

Changes in adjustments related to impairment recorded by the Company in 2017 and 2016, were as follows:

2017

Thousands of euros

	Opening balance	Charge	Application	Closing balance
Provision for depreciation of loans and credits	(3,389,356)	(840,196)	-	(4,229,552)
Total	**(3,389,356)**	**(840,196)**	**-**	**(4,229,552)**

2016

Thousands of euros

	Opening balance	Charge	Application	Closing balance
Provision for depreciation of loans and credits	(3,012,418)	(376,938)	-	(3,389,356)
Total	**(3,012,418)**	**(376,938)**	**-**	**(3,389,356)**

In application of the rules for measurement established by the Bank of Spain Circular 5/2015 for what are known as Financial Assets Units, in 2017 and 2016, the Company recognised charges for the impairment of its loans and credit portfolio for the amount of 840,196 and 376,938 thousand euros, respectively, for adjustments related to impairment of credit risk (see Note 4.7.2).

The provision for depreciation of loans and credits for the years 2017 and 2016 is composed of the following:

Type of operation	31/12/2017		31/12/2016	
	Carrying amount (million euros)	Loss / (gain) (million euros)	Carrying amount (million euros)	Loss /(gain) (million euros)
Secured by property guarantee	22,126	2,009	24,832	1,160
Personal guarantee or without	2,911	2,620	3,018	2,780
Allocated to Sareb	4,228	(400)	4,115	(551)
Totals	**29,265**	**4,229**	**31,965**	**3,389**

For its part, Note 7.3.1 includes the necessary information on the nature and degree of the credit risk of the portfolio of loans and items receivable at 31 December 2017 and 2016 (see Note 4.7.2).

Other information

At 31 December 2017 and 2016:

- The nominal amount of unused credit associated to loan and credit transactions is 1,343,553 and 1,517,598 thousand euros, respectively.
- There are no sales commitments for any significant amount regarding the financial assets appearing under the heading of "Loans to third and related parties".
- There are no lawsuits or seizure proceedings having any significant effect on the figure for long and short term financial investments.

Taking into additional consideration what is described in Note 4.7, the Directors of the Company consider that the carrying amount of the aggregate balances included in this heading of the balance sheet is approximate to the fair value.

According to the analysis and updating of the estimates made by the Company, any financial assets classified as doubtful are classified under the heading of non-current financial assets as they are estimated to be recovered within a time horizon of longer than twelve months (Note 2.4).

7.1.2 Long and short term Financial Investments - Other financial assets

The breakdown of the heading "Other long term and short term financial assets" on the balance at 31 December 2017 and 2016 is as follows:

Thousands of euros	31/12/2017		31/12/2016	
	Non-current	Current	Non-current	Current
Monetary guarantees from derivative contracts subscribed (Note 13.3)	2,186,100	-	2,766,800	-
Deposits for leases (Note 6)	4,656	-	5,342	-
Judicial deposits and consignments	15,630	-	4,169	-
Other financial assets	1,244	7,933	378	25,335
Total	**2,207,630**	**7,933**	**2,776,689**	**25,335**

Deposits for leases

Non-current bonds and deposits mainly correspond to the amounts paid by the tenants as a guarantee which the Company deposits with the Institute of Housing or Chamber of Property pertaining to each Autonomous Region.

Monetary guarantees given for transactions in derivatives

At 31 December 2017 and 2016 the Company held guarantees for an amount of 2,186,100 and 2,766,800 thousand euros, respectively, from the counterparties with which it has entered into financial derivative contracts (see Note 13.3). Those guarantees will have an interest rate indexed to the Eonia and to 3 month Euribor plus a market spread. The interest accrued as revenue in 2017 and 2016 was insignificant.

The Directors of the Company consider that the carrying amount of the balances included in this heading of the balance sheet approximates to the fair value.

Deposits and judicial consignments

At 31 December 2017 and 2016 the Company held judicial deposits and consignments for the amount of 15,630 and 4,169 thousand euros respectively, mainly as a result of the mortgage foreclosure procedures in which it is involved.

7.2 Breakdown of financial investments in group companies and associates

The balance of the accounts under the heading "Long term investments in group companies and associates" at the year end 2017 and 2016 is as follows:

2017

Thousands of euros	31/12/2016	Additions	Amortisations and retirements	31/12/2017
Financial investments in group companies and associates	12,129	173,272	(325)	185,076
Impairment Financial investments in associates	(2,427)	-	218	(2,209)
Total equity instruments	**9,702**	**173,272**	**(107)**	**182,867**
Credits to associates	30,704	-	(17,533)	13,171
Impairment credits to associates	(8,739)	(1,265)	-	(10,004)
Total Credit for associates	**21,965**	**(1,265)**	**(17,533)**	**3,167**
Total	**31,667**	**172,007**	**(17,640)**	**186,034**

2016

Thousands of euros	31/12/2015	Additions	Amortisations and retirements	31/12/2016
Financial investments in associates	1,897	10,232	-	12,129
Impairment of Equity instruments	-	(2,427)	-	(2,427)
Total equity instruments	**1,897**	**7,805**	**-**	**9,702**
Loans to associates	28,339	2,382	(17)	30,704
Impairment loans to associates	(8,739)	-	-	(8,739)
Total credit for associates	**19,600**	**2,382**	**(17)**	**21,965**
Total	**21,497**	**10,187**	**(17)**	**31,667**

7.2.1. Financial investments in group companies and associates

Group companies

2017

On 7 July 2017 Témpore Properties Socimi, S.A. was incorporated, in which the Company has a 100% interest, through the issue of 60,000 shares each with a par value of 1 Euro, all of the same class, fully subscribed and paid up by the Company.

Subsequently, on 24 November 2017 Tempore Properties Socimi, S.A. increased its capital; that increase was fully taken up by the Company through the non-monetary contribution of a portfolio of finished properties available for renting for the amount of 175,458 thousand euros. The carrying amount of that portfolio of properties was 172,055 thousand euros, this being the carrying amount assigned to the 100% holding in the capital of Tempore Properties Socimi, S.A.

In addition to the properties described above, the outstanding lease agreements associated with them were transferred; guarantees were received for the amount of 644 thousand euros, additional guarantees for the amount of 1,119 thousand euros, deposited with the different official institutions for the amount of 538 thousand euros and the rents received in advance for the amount of 39 thousand euros.

On 1 March 2018 the Board of Directors of Témpore Properties Socimi, S.A. decided to make the application to place the shares of that Company on the Alternative Stock Market (MAB).

Lastly the debt of tenants associated to the transferred lease contracts was also assigned at no charge for the amount of 380 thousand euros.

Company	Holding	Address	Main Activity	Miles de euros				
				Shares (*)	Issue Premium	Other members' contributions	Operating income/ (loss (*)	Profit / (Loss) after taxes
Témpore Properties Socimi, S.A.	100%	Paseo de la Castellana 89, Madrid	Arrendamiento de inmuebles	14,681	160,836	824	(719)	(719)

(*) Data extracted from the last annual accounts available at 31 December 2017, prepared in accordance with the regulations applicable to each company. At the date of drawing up these Annual accounts the annual accounts of that fund were yet to be audited.

Associates

2017

On 15 February 2017 the company sold 4,064,515 preferential subscription rights in the company Quabit Inmobiliaria, S.A., reducing the value of the holding by 325 thousand euros. That sale generated a loss of 122 thousand euros which has been recognised as a charge to the heading of "Impairment and income/ (losses) from disposal of financial instruments" on the attached income statement.

At the year end of 2017 the shares of that company were measured on the basis of their quoted price, recording a reversal of the impairment loss of the previous year for the amount of 218 thousand euros taken to the heading "Impairment and income/ (losses) from disposals of financial instruments" on the attached income statement.

Also, at 31 December 2016 the Company had a 6.94% interest in the capital of the company Hercesa Internacional, S.L. (whose registered address is in Plaza de Europa 3, Guadalajara and whose corporate object is property development). The main figures have not undergone any relevant changes in 2017.

2016

On 8 February 2016 the Company called in the mortgage granted to Martibalsa, S.L. and which corresponded to a pledge on all the shares of Quabit Inmobiliaria S.A. for a net carrying amount of 10,232 thousand euros. At the year end of 2016 the 4,064,515 shares were measured on the basis of their quoted price at year end of 2016, recording a provision for impairment of 2,427 thousand euros with a charge to the heading "Impairment of equity instruments, loans and credit for associates" on the attached income statement.

The Company 's holding in Quabit Inmobiliaria, S.A. (whose registered address is in C/ Roger de Lauria 19 – Valencia and whose corporate object is property development) was 7.66%. The unaudited equity and operating loss for the last year for that company was 113,341 and 19,674 thousand euros, respectively. The share listing of that company at the year end of 2017 was 1.88 euros per share.

Also, at 31 December 2016 the Company had a 6.94% interest in the capital of the company Hercesa

Internacional, S.L. (whose registered address is in Plaza de Europa 3, Guadalajara and whose corporate object is property development). The unaudited equity and operating loss for the last year for that company was 96,954 and 3,313 thousand euros, respectively.

Deconsolidated Bank Assets Funds

On 19 September 2017 an agreement was reached with the investment partner of the FAB May in order to liquidate that fund. The agreement reached provided for assigning 5% of the equity corresponding to Sareb to the investment partner in exchange for monetary compensation of 4,800 thousand euros. That amount is recorded under "Net Turnover" on the attached income statement (see Note 4.6.1).

2017

Company	Holding	Address	Main Activity	Thousands of euros			
				Values (*)	Reserves and other equity items	Gross margin (*)	Profit / (Loss) after taxes
1. Unlisted.-							
FAB 2013 Teide	15%	Pza. Pablo Ruiz Picasso 1, Madrid	Venta y gestión de inmuebles	87,815	-	4,164	-
FAB May(**)	-	-	-	-	-	-	-

(*) Data extracted from the last annual accounts available at 31 December 2017, prepared in accordance with the regulations applicable to each company. At the date of drawing up these Annual accounts the annual accounts of that fund were yet to be audited.

(**) That fund was liquidated on 19 September 2017 (see Note 4.6.1).

2016

Company	Holding	Address	Main Activity	Thousands of euros			
				Values (*)	Reserves and other equity items	Gross margin (*)	Profit / (Loss) after taxes
1. No cotizadas.-							
FAB 2013 Teide	15%	Pza. Pablo Ruiz Picasso 1, Madrid	Venta y gestión de inmuebles	87,815	-	14,152	-
FAB May	5%	Pª Castellana 143	Venta y gestión inmuebles	57,614	-	642	-

In 2015, at the request of the CNMV (Stock Market National Commission) the FAB Teide and FAB May made a change to their accounting criteria consisting of offsetting the profit/(loss) for the year by making an offsetting entry, for which the offsetting account is an allowance account that reduces the amount of the debt securities issued. That change in accounting criteria had no impact on the Annual accounts of the Company.

Non-Deconsolidated Bank Assets Funds

In 2017 and 2016 did not bring about any significant changes nor were any new deconsolidated funds set up other than those mentioned above. The most relevant information on those funds is provided below:

2017

Company	Holding	Address	Main Activity	Thousands of euros			
				Values (*)	Reserves and other equity items	Gross margin (*)	Profit / (Loss) after taxes
1. Unlisted.-							
FAB 2013 Bull	49%	Pza. Pablo Ruiz Picasso 1, Madrid	Property sales and management	50,364	-	771	-

Data extracted from the last annual accounts available at 31 December 2017, prepared in accordance with the regulations applicable to each company. At the date of drawing up these Annual accounts the annual accounts of that fund were yet to be audited.

2016

Company	Holding	Address	Main Activity	Thousands of euros			
				Values (*)	Reserves and other equity items	Gross margin (*)	Profit / (Loss) after taxes
1. Unlisted.-							
FAB 2013 Bull	49%	Pza. Pablo Ruiz Picasso 1, Madrid	Property sales and management	50,364	-	3.295	-

(*) In 2015, at the request of the CNMV (Stock Market National Commission) the FAB 2013 Bull and FAB Corona made a change to their accounting criteria consisting of offsetting the profit/(loss) for the year by making an offsetting entry, for which the offsetting account is an allowance account that reduces the amount of the debt securities issued. That change in accounting criteria had no impact on the Annual accounts of the Company.

7.2.2. Loans to associates

The changes under that heading in 2017 and 2016 are as follows:

2017

	31/12/2016	Disposals	Amortisations	31/12/2017
FAB 2013 Teide	**19,023**	**(1,266)**	**(14,590)**	**3,167**
Debt Securities	13,172	-	-	13,172
Impairment Debt Securities	(8,739)	(1,266)	-	(10,005)
Credit facility	14,590	-	(14,590)	-
FAB May	**2.942**	**-**	**(2.942)**	**-**
Debt securities (Note 7.2.1)	2,881	-	(2,881)	-
Credit facility	61	-	(61)	-
Total	**21,965**	**(1,266)**	**(17,532)**	**3,167**

2016

	31/12/2015	Drawdowns	Amortisations	31/12/2016
FAB 2013 Teide	**16,665**	**2,358**	**-**	**19,023**
Debt Securities	13,172	-	-	13,172
Impairment Debt Securities	(8,739)	-	-	(8,739)
Credit facility	12,232	2,358	-	14,590
FAB May	**2,935**	**24**	**(17)**	**2,942**
Debt Securities	2,881	-	-	2,881
Financing of VAT	-	-	-	-
Credit facility	54	24	(17)	61
Total	**19,600**	**2,382**	**(17)**	**21,965**

In 2017 Fab 2013 Teide cancelled in advance the full amount of the credit line taken, of which the amount drawn down was 14,590 thousand euros.

In 2017 the Company obtained yields from the debt securities subscribed to in the FAB Teide for the amount of 1,534 thousand euros. The total yields obtained from other FABs in 2017 and 2016 were 1,778 and 903 thousand euros, respectively (see Note 16.1).

7.3 Information on the nature and risk level of the financial instruments

Risk management is the key principle for achieving the objectives established for the Company, which consist of contributing to putting the financial system on a sounder basis, minimising public funding, settling debts and meeting obligations it assumes in the course of its operations, minimising any possible distortions in the markets that might arise from its actions and selling the assets received, enhancing their value within the time period established and for which the company was set up, while at all times preserving the Company's financial soundness and equity.

The Board of Directors is the governing body responsible for deciding on and approving the general procedures for internal control, as well as the policies on the assumption, management, control and reduction of the risks to which the Company is exposed. Having been assigned the functions delegated by the Board of Directors, the Risks Team and the departments of Network and Direct Management also act in managing risk.

For its part, the Audit Committee, backed up by the department of Internal Auditing and the department of Internal Control and Compliance, is responsible for supervising the effectiveness of the operating procedures and internal control systems, as well as ensuring compliance with applicable regulations.

The Company manages risk on the basis of the principles of independence, the commitment of Senior Management, delegation of functions, proactive management of lending and property investments in order to minimise default and the decreased value of the investments, by monitoring and controlling the positions and technical specialisation, establishing the most suitable tools and methods of risk management and measurement, and ensuring they are uniformly applied.

As a result of the very structure of the Company's opening balance sheet, the main risks to which it is subject are the following:

- Credit risk and the concentration of credit related to the units of financial assets acquired by the Company, and also to certain investments made in the normal course of its business.
- Liquidity risk associated with financial instruments, arising from the lack of availability of the funds necessary for meeting the commitments acquired by the Company at reasonable prices and for continuing with its credit activity.
- Interest rate risk, linked to the likelihood of losses being generated by an adverse trend in market interest rates.
- Operating risk, brought about by losses due to unsuitable or faulty processes, personnel or internal systems, or due to external events.

Considering the type of assets and liabilities of the Company, the exchange rate risk corresponding to potential losses due to the adverse evolution of the prices of assets and liabilities denominated in foreign currency is not significant.

7.3.1 Credit Risk

Credit risk is defined as the possibility of loss arising from the total or partial failure of our customers or counterparties to meet their financial obligations to the Group, or a deterioration in their credit-worthiness. At 31 December 2017 and 2016, 95.8% and 95.1%, respectively, of the loan portfolio as a whole was in default. It is managed by the Risks and Business Group according to the policies, methods and procedures approved by the Board of Directors of the Company.

In line with its corporate objects, the Company's policy centres on managing the portfolios acquired in order to maximise their recoverability through collection or sale. With this, specific procedures are established for the management of credit risk depending on the different characteristics of the financial assets units, according to the definition included in Note 1 above, and of the operations included in each of those categories, based on the:

- Identification, analysis, monitoring of specific risks during the life of the operation until they disappear.
- Measurement and valuation of those specific risks based on the methods established, which are in line with those used for calculating the transfer price of the financial assets units.

- Recovery management of risk transactions.

With regard to the business of assets for rent and property sales, the concentration of customer risk is not relevant and there are no significant deferrals of payment for the purposes of credit risk Furthermore, in the case of deferred payment, it is Company policy to obtain from the customer the guarantees necessary for ensuring the recoverability of the deferred amounts, either through bank guarantees or conditions precedent or subsequent in the public deeds of transfer.

The Company's exposure to credit risk at 31 December 2017 and 2016 mainly affects the transactions recorded in the category of financial assets under "Loans and items receivable" (see Note 7.1); its carrying amount, including the contingent unused amounts available of the loans and credits held to date, is the maximum exposure to the credit risk at that date. In this respect, at 31 December 2017 and 2016, the heading of "Long term financial investments-Credit to third and related parties" and "Short term financial investments - Loans to companies" account for 90.40% and 89.6%, respectively, of the total financial assets of the Company.

Below is relevant information on the profile of credit risk of the investments included in these headings:

Loans to third parties per segment of activity of the beneficiary

The breakdown at 31 December 2017 and 2016 of the "Long and short term Financial investments - Loans to third parties" based on the beneficiary's activities, is as follows:

Thousands of euros	Total		Of which: property collateral (gross of impairment)		Of which: remaining securities (gross of impairment)	
	31/12/2017	31/12/2016	31/12/2017	31/12/2016	31/12/2017	31/12/2016
Public Authorities	21,020	4,523	8,058	-	-	-
IFinancial institutions	-	-	-	-	-	-
Non finance companies and individual businessmen	24,926,322	27,745,774	23,354,344	25,985,587	23,963	59,602
Property construction and promotion	23,467,365	26,346,156	22,317,342	24,972,373	9,089	42,858
Civil engineering work	2,492	2,461	1,981	1,947	-	-
Other purposes	1,456,465	1,397,157	1,035,021	1,011,267	14,874	16,744
Major companies	28,166	26,728	3,474	3,641	-	45
Small & Medium businesses and individual businessmen	1,428,299	1,370,429	1,031,547	1,007,626	14,874	16,699
Other residential properties	77,453	87,011	73,615	82,829	49	-
Capitalised expenses (Note 4.6.2)	12,417	13,397	-	-	-	-
Impairment losses on assets	(4,229,552)	(3,389,356)	-	-	-	-
Total	**20,807,660**	**24,461,349**	**23,436,017**	**26,068,416**	**24,012**	**59,602**

Actions for recovery - debt restructuring and refinancing:

Within the scope of measures for recovery carried out by the Company, there were various actions aimed at providing beneficiaries with the conditions necessary for meeting the contractual obligations established on the basis of the continuity of their business as the principal guarantee of compliance.

Those actions comprised, amongst others, operations for allocating property as collateral or as payment of debts (see Note 5), liquidating collateral and operations for debt refinancing and restructuring.

The actions for recovery and, especially in the case of the operations for debt refinancing and restructuring, were carried out based on objective criteria which took into account both the circumstances common to specific loan and credit portfolios, and the specific circumstances of the beneficiaries, such as their economic and financial situation, and also the viability of their business. The main criteria governing the analysis and implementing of these actions for recovery is to provide a solution to the existing payment problems and to avoid postponing them in time, and also to maximise the recoverable value of the assets received.

The refinancing and debt restructuring tools put into effect include modifying the conditions originally arranged with the debtors in respect of maturity periods, interest rates, collateral provided and, in certain circumstances, writing off or partially reducing the amounts owed. The refinancing or restructuring operations involve bringing the transaction completely or partially up-to-date with the payments of the corresponding debts.

In no case has the refinancing of operations involved any adverse effect on the Company's assets in respect of the status of the refinanced or restructured operations nor any postponement of the recognition of possible losses due to the impairment of those operations in accordance with the circumstances thereof. Therefore, all operations which, in application of the provisions of the regulatory framework applicable to the Company, should be impaired have been considered as such for the purposes of drawing up these Annual accounts.

The number and amount of operations refinanced in 2017 and 2016 is as follows:

2017

	Nº operations	Amounts (thousands of euros)
Operations refinanced / restructured	760	515,497
Operations renegotiated/renewed	-	-
Total	**760**	**515.497**

2016

	Nº operations	Amounts (thousands of euros)
Operations refinanced / restructured	508	1,000,246
Operations renegotiated/renewed	-	-
Total	**508**	**1,000,246**

Geographical distribution of the balance of loans and credits

The geographical distribution at 31 December 2017 and 2016 of the "Long and short term financial investments – Loans to third and related parties", and also of "Cash and other cash equivalents" is as follows:

Thousands of euros	31/12/2017	31/12/2016
Andalusia	2,574,951	2,712,781
Aragón	1,134,552	1,332,416
Asturias	428,750	471,092
Balearic Islands	511,219	595,230
Canary Islands	515,076	602,879
Cantabria	458,725	494,319
Castilla - La Mancha	701,912	766,140
Castilla y León	1,582,051	1,668,537
Catalonia	4,804,340	5,346,517
Extremadura	258,221	269,817
Galicia	1,380,256	1,541,867
Madrid	8,336,267	8,269,719
Murcia	1,205,572	1,311,547
Navarra	36,779	38,693
Region of Valencia	4,516,481	5,084,825
Vasque Conuntry	358,223	406,864
La Rioja	335,548	393,784
Ceuta and Melilla	23,497	23,366
Other non-resident sectors	-	-
- Others – Capitalised expenses (Note 4.6.2)	12,417	13,397
- Adjustment for impairment of assets	(4.,229,552)	(3,389,356)
Total	**24,945,285**	**27,954,434**
Of which: Cash and other cash equivalents	4,137,625	3,493,085
Of which: Long and short term loans to third parties	20,807,660	24,461,349

7.3.2 Liquidity risk

Liquidity risk is defined as the risk of Sareb not having the resources available for being able to pay its debts on their maturity dates.

The Company periodically and specifically establishes the cash requirements by means of preparing a treasury budget over a 12-month time horizon, which will be updated on a recurring basis with the aim of identifying those cash requirements or surpluses in the short term. Furthermore, for managing the liquidity risk, the general financing requirements in the medium and long term are identified, and also how to address them in a way that is consistent with the business projections.

In any case the liquidity risk is also mitigated by the power that the Company has for renewing the bonds issued in consideration of the assets transferred by the banks upon their maturity (see Note 13.2).

During the first years of life of the Company, the criteria for prudence have prevailed in managing liquidity, which is intended to be made more versatile. To this end a procedure has been established for auctioning liquidity between entities to which limits of counterparty risk have been assigned. The auction takes place following the principles established in Sareb of transparency, competition, and maximisation of profitability.

The Board of Directors has also approved a policy for managing the company's liquidity risk which includes regular measuring and monitoring of a series of short term and of long term liquidity ratios, and also, where appropriate, implementing contingent measures designed to preserve the Company's liquidity position.

Breakdown of financial investments according to maturity

Following what is mentioned in Note 2.4, the Company considers its financial assets will be recovered in accordance with the schedule of payments contracted, except for those seen to have difficulties - doubtful - (Note 1) which will be recovered in a period greater than 12 months, in accordance with the updated estimates made by the Company.

Also, under the unilateral option to renew the maturity of the senior debt (Notes 2.4 and 13.2) the Company classifies the probable maturities of that debt according to updated forecasts. The breakdown of the maturities of the Company's financial assets and liabilities at 31 December 2017, is as follows:

In 2017:

	Thousands of euros						
	Less than 1 year	From 1 to 2 years	From 2 to 3 years	From 3 to 4 years	From 4 to 5 years	Over 5 years	Total
Assets:							
Cash and other cash equivalents	**4,137,625**	**-**	**-**	**-**	**-**	**-**	**4,137,625**
Financial investments	**3,608,270**	**3,508,700**	**2,769,347**	**2,271,462**	**4,464,093**	**6,401,351**	**23,023,223**
Loans and Credits to third parties	**3,600,337**	**3,508,700**	**2,769,347**	**2,271,462**	**4,464,093**	**4,193,721**	**20,807,660**
Other financial assets	7,933	-	-	-	-	2,207,630	2,215,563
Financial investments with associates	**-**	**-**	**-**	**-**	**-**	**3,167**	**3,167**
Loans to companies	-	-	-	-	-	3,167	3,167
Total at 31 December 2017	**7,745,895**	**3,508,700**	**2,769,347**	**2,271,462**	**4.,464,093**	**6,404.,518**	**27,164,015**
Liabilities:							
Long and short term debts	**3,968,991**	**3,709,009**	**4,390,995**	**4,272,983**	**4,038,623**	**22,962,068**	**43,342,669**
Debentures and other marketable securities	3,907,378	3,632,100	4,094,317	4,221,302	4,038,623	20,904,748	40,798,468
Amounts owed to credit institutions	22,947	-	-	-	-	-	22,947
Other financial liabilities	38,666	76,909	296,678	51,681	-	-	463,934
Derivatives	-	-	-	-	-	2,057,320	2,057,320
Total at 31 December 2017	**3,968,991**	**3,709,009**	**4,390,995**	**4,272,983**	**4,038,623**	**22,962,068**	**43,342,669**

In 2016:

	Thousands of euros						
	Less than 1 year	From 1 to 2 years	From 2 to 3 years	From 3 to 4 years	From 4 to 5 years	Over 5 years	Total
Assets:							
Cash and other cash equivalents	**3,493,085**	-	-	-	-	-	**3,493,085**
Financial investments	**3,584,025**	**3,319,983**	**3,228,643**	**2,854,789**	**2,690,164**	**11,585,769**	**27,263,373**
Loans and Credits to third parties	3,558,690	3,319,983	3,228,643	2,854,789	2,690,164	8,809,080	24,461,349
Other financial assets	25,335	-	-	-	-	2,776,689	2,802,024
Financial investments with associates	-	-	-	**19,023**	-	**2,942**	**21,965**
Loans to companies	-	-	-	19,023	-	2,942	21,965
Total at 31 December 2016	**7,077,110**	**3,319,983**	**3,228,643**	**2,873,812**	**2,690,164**	**11,588,711**	**30,778,423**
Liabilities:							
Long and short term debts	**4,021,822**	**3,937,496**	**3,704,508**	**3,962,992**	**4,501,492**	**26,149,997**	**46,278,307**
Debentures and other marketable securities	3,959,509	3,858,671	3,620,566	3,879,966	4,422,463	23,286,994	43,028,169
Amounts owed to credit institutions	61,430	-	-	-	-	-	61,430
Other financial liabilities	883	78,825	83,942	83,026	79,029	176,202	501,907
Derivatives	-	-	-	-	-	2,686,801	2,686,801
Total at 31 December 2016	**4,021,822**	**3,937,496**	**3,704,508**	**3,962,992**	**4,501,492**	**26,149,997**	**46,278,307**

The Company's available cash position at 31 December 2017 was 4,137,625 thousand euros. This liquidity, together with the cash generated from amortisations, cancellations and sales of loans and credits, the cash generated from sales of real-estate assets and from renting Company assets, lead the Directors to being confident that they will have sufficient resources to meet the cash requirements, mainly motivated by the maturity of the senior bonds and the financial expenses incurred. In this respect it should be pointed out that the Company has the unilateral right to cancel the senior bonds upon their maturity by delivering new senior bonds of similar characteristics, which very significantly reduce the liquidity risk. Furthermore, and if certain circumstances are fulfilled, Sareb has the option of extending the term of the marketable securities.

7.3.3. Interest rate risk

Structural interest rate risk is defined as being the exposure of the Company to fluctuations in the market interest rates resulting from the varying maturity and repricing dates of assets and liabilities on the balance sheet. Management of the interest rate risk of the balance sheet seeks to keep the Company's exposure within levels in line with its strategy compatible with the Company's business plan and risk profile in the face of changes in market interest rates.

As regards assets, internal tools have been developed which make it possible to simulate cash flows and loan interest according to the contractual conditions on the basis of the information provided by the management companies. These tools allow for the inclusion of scenarios of interest rate variations and assess the impact on future interest flows, taking into account the likelihood of the borrower's creditworthiness.

Liability modelling also makes it possible to simulate the flows of issued debt with the market conditions or simulated scenarios and make an assessment of that debt. To mitigate the Company's strong exposure to variations in interest rate, arising from the high sensitivity of the company's liability and the strong insensitivity of the assets in the face of those variations, in 2013 the Company decided to use derivative instruments to hedge around 85% of the expected outstanding amount of the senior debt during a 9-year time horizon (5 years at 31 December 2017) with the object of reducing the risk of any increases in interest rates having a significant negative effect on the future income statement. That decision was taken considering that the rates in force at the time of adopting the hedge were compatible with the Company's business plan.

Reference interest rates

With regard to the contractual interest rates to which the portfolio of loans and credits acquired is linked, 88.7% (89.4% at 31 December 2016) of the them are linked to floating interest rates, 11.3% (10.6% at 31 December 2016) of them are linked to fixed interest rates. Notwithstanding the above, and given that a large part of the portfolio of loans received has the status of non-performing loans, their actual sensitivity to fluctuations in interest rate is very low.

The floating interest rates applied to the above-mentioned amounts are linked to Euribor at different periods plus the corresponding differential. However, the Company earns interest income on the basis of the provisions of Note 4.13.

Interest rate hedging instruments

As stated in Note 13.3, the Company has interest rate hedge contracts in place with various financing institutions which make it possible to fix the interest rate of approximately 85% of the senior bonds that are estimated during the next 5 years, thus eliminating the uncertainty in the income statement and the future cash flows for the coming years that would result from the evolution of the reference rates.

The Directors of the Company have assessed the interest rate risk using a probability-based structure such as VAR with a 95% probability of standard deviation and a time horizon of one year. That analysis has concluded that upward fluctuations of 3-month Euribor by 79 b.p. and of the spread to which the company's senior debt is fixed (see Note 13.2) could have a negative impact of 30 million euros in both cases.

8. Inventories

The composition of this heading at 31 December 2017 and 2016, is as follows:

	Thousands of euros	
	31/12/2017	31/12/2016
Buildings completed	**17,327**	**21,764**
Units	17,327	21,764
Offices, commercial premises and multiple use facilities	-	-
Other properties	-	-
Residential - Other than the borrower's main residence	-	-
Buildings under construction	**217,790**	**95,085**
Units	217,790	95,085
Offices, commercial premises and multiple use facilities	-	-
Other properties	-	-
Residential - Other than the borrower's main residence	-	-
Advances to suppliers	33,242	33,916
Total	**268,359**	**150,765**

Changes in 2017 and 2016 under the heading of "Inventories" were as follows:

	Thousands of euros			
	Buildings completed	Buildings under construction	Advances to suppliers	Total
Balance at 31 December 2015	**12,121**	**77,286**	**28,212**	**117,619**
Additions	-	13,042	33,916	46,958
Retirements	(17,590)	-	(28,212)	(45,802)
Transfers to Buildings Completed	27,233	(27,233)	-	-
Transfers to Property Investments (Note 5)	-	31,990	-	31,990
Balance at 31 December 2016	**21,764**	**95,085**	**33,916**	**150,765**
Additions	-	32,174	33,242	65,416
Retirements	(15,841)	-	(33,916)	(49,757)
Transfers to Buildings Completed	11,404	(11,404)	-	-
Transfers from Property Investments (Note 5)	-	101,935	-	101,935
Balance at 31 December 2017	**17,327**	**217,790**	**33,242**	**268,359**

The most relevant changes produced in 2017 and 2016 under this heading are itemised as follows:

Additions

In 2017 and 2016 the Company incurred expenses of 32,174 and 13,042 thousand euros in building work and in continuing the work in progress. Those amounts were capitalised as the higher value of the inventories at 31 December 2017 and 2016.

Transfers between items

In 2017 and 2016 the Company carried out a detailed analysis of its works in progress with the object of maximising their value. That analysis mainly sought to differentiate those works in progress on which it expects to obtain a higher degree of profitability through building work, development, completion and offering the properties for sale through the retail channel. That analysis involved the Company making transfers from Property Investments to Inventories for the amount of 101,935 and 31,990 thousand euros, respectively, in 2017 and 2016.

Rectifications

In 2017 and 2016 no rectifications were made affecting the heading of Inventories.

Other information

At 31 December 2017 and 2016 the entire inventory of the Company is unencumbered and free from security rights.

Furthermore, in 2017 and 2016 no financial expenses were capitalised as the higher cost of inventories.

As a standard procedure, practically all the pre-sales are subject to indemnity clauses in the case of delayed delivery as they are formalised in contracts in similar terms. The mentioned clauses on indemnity for delay mainly consist of legal interest on the amounts paid during the period between the delivery date scheduled in the contract and the actual delivery date. The Company does not estimate any impact for this reason mainly due to the fact that the delivery date scheduled in the contracts allows for a safety margin of a certain number of months in respect of the anticipated delivery date. For this reason and due to the low number of operations of this kind in 2017 and 2016, the Company has not considered any impact in the Annual accounts of 2017 and 2016 for this item. Generally speaking, presales include indemnities in favour of the Company in the event of cancellation by the buyer, although no amount is recorded for this item until the formalisation of any contracts terminated for causes not attributable to the Company.

The procedure followed by the Company in relation to collateral or guarantees covering the advance payments received from clients anticipates that all advance payments received from clients are guaranteed. The total of advance payments received from clients as reservation deposits at 31 December 2017 was 1,121 thousand euros (925 thousand euros at 31 December 2016).

The Directors of the Company consider that the carrying amount of the balances included in this heading of the balance sheet is at least approximate to the fair value (see Note 5).

9. Trade debtors and other accounts receivable

The breakdown of this heading at 31 December 2017 and 2016 is as follows:

	31/12/2017	31/12/2016
Customer receivables from sales	180,970	218,448
Sundry debtors	7,938	26,437
Doubtful debts	54,981	41,212
Provision for insolvency	(54,981)	(41,212)
Staff	8	7
Current tax assets (Note 15.1)	1,231	5,899
Other receivables from the Public Administrations (Note 15.1)	5,422	1,241
Total	**195,569**	**252,032**

At 31 December 2016 the heading "Sundry debtors" mainly included the amount pending payment arising from the rectifications formalised in 2016 with the bank Banco Mare Nostrum, S.A. for the amount of 23,177 thousand euros. In 2017, that balance was settled and offset by the bonds for the same amount returned by the bank (see Note 1).

It is Company policy to require guarantees for deferred payments, whether guarantees payable on first demand or guarantors with proven solvency.

The amount recorded by the Company under the heading of "Customer receivables for sales and services rendered" includes the amount still to be received, mainly from property sales and revenue from rentals handled by the Company in 2017 and 2016.

The Directors of the Company consider that the carrying amount of the accounts of trade debtors and other accounts receivable is approximate to its fair value.

10. Cash and other cash equivalents

The heading "Cash and other cash equivalents" includes cash and short-term bank deposits with an initial maturity of three months or less.

The breakdown of those assets at 31 December 2017 and 2016 is as follows:

	31/12/2017	31/12/2016
Other cash equivalents	1,385,763	1,766,263
Banks	2,751,862	1,726,822
Total	**4,137,625**	**3,493,085**

The amount recognised at 31 December 2017 and 2016 under the heading of "Other cash equivalents" corresponds to various fixed-term deposits taken out by the Company for the amount of 1,385,763 and 1,766,263 thousand euros, respectively, with different banks. While the initial maturity of those deposits is set for more than three months, the Company has decided to classify it under that heading as it can opt to cancel them in advance with no cancellation charge.

In 2017 and 2016, the Company recognised 2,341 and 4 thousand euros, respectively, as interest from those investments, and also the money deposited in current accounts (see Note 16.6). Furthermore, in 2017 the Company obtained negative remuneration on various deposits and current accounts. That negative remuneration amounted to 2,419 thousand euros, recorded under the heading of "Other Financial Expenses" on the attached income statement (see Note 16.5).

At 31 December 2017 and 2016 there are no restrictions on the use of cash and other cash equivalents, except for an amount equivalent to 8% of the cash generated by the Company since it was incorporated. At 31 December 2017 and 2016 that amount stood at 889,000 and 706,000 thousand euros, respectively, and will be released during the first quarter of 2018 to be used for repaying the debt as set out in the contracts related to the issue of the Company's senior financing (see Note 13).

11. Equity

11.1 Share Capital

At 31 December 2017 and 2016 the Company's share capital is represented by 2,170,440,000 shares, with a par value of euros 0.14 each one, respectively, fully subscribed and paid up. These shares all have the same voting and monetary rights.

On 5 May 2016, in view of the situation of asset imbalance which the Company was undergoing and pursuant to the provisions of article 363.1.e) of the Capital Companies Act (LSC), the Shareholders General Meeting and the Board of Directors approved the following:

a) To reduce the share capital and issue premium existing at that date (300,060 and 900,000 thousand euros, respectively) to offset the losses from previous years.

b) To waive the shareholders' preferential subscription right.

c) To increase the share capital by capitalising the subordinated debt (under the provisions of article 343 of the Capital Companies Act, the resolution for reducing the capital to zero can only be adopted if there is a simultaneous resolution for a capital increase with a preferential subscription right, so the General Meeting has to either approve a capital increase recognising the shareholders' preferential subscription right or that right has to be expressly waived by all the shareholders of the Company; to this end the Board of Directors will put forward two alternative proposals for resolution in this respect). As described in Notes 1 and 13.2, at the same time as acquiring the assets, the Company issued 3,600 million euros of subordinated convertible debt, most of which was subscribed by the original shareholders of the Company. The deed for that issue provides that it can occasionally be convertible in cases of insufficient assets (i) when the cumulative losses are more than the share capital plus the reserves of the Company or (ii) if there are grounds for dissolution due to the fact that the cumulative losses have reduced the equity of the Company to an amount less than half of its capital. That deed provides that, in case of any need for conversion, the capital to be converted will be the amount necessary so that, after the conversion, the share capital figure represents 2% of the value of the Company's assets. In consequence, the Shareholders General Meeting established the necessary conversion of capital in the amount of 2,170,440 thousand euros by way of issuing 2,170,440,000 new shares with a par value of 1 Euro, all new shares having the same voting and monetary rights, and of the same class and series.

d) Capital reduction to offset losses of previous years for the amount of 1,217,977 thousand euros and setting up a legal reserve (see Note 11.2) for the amount of 19,174 thousand euros. That capital reduction was carried out by way of reducing the par value of the existing shares by 0.57 euros per share. Therefore, after this conversion, the face value of the shares was established at 0.43 euros per share.

e) To further reduce the share capital in order to allocate a restricted reserve for the amount of 629,428 thousand euros. The same as for the previous capital reduction, it was carried out by reducing the par value of each of the shares issued to 0.29 euros. After that capital reduction, the par value of the shares stood at 0.14 euros.

The operations described above did not involve any cash inflow for the Company.

Below is a list of shareholders having a shareholding equal or greater than 2.5% of the share capital at 31 December 2017:

	% Holding	Share Capital	Issue Premium
Fund for Orderly Bank Restructuring (FROB)	45,90%	139,472	-
Banco Santander, S.A.	16,62%	50,491	-
Caixabank, S.A.	12,24%	37,181	-
Banco de Sabadell, S.A.	6,61%	20,097	-
Banco Popular Español, S.A. (Grupo Banco Santander. S-A.)	5,60%	17,008	
Kutxabank, S.A.	2,53%	7,698	-
Other shareholders	10,50%	31,915	-
Total	**100%**	**303,862**	**-**

The Company has no knowledge of any other shareholdings of 3% or more in the Share Capital or in the voting rights, or of any which, while lower than the percentage established, allow it to exercise a notable influence over the Company.

As established under article 326 of the Capital Companies Act, once the share capital has been reduced, the legal reserve will have to be funded so that it is again equivalent to 10% of the new capital.

11.2 Legal Reserve

The legal reserve is restricted in its use, which is determined by different legal provisions. According to article 274 of the Capital Companies Act business companies incorporated under that legal form are obliged, if they make profits, to transfer 10% of those profits to a reserve until such reserve reaches one fifth of the subscribed Share Capital. The purposes for which the legal reserve may be used are to offset losses, or to increase capital, in respect of the portion of the reserve that exceeds 10% of the increased capital, or to be distributed to shareholders in the event of liquidation.

At 31 December 2017 and 2016 the balance of the legal reserve was 19,174 thousand euros.

11.3 Other reserves

The composition of this heading at 31 December 2017 and 2016 is as follows:

Thousands of euros	31/12/2017	31/12/2016
Accumulated loss from previous years	-	-
Voluntary Reserves under application RD 4/2016 (see Notes 2.1 and 2.5)	1,667,479	2,330,270
Restricted reserve	629,428	629,428
Total	**2,296,907**	**2,959,698**

11.4 Value change adjustments

This heading of the attached balance sheet includes the amount, net of taxes, of changes in the value of financial derivatives designated as cash flow hedging instruments (see Note 13.3) and the amount, net of taxes, arising from the impairment existing in the financial assets unit, in application of the provisions of RD 4/2016 (See Notes 2.1, 2.5 and 7.1.1.).

The changes in the figure for this heading during the course of 2017 and 2016 are as follows:

2017

Thousands of euros

	Opening balance	Reductions for retiring tax credits	Reduction for impairment of FA unit	Increases / Decreases	Closing balance
Measurement of derivatives	(1,987,672)	-	-	454,627	(1,533,045)
Impairment Financial Assets unit	(3,289,542)	(99,814)	(840,196)	-	(4,229,552)
Balance	**(5,277,214)**	**(99,814)**	**(840,196)**	**454,627**	**(5,762,597)**

2016

Miles de euros

	Opening balance	Reductions for retiring tax credits	Reduction for impairment of FA unit	Increases / Decreases	Closing balance
Measurement of derivatives	(1.943.305)	-	-	(44.367)	(1.987.672)
Impairment Financial Assets unit	(2.330.270)	(582.334)	(376.938)	-	(3.289.542)
Balance	**(4.273.575)**	**(582.334)**	**(376.938)**	**(44.367)**	**(5.277.214)**

The equity valuation adjustments are as follows:

Thousands of euros

	31/12/2017	31/12/2016
Interest rate derivatives (Note 13.3)	(2,057,320)	(2,686,801)
Ineffectiveness derivatives	13,260	36,572
Tax effect	511,015	662,557
Value change adjustments – Hedge transactions (net of taxes)	**(1,533,045)**	**(1,987,672)**
Impairment Financial Assets unit (see Note 7.1.1)	(4,229,552)	(3,389,356)
Tax effect recognised	99,814	682,148
Decapitalisation tax credits from previous years	(99,814)	(582,334)
Value change adjustments – Impairment Financial Assets unit (net of taxes)	**(4,229,552)**	**(3,289,542)**
Total Value change adjustments	**(5,762,597)**	**(5,277,214)**

As indicated in Note 15.3, the Company has derecognised from the balance sheet any tax credits that will not be recoverable over the life of the Company according to its best estimates.

11.5 Equity Situation of the Company

The equity accountable for the purposes of the mentioned articles 317 and 363.1 e) of the TRLSC is as itemised below, and therefore the Company is not involved in any of those circumstances at 31 December 2017:

Thousands of euros

Equity in the Annual accounts of Sareb, S.A. at 31/12/2017	**(3,707,230)**
Less:	
Value change adjustments for cash flow hedges	1,533,045
Value change adjustments for impairment of Financial Assets	4,229,552
Equity for the purposes of reduction and dissolution 31/12/2017	**2,055,367**

It should be mentioned that under prevailing accounting legislation, any changes in the value of derivative hedging instruments are recognised in equity until they are allocated to profit or loss in the corresponding year. The total fair value of this interest rate risk derivative, net of its tax effect, is recognised under the heading "Value change adjustments – Hedging Operations". However, from a business perspective and according to the provisions of article 36 of the Code of Commerce, these value changes in the hedging derivative yet to be charged to the income statement are not considered as equity for the purposes of profit distribution, compulsory reduction of share capital and compulsory dissolution for losses.

In turn, as established by article 2 of RD 4/2016, the Company has recorded the value adjustments of the units of assets established in Circular 5/2015 allocating them to the heading "Value change adjustments – Impairment of Financial Assets" net of taxes, although the Company has decapitalised the tax credits that were capitalised during the year against that heading on the basis of updated future estimates. As established in that RD the adjustments referred to above will not be considered as equity for the purposes of profit distribution, compulsory reduction of share capital and compulsory dissolution for losses.

12. Provisions and contingencies

This heading of the balance sheet at 31 December 2017 and 2016 includes the long term provisions set up by Sareb with the object of covering certain contingent liabilities, and also to cover other responsibilities undertaken by Sareb in the ordinary course of its business, which are reasonably covered. The changes that took place under this chapter of the balance sheet in 2017 and 2016 are shown below:

Thousands of euros

	2017	2016
Opening balance for the year	10,947	9,485
Charges	1,203	2,561
(Reversal)	(2,620)	(1,099)
Transfers and other changes	-	-
Closing balance for the year	**9,530**	**10,947**

The Company is party, as defendant, to certain lawsuits due to the responsibilities inherent to the business it is engaged in. The litigation for which it made provision in 2017 are for amounts of little relevance if considered individually, and there are no others of any particular relevance. In this respect, Sareb makes provision for any likely risks arising from litigation according to the assessment made by its legal advisors. Additionally, short term provisions have been reversed for the amount of 433 thousand euros.

13. Breakdown of Financial Debts

Below is the breakdown of financial liabilities assumed by Sareb at 31 December 2017 and 2016, classified according to the breakdown required under applicable legislation:

2017

Thousands of euros

Categories	Long term debts			Short term debts			Total
	Amounts owed to credit institutions	Debentures and other marketable securities	Derivatives and others	Amounts owed to credit institutions	Debentures and other marketable securities	Derivatives and others	
Debits and items payable	-	36,891,090	425,268	22,947	3,907,378	38,666	41,285,349
Hedge derivatives	-	-	2,057,320	-	-	-	2,057,320
Total	**-**	**36,891,090**	**2,482,588**	**22,947**	**3,907,378**	**38,666**	**43,342,669**

2016

Thousand of euros

Categories	Long term debts			Short term debts			Total
	Amounts owed to credit institutions	Debentures and other marketable securities	Derivatives and others	Amounts owed to credit institutions	Debentures and other marketable securities	Derivatives and others	
Debits and items payable	-	39,068,660	501,074	61,430	3,959,509	833	43,591,506
Hedge derivatives	-	-	2,686,801	-	-	-	2,686,801
Total	**-**	**39,068,660**	**3,187,875**	**61,430**	**3,959,509**	**833**	**46,278,307**

13.1 Amounts owed to credit institutions

At 31 December 2016, the Company had recognised 47,220 thousand euros under that heading of the balance sheet arising from a number of assets that were pending payment to one of the Group 2 assigning banks. In 2017 that balance was rectified (see Note 1).

Furthermore, at 31 December 2017 and 2016 the Company had recognised 15,510 and 14,210 thousand euros respectively under the heading of "Amounts owed to credit institutions" as "Accrued interest payable" on the hedge derivatives subscribed in 2013 (see Note 13.3).

13.2. Debentures and other long and short term negotiable securities

The composition of the heading "Long term debts - Debentures and other negotiable securities" and "Short term payables- Debentures and other negotiable securities" at 31 December 2017 and 2016 is shown below:

Thousands of euros	31/12/2017		31/12/2016	
	Non-current	Current	Non-current	Current
Negotiable securities- Senior Debt	35,461,530	3,906,970	37,639,100	3,958,000
Negotiable securities- Subordinated Debt	1,429,560	-	1,429,560	-
Interest accrued and pending payment	-	408	-	1,509
Total	**36,891,090**	**3,907,378**	**39,068,660**	**3,959,509**

Negotiable securities- Senior Debt

The breakdown of the balances included under the heading "Negotiable securities- Senior Debt" in the previous table at 31 December 2017 and 2016 is as follows:

31 December 2017

Denomination	Date of issue	Contractual maturity date	Applicable rate in force	Thousands of euros
SAREB/VAR BO 20151231 2015-4	31/12/2015	31/12/2018	Eur 3m + 0.389%	3,684,300
SAREB/VAR BO 20161230 2016-4	30/12/2016	31/12/2018	Eur 3m + 0.040%	13,817,100
SAREB/VAR BO 20171229 2017-3	29/12/2017	31/12/2018	Eur 3m – 0.090%	10,262,600
SAREB/VAR BO 20170228 2017-1	28/02/2017	28/02/2018	Eur 3m – 0.010%	4,064,100
Total short term contractual maturities				**31,828,100**
SAREB/VAR BO 20160226 2016-2	26/02/2016	28/02/2019	Eur 3m + 0.516%	1,850,000
SAREB/VAR BO 20170228 2017-2	28/02/2017	28/02/2019	Eur 3m + 0.070%	5,690,400
Total long term contractual maturities				**7,540,400**
Total				**39,368,500**

31 December 2016

Denomination	Date of issue	Contractual maturity date	Applicable rate in force	Thousands of euros
SAREB/VAR BO 20161230 2016-3	30/12/2016	29/12/2017	Eur 3m + 0.030%	10,262,600
SAREB/VAR BO 20150228 2015-2	28/02/2015	28/02/2017	Eur 3m + 0.263%	5,704,100
SAREB/VAR BO 20160226 2016-1	26/02/2016	28/02/2017	Eur 3m + 2.288%	4,073,300
Total short term contractual maturities				**20,040,000**
SAREB/VAR BO 20151231 2015-4	31/12/2015	31/12/2018	Eur 3m + 0.389%	5,109,600
SAREB/VAR BO 20161230 2016-4	30/12/2016	31/12/2018	Eur 3m + 0.040%	13,918,000
SAREB/VAR BO 20160226 2016-2	26/02/2016	28/02/2019	Eur 3m + 0.516%	2,529,500
Total long term contractual maturities				**21,557,100**
Total				**41,597,100**

The total amount of negotiable securities at 31 December 2017 and 2016 are represented by book entries. In addition they have an irrevocable and unconditional guarantee from the Central Administration, waiving the benefit of excussion.

Sareb has the unilateral option to renew the above-mentioned issues of senior debt upon maturity even if at the time of the transaction there were no significant differences between their fair value and face value.

That unilateral option, and also on the basis of its business forecasts and the experience acquired since it was set up, allows the Company to consider that the mentioned short term contractual maturities will materialise in the long term for an approximate amount of 27,921,130 thousand euros.

The interest rates accruing on those bonds are established as 3-month Euribor plus a spread. That spread is the same during the whole life of the issue.

2017

Amortisation of bonds in 2017

The summary of the amortisations of senior debt made by the Company in 2017 is as follows:

Denomination	Amortisation in cash	Amortisation by rectification (Note 1)	Amortisation through new issue	Total
SAREB/VAR BO 20151231 2015-4	1,425,300	-	-	1,425,300
SAREB/VAR BO 20161230 2016-4	100,900	-	-	100,900
SAREB/VAR BO 20161230 2016-3	-	-	10,262,600	10,262,600
SAREB/VAR BO 20160226 2016-1	-	-	4,073,300	4,073,300
SAREB/VAR BO 20150228 2015-2	-	-	5,704,100	5,704,100
SAREB/VAR BO 20160226 2016-2	671,900	7,600	-	679,500
SAREB/VAR BO 20170228 2017-1	-	9,200	-	9,200
SAREB/VAR BO 20170228 2017-2	-	13,700	-	13,700
Total	**2,198,100**	**30,500**	**20,040,000**	**22,268,600**

Rectification deed of acquisition of assets

As stated in Note 1, in 2017 the Company amortised the following bonds, on the basis of the rectifications formalised during the year:

Thousands of euros	Banco Mare Nostrum, S.A.	Total
SAREB/VAR BO 20160226 2016-2	7,600	7,600
SAREB/VAR BO 20170228 2017-1	9,200	9,200
SAREB/VAR BO 20170228 2017-2	13,700	13,700
Total	**30,500**	**30,500**

2016

Amortisation of bonds in 2016

The summary of the amortisations of senior debt made by the Company in 2016 is as follows:

Denomination	Amortisation in cash	Amortisation by rectification (Note 1)	Amortisation through new issue	Total
SAREB/VAR BO 20141231 2014-3	-	-	13,918,000	13,918,000
SAREB/VAR BO 20151231 2015-3	-	-	10,262,600	10,262,600
SAREB/VAR BO 20151231 2015-4	1,460,100	-	-	1,460,100
SAREB/VAR BO 20130228 2013-3	-	-	2,537,900	2,537,900
SAREB/VAR BO 20150228 2015-1	-	-	4,084,500	4,084,500
SAREB/VAR BO 20150228 2015-2	382,000	17,600	-	399,600
SAREB/VAR BO 20160226 2016-1	-	11,200	-	11,200
SAREB/VAR BO 20160226 2016-2	-	8,400	-	8,400
Total	**1,842,100**	**37,200**	**30,803,000**	**32,682,300**

Rectification deed of acquisition of assets

As stated in Note 1, in 2016 the Company amortised the following bonds, on the basis of the rectifications formalised during the year:

Thousands of euros	Banco Grupo Cajatres, S.A.	Liberbank, S.A.	Banco Caja España de Inversiones Salamanca y Soria, S.A.	Total
SAREB/VAR BO 20150228 2015-2	5,700	11,700	200	17,600
SAREB/VAR BO 20160226 2016-1	3,800	7,200	200	11,200
SAREB/VAR BO 20160226 2016-2	3,100	5,200	100	8,400
Total	**12,600**	**24,100**	**500**	**37,200**

Other information

The interest on those negotiable securities accruing in 2017 and 2016 was 5,471 and 54,526 thousand euros, respectively, and is recognised under the heading "Financial Expenses - From debts with third parties" on the attached income statement (see Note 16.5.). At 31 December 2017 and 2016, the interest accrued and pending payment was 408 and 1,509 thousand euros and is recognised under the heading "Short term payables - Debentures and negotiable securities" on the attached balance sheet. At the date of preparing these Annual accounts that interest has been paid in full.

At 31 December 2017 and 2016 the senior negotiable securities issued by the Company are listed and admitted for trading.

The Directors consider that the carrying amount of the negotiable securities is approximate to their fair value.

Negotiable securities - Subordinated debt

The breakdown of the balances included under the heading "Negotiable securities - Subordinated Debt" in the previous table at 31 December 2017 and 2016 is as follows:

31 December 2017 and 2016

	Date of issue	Expiry date	Applicable rate in force	Thousands of euros
SAREB/8.00 OBSUBDCONV 20271127 2013	26/02/2013	27/11/2027	8.00%	1,429,560
Total				**1,429,560**

The principal conditions of the unsecured subordinated debentures which are occasionally convertible is itemised below:

- All the securities belong to a single series, have the same terms and conditions and therefore grant the same rights to their holders. They can be freely transferred and are represented by book entries and have been registered in the accounts ledgers kept by Iberclear and its authorised participants.

- The interest rate accruing on those bonds is fixed and will be due on an annual basis provided that profits have been obtained as established and sufficient reserves being available. For this reason, in 2017 and 2016 the Company has no coupons due or paid for this item due to the difficulty of estimating future distributable cash flows.

- Total Amortisation: compulsory on 27 November 2027.

- Partial Amortisation: This is possible at the Company's discretion after the fifth year since issue, according to the existing solvency and leverage ratios.

- Conversion: The subordinated debt can be converted to capital in the event of insufficient company equity in the event of: i) cumulative losses equal to or more than the share capital plus the reserves of the Company or (ii) if there are grounds for dissolution due to the fact that the losses have reduced the equity of the Company to an amount less than half of its capital If conversion takes place, the shares will have the same par value, be of the same class and series, and will have the same rights as the ordinary shares outstanding and it will be for an amount equivalent to 2% of the Company assets after the conversion. In 2016, after approval from the Shareholders General Meeting on 5 May 2016, the Board of Directors approved the conversion of 2,170,440 thousand euros to share capital of the Company, by issuing 2,170,440 thousand shares each with a par value of 1 Euro (see Note 11). Following that conversion the balance of the subordinated debt was 1,429,560 thousand euros.

- Rank: the convertible subordinated bonds are placed, in terms of credit priority:

  - Behind all other common creditors (senior) of the Company;

  - "Pari passu" with any subordinated, simple or convertible debt of the Company, issued or to be issued in the future, or that has been incurred or may be incurred in the future under any other title.

  - Ahead of the Company's ordinary or preference shares.

13.3 Derivatives

At 31 December 2017 and 2016, the main source of Sareb's financing came from debentures and negotiable securities issued in 2013 and 2012, or, where appropriate, renewed upon maturity, for the intention of the acquisition of the real-estate and credit assets described in Note 1, which are indexed to floating interest rates. Due to the high volume of the operation and in order to reduce the high exposure and the consequent risk for the Company to a possible rise in the interest rate, on 2 August 2013 the Company contracted an interest rate swap that enabled it to cover this risk for an initial notional amount of 42,221 million euros, which will be gradually reduced upon the maturity of each of the senior bonds hedged in future years, and establishing the debt at fixed interest rates within a range of between 0.491% and 3.145% per year This operation is not for speculation purposes as it is not considered to be a cash flow hedge and, in reality, it involved converting part of the Company's borrowing during the period covered into borrowing at a fixed interest rate rather than the floating interest rate of the bonds issued.

The cash flow hedging was made in the context of time and market in which the interest rates were compatible with those contemplated in the Company's business plan, whereby under this operation a substantial part of it could be assured, reducing the risk that an increase in interest rates could jeopardise the Plan in question and the viability of the Company. In exchange, the operation meant waiving any possible benefits arising from a decrease in the reference interest rates for the portion and the period of time hedged.

The measures for easing monetary policy adopted by the European Central Bank since the end of 2013 have contributed to a gradual decrease in the interest rates which currently stand at historic minimums. That evolution has been transferred to the valuation of the hedging derivative contracted by the Company.

The market value of the interest rate instruments (swaps) is obtained as the sum of the present value of all cash flows according to the contractual conditions and interest rates quoted on the market. The interest rates used for the future estimation of floating interest rates are obtained from instruments listed in financial markets and indexed to the 3M EURIBOR index. The discount interest rates used for updating cash flows are obtained from instruments listed in financial markets and indexed to the EONIA index.

The balance of the heading "Long term debts – Derivatives" on the liability side of the balance at 31 December 2017 and 2016, corresponds entirely to the fair value of the mentioned interest rate risk hedging derivative taken out with various financing institutions. The fair value of this derivative, obtained by applying generally accepted valuation methods based on observable market based inputs, at 31 December 2017 and 2016 is 2,057,320 and 2,686,801 thousand euros, respectively (see Note 11.4).

The breakdown of the amount of the notional value and fair value of these operations, in relation to the time periods in which the cash flows are expected to arise, and the years in which they are expected to have any effect on the income statement, is as follows (in thousands of euros):

SWAPS INTERETS RATES	Fixed Rate Range	Maturity	2018	2019	2020	2021	2022	More than 5 years	Total
Notional value	0.49%-3.15%	2017-2023	23,089,000	19,872,000	16,782,000	14,009,000	11,397,000	2,967,000	88,116,000
Fair value			**(532,720)**	**(510,603)**	**(413,946)**	**(325,678)**	**(258,444)**	**(16,929)**	**(2,057,320)**

The Company estimates that the effect of a 1 basis point increase in reference interest rates on the market value of those derivatives would have a positive impact of 7,927 thousand euros on the Company's equity. The estimated impact of a downward variation of 1 basis point in the reference interest rates would have a negative impact of a similar figure. That effect was also calculated at the year end of 2016, when a positive impact of 10,100 thousand euros on the Company's equity was calculated and with a similar negative effect in the case of a downward variation.

Under prevailing accounting legislation, any changes in the value of derivative hedging instruments are recognised in equity until they are allocated to profit or loss in the corresponding year. As set out in Note 4 in 2017 and 2016, the derivatives that hedge bonds issued over one year and part of the bonds issued over two years have maintained their effectiveness within the thresholds required under the Accounting and Measurement Rule 9. 6, but due to the downward trend in interest rates to which the hedged risks are indexed and to Sareb's application in 2016 and 2017 of a "floor" which stipulated that the interest rate could in no event go lower than 0%, it has lost part of that effectiveness. In consequence, the Company has recognised an amount of 23,312 thousand euros of lower expense (36,572 thousand euros of greater expense in 2016), resulting from the measurement of those hedge instruments under the heading "Financial Expenses" of the attached income statement (see Note 16.5). Sareb has decided to cease applying the mentioned floor in 2018 as it considers it is no longer necessary to ensure the use of the bonds as collateral in operations under the monetary policy of the European Central Bank.

The rest of the value of the derivatives, net of taxes, is recorded under the heading "Value change adjustments" for the amount of 1,533,045 and 1,987,672 thousand euros respectively at 31 December 2017 and 2016. This effect, together with the impairment of the financial assets unit, places the Company in negative equity. However, from a business point of view, and according to the provisions of article 36 of the Code of Commerce in respect of the distribution of profits, the mandatory reduction of share capital and mandatory winding-up due to losses, these changes in the value of the hedging derivative yet to be charged to the income statement are not considered as equity.

Similarly, the amount that has been taken to the income statement from equity at 31 December 2017 and 2016 was 525,423 and 505,607 thousand euros, respectively, recorded under the heading "Financial Expenses – On debts with third parties" (see Note 16.5).

The credit risk associated to derivatives transactions is minimised through contractual arrangements for exchanging collateral and by other types of guarantee which depend on the nature and type of counterparty, according to the rules of the "International Swaps and Derivatives Association" (ISDA).

At 31 December 2017 and 2016, for the purpose of ensuring compliance with the terms of the derivatives contracts mentioned, Sareb had set up monetary guarantees in the name of the counterparties of the derivatives contracted which at that date showed a negative value for the Company, in the amount of 1,968,600 and 2,549,300 thousand euros, respectively; these are recognised under the heading "Long term financial investments - Other financial assets" of the balance sheet, and also deposits in the balancing entries for a total amount of 217,500 thousand euros in both years (see Note 7.1.2).

13.4 Other non-current financial liabilities

The breakdown of this heading of the balance sheet at 31 December 2017 and 2016 is as follows:

Thousands of euros

	31/12/2017	31/12/2016
Fair value of the Íbero bonds	411,287	480,955
Updating effect on Ibero bonds	3,061	4,572
Total nominal amount of Íbero bonds	**414,349**	**485,527**
Advance FAB 2013 Bull	2,626	6,515
Deposits from tenants and Others	8,293	9,032
Total	**425,268**	**501,074**

In accordance with the provisions of Accounting and Measurement Rule 9, 5.6 of the General Chart of Accounts, the Company has measured the fair value of the deposits mentioned in Note 1 in relation to the Ibero Project. To calculate that update, the weighted average cost of the Company's debt was taken into consideration (see Note 13.1).

Based on the last estimates provided in the business plan of the FAB 2013 Bull, it is considered that, given its configuration and payment structure, there are 23,059 thousand euros (19,170 thousand in 2016) of the advance received by the investor in the FAB, which will not be returned during the course of its life. Based on the above, the Company has recorded revenue under the heading of "Financial Income" on the attached income statement for the amount of 3,889 and 19,170 thousand euros in 2017 and 2016 respectively (See Note 16.6).

The Directors estimate that the fair value of the heading "Other non-current financial liabilities" does not differ from its carrying value.

14. Trade accounts and other accounts payable

The breakdown of this heading of the balance sheet at 31 December 2017 and 2016 is shown below:

	Thousands of euros	
	31/12/2017	31/12/2016
Suppliers	28,064	43,817
Suppliers, bills still to be received	352,005	297,212
Staff	8,545	11,989
Current tax liabilities (Note 15.1)	-	-
Other payables to the Public Administrations (Note 15.1)	50,586	75,258
Customer Advances	51,311	29,281
Total	**490,511**	**457,557**

The heading of "Trade accounts and other accounts payable" mainly includes the amounts pending payment for trade purchased and related expenses, and the amounts of payments on account from clients received prior to the recognition of the sale of the properties or land.

At 31 December 2017 the heading of "Suppliers, bills yet to be received" includes amounts of 72,051 and 109,871 thousand euros (74,417 and 80,761 thousand euros at 31 December 2016) for expenses arising from management fees and sales commissions, respectively, and 170,083 thousand euros (142,034 thousand euros at 31 December 2016) for general expenses and maintenance of the assets managed by the Company, for which the Company has not received the corresponding invoices.

At 31 December 2017 and 2016 the heading of "Customer Advances" mainly includes the amounts received in advance on account of future transfers of certain properties included under the headings of Property Investments and Inventories (see Notes 5 and 8).

The Directors consider that the carrying amount of the negotiable securities is approximate to their fair value.

Information on deferral of payments made to suppliers. Third Additional Provision. "Duty to provide information" under Act 15/2010, of 5 July

In accordance with the provisions of the Second Final Provision of Act 31/2014, of 3 December, in amendment of the Third Final Provision of Act 15/2010, of 5 July, modifying Act 3/2004, of 29 December, which established measures of combating late payment in commercial transactions, and in relation to the information to be included in the Report accompanying the Annual accounts on the deferral of payment to Suppliers in trade transactions calculated on the basis of the provisions of Resolution of 29 January 2016 of the Institute of Accounting and Account Audits, the breakdown of the average period for payments made by the Company to Suppliers in 2017 and 2016 is as follows:

	Ejercicio 2017	Ejercicio 2016
Average payment period to suppliers	34	30
Ratio of transactions paid	33	31
Ratio of transactions pending payment	50	20
	Thousands of euros	
Total payments made	**442,776**	**502,318**
Total payments outstanding	**26,651**	**43,271**

15. Public Administrations and tax position

15.1 Current balances receivable from and payable to Public Authorities

The composition of the current balances receivable from and payable to Public Authorities at 31 December 2017 and 2016 is as follows:

31 December 2017

Thousands of euros

	Assets		Liabilities	
	Non-current	Current	Non-current	Current
Tax Authority deferred VAT	-	29	-	647
Tax Authority VAT/IGIC receivable	-	5,342	-	-
Deferred tax assets	611,046	-	-	-
Provision for taxes	-	-	-	19,833
Tax Authority VAT/IGIC payable	-	-	-	25,755
Tax Authority Personal Income Tax payable	-	-	-	3,203
Tax Authority IGIC payable	-	-	-	626
Social Security payable	-	-	-	522
Corporate Income Tax	-	1,949	-	-
Tax Authority payable/receivable for other tax items	-	-	-	-
Total	**611,046**	**7,320**	**-**	**50,586**

31 December 2016

Thousands of euros

	Assets		Liabilities	
	Non-current	Current	Non-current	Current
Tax Authority deferred VAT	-	29	-	624
Tax Authority VAT/IGIC receivable	-	1,212	-	-
Deferred tax assets	894,177	-	-	-
Provision for taxes	-	-	-	24,917
Tax Authority VAT/IGIC payable	-	-	-	46,800
Tax Authority Personal Income Tax payable	-	-	-	2,443
Tax Authority IGIC payable	-	-	-	-
Social Security payable	-	-	-	474
Corporate Income Tax	-	5,899	-	-
Tax Authority payable/receivable for other tax items	-	-	-	-
Total	**894,177**	**7,140**	**-**	**75,258**

15.2 Reconciliation of accounting profit/(loss) and taxable income

The reconciliation of accounting profit/(loss) and the tax base for the tax in question, is as follows:

2017

Thousands of euros

	Income Statement		Income and expense taken directly to equity		Total
Balances of net income and expense for the period Profit / (Loss)		(564.576)		(485.382)	(1.049.958)
	Increases	Decreases	Increases	Decreases	
Corporate Income Tax	30,671	-	251,356	-	282,027
Permanent differences	11,343	(39,373)	-	-	(28,030)
Temporary differences	-	-	-	-	-
- Originating in the period	5,136	-	234,026	-	239,162
- Originating in previous periods	-	(278,752)	-	-	(278,752)
Tax base (tax result)	**47,150**	**(882,701)**	**485,382**	**(485,382)**	**(835,551)**

2016

Thousands of euros

	Income Statement		Income and expense taken directly to equity		Total
Balances of net income and expense for the period Profit / (Loss)	(662.791)		(1.003.640)		(1.666.431)
	Increases	Decreases	Increases	Decreases	
Corporate Income Tax	143	-	567,545	-	567,688
Permanent differences	15,619	(38,354)	-	-	(22,735)
Temporary differences	-	-	-	-	-
- Originating in the period	2,426	-	436,095	-	438,521
- Originating in previous periods	-	(20,341)	-	-	(20,341)
Tax base (tax result)	**18,188**	**(721,486)**	**1,003,640**	**(1,003,640)**	**(703,298)**

At 31 December 2017 and 2016 the main temporary differences arise from charges to provisions and amortisations, amongst others. For its part, the permanent differences originate in surcharges, penalties, the results contributed by the FABs (see Note 4.7) and exemptions for income resulting from the transfer of certain properties.

The above tables are shown in accordance with the format required by the General Chart of Accounts of 2007. The amounts included under the heading of "Income and expenses attributed directly to equity" correspond to accounting adjustments not reflected in the tax base for the tax and, therefore are not effectively included in the tax base for Corporate Income Tax for the year.

The relevant tax effects recognised directly in equity at 31 December 2017 and 2016 correspond to the financial derivatives designated as hedge instruments for the amount of 511,015 and 662,557 thousand euros, respectively (see Note 11.4). For its part, at the year end 2016 the Company had recognised 99,814 thousand euros in equity corresponding to the tax effect associated to the impairment of the financial assets unit. In 2017 the Company derecognised those tax credits on the basis of its best estimates.

Shown below is the reconciliation between the expense for Corporate Income Tax booked by Sareb and the result of multiplying the applicable rate for Corporate Income Tax by the total income and expenses recognised, before taxes, corresponding to 2017 and 2016:

2017

	(Income) / expenses (Thousands of euros)		
	Income Statement	Amounts recorded directly against equity	Total recognised income and expenses
Profit / (Loss) before taxes	(533,905)	(234,026)	(767,931)
Permanent differences	(28,030)	-	(28,030)
Total	(561,935)	(234,026)	(795,961)
Corporate Income Tax rate	25%	25%	25%
Total	(140,484)	(58,506)	(198,990)
Deductions and rebates	(813)	-	(813)
(Profit) / Loss arising from Corporate Income Tax	**141,297**	**58,506**	**199,803**
Adjustment for Corporate Income Tax previous year	436	-	436
Corporate Income Tax non-deconsolidated FABs (Note 4.6.1.)	-	-	-
Adjustment for limitation on tax assets of previous years	(31,774)	(99,814)	(131,588)
Adjustment for limitation on tax assets of the current year	(140,630)	(210,049)	(350,679)
Total income /(expense) recognised in the income statement	**(30,671)**	**(251,357)**	**(282,028)**

2016

	(Income) / expenses (Thousands of euros)		
	Income Statement	Amounts recorded directly against equity	Total recognised income and expenses
Profit / (Loss) before taxes	(662,648)	(436,095)	(1,098,743)
Permanent differences	(22,735)	-	(22,735)
Total	(685,383)	(436,095)	(1,121,478)
Corporate Income Tax rate	25%	25%	25%
Total	(171,346)	(109,024)	(280,370)
Deductions and rebates	(141)	-	(141)
(Profit) / Loss arising from Corporate Income Tax	**171,487**	**109,024**	**280,511**
Adjustment for Corporate Income Tax previous year	-	-	-
Corporate Income Tax non-deconsolidated FABs (Note 4.6.1.)	(143)	-	(143)
Adjustment for limitation on tax assets of previous years	-	(582,334)	(582,334)
Adjustment for limitation on tax assets of the current year	(171,487)	(94,235)	(265,722)
Total income /(expense) recognised in the income statement	**(143)**	**(567,545)**	**(567,688)**

During the course of 2017, the Company has received confirmation from the General Directorate of Taxes of the principles applied and also the principles to be applied in respect of changes in the figure for the provision and account for "Value change adjustments" arising in the future. In this respect, any value adjustments that had been recognised subsequent to 1 January 2016, taken to the "Value change adjustments" account with the intention of increasing the amount of the provision for impairment of the unit of financial assets are not considered to be tax-deductible expenses. Any reductions in the amount of that provision credited to the account for "Value change adjustments" are disregarded when calculating the profit/(loss) for the year. For this reason, given that, after 1 January 2016, the corresponding charge would not have been considered a tax-deductible expense, it should not be included in the tax base, notwithstanding the comments in the following paragraph.

At 1 January 2016, the balance of the account for "Value change adjustments" included the amount of the provision for impairment of the unit of financial assets, recorded at 31 December 2015 net of taxes, with those charges being classified as tax-deductible. Conversely, the charges made as from 1 January 2016 were not classified as tax-deductible. For the purposes of taxation in respect of the reduction arising in the provision, and for determining if it relates to charges that were tax-deductible or not, the Company applies a FIFO principle, considering that the amounts reversed relate initially to amounts that were considered to be tax-deductible. Once an amount has been accumulated equal to that included in the tax bases for the tax periods 2012 to 2015 for considering the corresponding charges to be tax-deductible of the reductions in the figure of the provision credited to the account for "Value change adjustments" will not be included in the tax base.

The Company also considers that the increase in the figure for the provision that has been recognised for the year in the "Value change adjustments" account of the Equity of the Sareb in application of RD 4/2016 is classified as a non-deductible item. The Company will make every effort to obtain confirmation of the principles mentioned from the Tax Authorities.

On 3 December 2016 Royal Decree-Law 3/2016 of 2 December was published in the Official State Gazette [BOE], under which measures are adopted in the area of taxation intended for the consolidation of public finances and other urgent social measures. That regulation introduces some amendments to the Corporate Income Tax Act 27/2014, of 27 November. It specifically adds the Fifteenth Additional Provision under which it establishes, indefinitely, the offsetting of tax losses up to a limit of 25 per cent of the previous tax base if the net turnover for the preceding 12 months was less than 60 million euros.

The company has analysed the recovery of all the deferred tax assets based on the Resolution of 9 February 2016, of the Institute of Accounting and Account Audits which implements the standards for accounting, measurement and preparation of Annual accounts for the accounting for Corporate Income Tax under tax legislation, including the amendment mentioned and in accordance with the forecasts of the Business Plan, which covers a ten-year time horizon.

In consequence, the deferred tax assets recognised by the company at the year end 2017, at a rate of 25 per cent (tax rate applicable under Corporate Income Tax), are those thought likely to be applied, according to future taxable income. The company has specifically decided to retire 131,588 thousand euros from the balance sheet, leaving a total figure of 611,046 thousand euros recognised for deferred tax assets. The Company has acted as described considering the time horizon contemplated in its business plan, which anticipates generating future taxable income to offset the tax assets booked.

The reconciliation between the taxable base and the tax payable for Corporation Tax for the years 2017 and 2016 is as follows:

	Thousands of euros	
	2017	2016
Taxable base (taxable income/loss)	**(835,551)**	**(703,298)**
Tax base according to tax rate (25%)	(208,888)	(175,825)
Deductions and rebates	(980)	(141)
-Of which monetisable	(667)	-
Withholdings and payments on account	(1,282)	(1,935)
Tax amount to be (received) / paid	**(1,949)**	**(1,935)**

The breakdown of the tac bases recognised at 31 December 2017 and 2016, is as follows:

2017

	Thousands of euros	At 25 %	Amount capitalised 2016
Tax losses			
2012	200	50	-
2013	120,594	30,149	-
2014	494,350	123,588	-
2015	2,387,698	596,925	6,490
2016	706,118	176,530	5,408
2017	835,551	208,888	68,545
Total	**4,554,511**	**1,136,130**	**80,443**

2016

	Thousands of euros	At 25 %	Amount capitalised 2016
Tax losses			
2012	200	50	50
2013	106,561	26,640	26,640
2014	535,424	133,856	112,682
2015	2,526,794	631,698	-
2016	703,299	175,825	-
Total	**3,872,278**	**968,069**	**139,372**

The above tax losses do not expire and can be offset at any time during the life of the Company.

For its part the Company has the following deductions at the year end 2017 and 2016:

	Amount of deduction	Expiry date
Deductions for R +D		
2016	833	Year 2034
Total	**833**	

The whole of the expense for Corporate Income Tax arising in 2017 and 2016 corresponds to ongoing operations.

15.3 Deferred tax assets

The breakdown of the balance of this account at the close of 2017 and 2016 is as follows:

	Thousands of euros	
	2017	2016
Tax credit: - For tax losses	80,443	139,372
- For unused tax credits	-	-
Temporary differences 2013	3,966	18,626
Temporary differences 2014	13,062	69,998
Temporary differences 2015	723	3,624
Temporary differences 2016	552	-
Temporary differences 2017	1,285	
Market valuation of derivatives	511,015	662,557
Others	-	-
Total deferred tax assets	**611,046**	**894,177**

Both the prepaid taxes payable and the tax credits for negative tax bases were recognised on the balance sheet as the Directors consider that, based on their best estimate of the Company's future earnings, including certain tax planning measures, it is probable that these assets will be recovered.

15.4 Years open for inspection

Under current legislation, tax returns cannot be deemed definitive until they have been inspected by the tax authorities or the statute of limitations period has elapsed. At 31 December 2017 the Company has all the taxes submitted applicable to it since its incorporation open for tax inspection. As a result, amongst others, of the different interpretations of tax rules there could be additional tax assessments in the event of a tax inspection. In any case, the Directors consider that those liabilities, should the case arise, would not have any significant effect on the Annual accounts.

At the year end 2017 the Company has no inspection procedures open with the Tax Authorities.

16. Income and expenses

16.1 Net Turnover

The breakdown per branch of activity at the year end 2017 and 2016, is as follows:

	Thousands of euros	
	2017	2016
Income from sales of loans and credits (Note 7.1.1)	452,427	474,285
Income from interest received on loans and credits (Note 7.1.1)	723,818	890,563
Income from sales of Property Investments (Note 5)	1,109,609	986,238
Income from sales of Inventories	22,769	23,659
Income from rent (Note 6)	49,443	42,135
Income from remuneration of FABs (see Note 7.2.2)	1,778	903
Income from sale and liquidation of FABs (see Note 7.2.2)	4,800	
Recovery of capital gains on loans and credits – net of debt remission (Note 7.1.1)	(220,844)	(283,634)
Total	**2,143,800**	**2,134,149**

All the Company's income has been obtained in Spain.

In 2017 and 2016, and as a result of the principle of application of the amounts recovered by Sareb from its debtors, which is applied firstly to interest and then to capital, the figure for "Margin of recovery of capital gains on loans and credit" is negative for the amount of 220,844 and 283,634 thousand euros, respectively. Nevertheless, the total revenue taking into account the figure for income from interest amounts to 502,974 and 606,929 thousand euros, respectively.

16.2 Cost of sales and change in Inventories

The composition of this heading of the attached income statement is as follows:

	Thousands of euros	
	2017	2016
Changes in Inventories	(15,841)	(17,483)
Total changes in Inventories	**(15,841)**	**(17,483)**
Cost of Property Investments (Note 5)	(962,234)	(886,246)
Sales costs of Financial Assets (Note 7.1.1)	(413,165)	(593,115)
Sales costs of the FABs (Note 7.2.2)	(2,614)	-
Total sales costs	**(1,378,013)**	**(1,479,361)**

16.3 Staff Expenses

The breakdown of staff expenses for the years 2017 and 2016 is as follows:

	Thousands of euros	
	2017	2016
Salaries, wages and similar	34,890	34,606
Social Security	5,897	4,795
Total	**40,787**	**39,401**

The average number of people employed in 2017 and 2016, distributed per category, is as follows:

	Number of employees	
	2017	2016
Management	66	69
Servicers and Technical Staff	246	227
Administration and sales staff	61	62
Total	**373**	**358**

Similarly, the distribution according to gender at 31 December 2017 and 2016, detailed per category, is as follows:

	2017			2016		
	Women	Men	Number of employees	Women	Men	Number of employees
Management	15	51	66	14	51	65
Servicers and Technical Staff	108	150	258	94	133	227
Administration and sales staff	42	21	63	40	24	64
Total	**165**	**222**	**387**	**148**	**208**	**356**

In 2017 and 2016 the Company employed two and one members of staff respectively with a degree of disability that is 33% or higher.

16.4 External Services

The breakdown of this item corresponding to 2017 and 2016 is as follows:

	Thousands of euros	
	2017	2016
Fees for assets management and marketing (Note 1)	242,926	236,962
Leases and ground rents	3,479	3,254
Repairs and conservation	88,872	89,976
Independent professional services	99,759	96,506
Insurance premiums	4,679	5,437
Advertising, publicity and public relations	2,942	1,946
Bank services	415	314
Supplies	10,983	7,338
Other services	6,509	3,642
Total External Services	**460,564**	**445,375**
Total Taxes	**177,766**	**197,205**

The heading "Repairs and conservation" in 2017 and 2016 mainly includes the expenses of residents associations of the property assets, for the amount of 42,388 and 53,689 thousand euros, respectively. The heading of "Taxes" mainly contains the cost for Property Tax (IBIs) relating to the Company's the real-estate assets and the non-deductible VAT it has paid in 2017 and 2016.

Fees charged by PricewaterhouseCoopers Auditores, S.L. for auditing the Company's separate Annual accounts for 2017 and 2016 were 1,133 and 1,031 thousand euros, respectively. Furthermore, in 2017 and 2016 fees were charged for other services for the amounts of 93 and 85 thousand euros, respectively, which mainly correspond to the review of the annual report by the external expert in relation to the prevention of money laundering and financing of the terrorism.

16.5 Financial Expenses

Below is a breakdown of this heading of the income statement for the years 2017 and 2016:

	Thousands of euros	
	2017	2016
Interest from Debentures and other marketable securities (Note 13.2)	5,471	54,526
Interest from financial derivatives (Note 13.3)	548,735	469,034
Financial expense – Ineffective derivatives (Note 4.9)	(23,312)	36,572
Other financial expenses	17,600	17,333
Total	**548,494**	**577,465**

The heading of "Other financial expenses" mainly includes the finance cost arising from the funding granted by the investor of the FAB Bull 2013 for the amount of 5,066 and 12,466 thousand euros in 2017 and 2016 respectively, which has not been deconsolidated from the attached balance sheet (see Note 4.6.1) and the effect of updating the Ibero bonds for the amount of 1,517 and 4,116 thousand euros, respectively (see Note 13.4). Furthermore at 31 December 2017 that heading includes 2,419 thousand euros arising from the negative remuneration that the Company has obtained on its cash balances (see Note 10).

16.6 Financial revenue

Below is a breakdown of this heading of the income statement for the years 2017 and 2016:

	Thousands of euros	
	2017	2016
For remuneration from cash and other cash equivalents (Note 10)	2,341	4
For remuneration from "Other financial assets"	1,366	-
Other financial income – Rectification (Note 1)	44	-
Other financial income (Note 13.4)	3,889	19,170
Total	**7,640**	**19,174**

17. Operations and balances with related parties and legal information relating to the Board of Directors

17.1 Operations with related parties

The breakdown of the balances held and the operations carried out by Sareb with related parties recognised in these annual accounts for the years 2017 and 2016 is as follows:

2017

Thousands of euros

	FROB and entities under FROB control.	Significant Shareholders	Bank Assets Funds, group companies and other related parties	Board of Directors (*)	Senior Management (*)
Assets:					
Credits and loans	-	-	3,167	-	-
Long term investments in Group companies and associates (Note 7.2.1)	-	-	182,867	-	-
Short term investments in Group companies and associates	-	-	-	-	-
Cash and other cash equivalents	101	-	-	-	-
Liabilities:					
Debentures and other long term negotiable securities	22,126,992	-	-	-	-
Debentures and other short term negotiable securities	1,061,675	-	-	-	-
Gains and Losses:	-	-	-	-	-
Income from sales of Property Investments	-	-	-	-	-
Income from remuneration FABs	-	-	1,778	-	-
Other operating expenses	-	-	-	(1,112)	(4,212)
Impairment of financial instruments	-	-	(1,047)	-	-
Financial revenue	-	-	3,889	-	-
Financial Expenses	(2,689)	-	(7,784)	-	-
Contingent risks:					-
Guarantees given	-	-	-	-	-

(*) Those amounts refer to the remuneration received by the Board of Directors and Senior Management of the Company during 2017 (See Note 17.3).

2016

Thousands of euros

	FROB and entities under FROB control	Significant Shareholders	Bank Assets Funds and other related parties	Board of Directors (*)	Senior Management (*)
Activo:					
Credits and loans	-	-	-	-	-
Long term investments in Group companies and associates	-	-	41,369	-	-
Short term investments in Group companies and associates	-	-	-	-	-
Cash and other cash equivalents	135	-	-	-	-
Liabilities:					
Debentures and other long term negotiable securities	22,695,374	-	-	-	-
Debentures and other short term negotiable securities	1,122,226	-	-	-	-
Gains and Losses:	**-**	**-**	**-**	**-**	**-**
Income from sales of Property Investments	-	-	20,362	-	-
Income from remuneration FABs	-	-	903	-	-
Other operating expenses	(2,259)	-	-	(1,181)	(4,830)
Impairment of financial instruments	-	-	(2,427)	-	-
Financial revenue	-	-	19,170	-	-
Financial Expenses	(31,220)	-	(12,467)	-	-
Contingent risks:					**-**
Guarantees given	-	-	-	-	-

(*) Those amounts refer to the remuneration received by the Board of Directors and Senior Management of the Company during 2016 (See Note 17.3).

The variation shown under the heading of "Debentures and other marketable securities" corresponds to the repayments of senior debt made by the Company during 2017 (see Note 13), while the variation undergone in the heading of "Credits and loans" corresponds to sales and to cancellations as a result of the ordinary course of business of the Company.

17.2 Transparency in relation to the interests and activities of the members of the Board of Directors

In reference to any situations of conflict of interest, in accordance with the Regulations governing the Board of Directors (article 22) and the Policy on Conflicts of Interest and Related Transactions, the Directors have to inform the Board of any situation of direct or indirect conflict between them and the Company's interests.

Once the Company has become aware of an existing conflict of interest, either on its own account or following notification from a Director, and in accordance with the procedure established in the Policy on Conflicts of Interest and Related Transactions, the Company shall not provide any information on that transaction to the Director in question, and he shall not participate in the debate nor vote on the issue giving rise to the conflict of interest.

Under the obligation of preventing situations of conflict with the interest of the Company, during the directors who have held office on the Board of Directors have complied with the obligations provided for in article 228 of the consolidated text of the Capital Companies Act and in the Company's Policy on Conflicts of Interest and Related Transactions. Similarly, both they and any related persons have abstained from falling under any situation of conflict of interest set out in article 229 of that regulation.

17.3 Remuneration and other benefits paid to the Board of Directors and to Senior Management

For the purposes of drawing up these Annual accounts, Senior Management is taken to be 19 people at 31 December 2017 and 2016, respectively, of which 12 are men and 7 women, who for those purposes are classified as key Sareb personnel.

The amount for salaries, allowances and remunerations of any kind received in 2017 and 2016 by the members of the governing body and Senior Management of the Company was 5,324 and 6,011 thousand euros, respectively, according to the following breakdown:

2017

Thousands of euros

	Board of Directors	Senior Management	Total
Fixed remuneration	1,021 (1)	3,534 (3)	4,555
Variable remuneration	91 (2)	678(4)	769
Loyalty Incentive Scheme	-	-	-
Total	**1,112**	**4,212** (6)	**5,324**

(1) Includes the fixed remuneration at 31 December 2017 for the Executive Director of the Company, for the amount of 385 thousand euros.

In addition to the Fixed Remuneration included in this sub-section, the amounts itemised below have been paid as a result of the changes that took place in the Board during 2017: Effective on 13 December, 4 Proprietary Directors resigned from office, of which 3 had received the amount of 245 thousand euros for their services up until that date. The remaining Director did not receive any amount at all, having waived the remuneration due to him for holding office.

(2) It includes the last third of the Variable Remuneration of the Executive Director for 2015 (25.5 thousand euros), a first third of the Variable Remuneration for 2016 (32.5 thousand euros) received in April 2017, and a second third of the Variable Remuneration for 2016 (32.5 thousand euros) received in January 2018, leaving the final third of the Variable Remuneration for 2016 still to be received in the first quarter of 2019.

Furthermore, the Executive Director is due to receive the amount of 75 thousand euros as Variable Remuneration corresponding to 2017, which, according to the terms of the Policy on Remunerations for members of the Board of Directors of Sareb, is to be paid over the course of three years.

(3) This sub-section includes the total information of the 19 members of Sareb Senior Management at 31 December 2017. Furthermore one member of Senior Management who resigned in 2017 prior to 31 December received the amount of 53.7 thousand euros.

(4) It includes the Variable Remuneration for 2016 received in 2017; 2 of the 19 members of Senior Management have only received the last outstanding third of the Variable Remuneration for 2015 and 5 of the 19 members of Senior Management have received two thirds of the Variable Remuneration for 2016 as the Variable Remuneration is spread over the period with the remaining third to be received during the first quarter of 2019. This figure also includes the last outstanding third of the Variable Remuneration of 2015 (36 thousand euros) for two members of Senior Management for whom at that date the Variable Remuneration was deferred.

Furthermore, there is a total aggregate amount of 665 thousand euros due to Senior Management for Variable Remuneration corresponding to 2017, payment of which will be deferred over three years, for those to whom it applied.

Furthermore one member of Senior Management who resigned in 2017 prior to 31 December is due 39.8 thousand euros of Variable Remuneration.

Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A.

Ejercicio 2016

Miles de euros

	Board of Directors	Senior Management	Total
Fixed remuneration	1,102 (1)	3,270 (3)	4,372
Variable remuneration	79 (2)	506 (4)	585
Loyalty Incentive Scheme	-	1,054 (5)	1,054
Total	**1,181**	**4,830** (6)	**6,011**

(1) Includes the fixed remuneration at 31 December 2016 for the Executive Director of the Company, for the amount of 385 thousand euros.

In addition to the Fixed Remuneration included in this sub-section, the amounts itemised below have been paid as a result of the changes that took place in the Board during 2016:

Effective on 1 April, one Proprietary Director resigned from office, having received the amount of 28 thousand euros for his services up until that date.

In June, two Independent Directors resigned, effective as of 28 November, having respectively received the amount of 45 and 49 thousand euros.

(2) It includes the last third of the Variable Remuneration for 2014 (28 thousand euros), a third of the Variable Remuneration for 2015 (25.5 thousand euros) received in 2016, and another third of the Variable Remuneration for 2015 (25.5 thousand euros) received in January 2017, leaving the final third of the Variable Remuneration for 2015 still to be received in the first quarter of 2018.

Furthermore, the Executive Director is due to receive the amount of 97.5 thousand euros as Variable Remuneration corresponding to 2016, which, according to the terms of the Policy on Remunerations for members of the Board of Directors of Sareb, is to be paid over the course of three years.

(3) This sub-section includes the total information of the 19 members of Sareb Senior Management at 31 December 2016.

(4) It includes the Variable Remuneration for 2015 received in 2016; 2 of the 19 members of Senior Management have only received the last outstanding third of the Variable Remuneration for 2014 and two thirds of the Variable Remuneration for 2015 as the Variable Remuneration is spread over the period with the remaining third to be received during the first quarter of 2018. This figure also includes the last outstanding third of the Variable Remuneration of 2014 (12 thousand euros) for two members of Senior Management for whom at that date the Variable Remuneration was deferred.

Furthermore, there is a total aggregate amount of 715 thousand euros due to Senior Management for Variable Remuneration corresponding to 2016, payment of which will be deferred over three years, for those to whom it applied.

(5) 15 of the 19 members of Senior Management received the Loyalty Incentive 2014-2016 in January 2017.

(6) In addition to these Remunerations, in 2016, two members of Senior Management resigned from office, having received a total aggregate amount of 627 thousand euros for the services provided until their respective resignations.

The Company has taken out liability insurance for Directors and Senior Executives. Sareb declared the cost of the premium corresponding to each Director until month June 2017 inclusive as remuneration in kind for tax purposes. In accordance with the reply from the Department of Taxation on a binding consultation brought up by the Company in this respect, it was confirmed that the Company's payment of that insurance was not considered as remuneration for tax purposes, which regularised the tax situation corresponding to the whole 2017 period, although it continues to be considered as a business remuneration.

The cost of that premium in 2017 and in 2016 (which amounted to 97 and 87 thousand euros respectively) has been passed on to each of them, reducing their monetary remuneration, which has resulted in no increase in remuneration on the total remuneration approved by the Shareholders General Meeting of Sareb for the years 2017 and 2016.

At 31 December 2017 and 2016 the Company had not given any guarantee or protection clauses in favour of the Executive Directors or members of Senior Management to cover the event of dismissal arising from changes of control in the company or from events depending totally or partially on the will of the board.

The Company has not entered into pension obligations with members of its Board of Directors or Senior Management.

The Company did not grant any advances, loans or guarantees to the members of the Board of Directors, and it did make any share-based payments to any members of the Board of Directors, or to Senior Management.

18. Third party guarantees and other contingent liabilities

At 31 December 2017 and 2016 the Company has given the following bonds and guarantees to third parties:

	Thousands of euros	
	2017	2016
For outstanding liabilities on land, developments and others	22,532	21,179
Total	**22,532**	**21,179**

The Directors of the Company do not expect any additional liabilities to arise on account of those guarantees.

19. Subsequent events

On 28 February 2018, the Company carried out a simultaneous partial amortisation and novation of the maturity of the senior debt not paid during 2013 for the acquisition of assets in Group 2.

Denomination	Opening balance 2017	Depreciation	Novation	Outstanding amount	Maturity	Applicable rate in force	New ISIN novation
SAREB/VAR BO 20180228 2017-1	4,064,100	-	4,064,100	4,064,100	28/02/2019	Eur 3m -0.10%	ES0352506218
SAREB/VAR BO 20190228 2017-2	5,690,400	90,000		5,600,400	28/02/2019		N/A
SAREB/VAR BO 20190228 2016-2	1,850,000	514,800	-	1,335,200	28/02/2019		N/A
Total Group 2	**11.604.500**	**604.800**	**4.064.100**	**10.999.700**			

Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A.

Directors Report for the year ended on 31 December 2017

1. Significant aspects of the period

Previous years

The scale of the challenge facing Sareb from the outset at the end of 2012 was evident from the significance of the figures: 50,781 million euros of assets transferred in the form of nearly 200,000 property and financial assets, over 18,000 borrowers to which more than 400,000 properties as collateral for loans and credit must be added.

This challenge becomes even more evident if seen in relation with the necessary creation of a human and technical structure to overcome the difficulties arising from the technological and commercial dependence of the banks who have transferred the assets. Even more so if those banks have also undergone deviations and shortcomings following their own restructuring processes, whereby in addition to sometimes providing limited information on the assets, their management and marketing of them was not always sufficiently active.

In 2013 Sareb had to face two fronts: on the one hand, to set up its own internal structure, forming teams and creating procedures that would make it possible to go forward in the process of orderly liquidation of its assets: and, at the same time, to generate the mechanisms for revitalising the activity of the banks, while creating its own units so that, by selling portfolio, any budgetary deviations due to the possible lack of activity of the banks can be offset.

In 2014, it addressed procedures for having more knowledge on the various assets transferred in order to set up systematic marketing actions unifying the criteria for the centralised management of the assets received: focussing business on the divestment of any assets that were considered to be sufficiently matured for doing so; on strengthening the logistic aspects of the company; and on advancing with the introduction of the technical, legal and human infrastructure necessary for the Company to develop its activities. But those measures were put forward as the starting point for a more defined commercial momentum in which certain business lines would be built up and streamlined, and above all, Sareb was consolidated as a relevant agent in the institutional market, making a marked contribution to the revitalisation of this sector.

Going beyond this ordinary momentum, the second quarter saw the launching of the Íbero Project which had the intention of changing to a system of professional and vocational outsourced management which would make it more possible to identify and align objectives between the parties, based on principles of willingness, specialised management and dedication to service. The process concluded with the assignment of the different portfolios to the four servicers, as described in Note 1 of the annual accounts, which during the course of 2015 would carry out the procedures for operational migration and management. That migration process concluded in the first quarter of 2017 with the technological migration of the portfolio of loans and credits originally transferred by Bankia, S.A.

In parallel to the implementation of the bidding process, and as part of the agreements entered into, Sareb has initiated a process of re-engineering its internal procedures by way of complex informational projects (Colabora, Medea, Alejandría and Carcasa) which have involved considerable effort over successive years. This does not mean that the Company´s main objective has been sidelined, which is to maximise the value of its assets and the orderly disposal thereof, and to achieve turnover figures in accordance with its business plan.

The most important aspect of 2015 for Sareb, once the Íbero bidding process was over, were operational migrations from the assigning banks to the new servicers. The complexity of the process (involving 14 migrations) made it a challenge that was satisfactorily resolved, inasmuch as all of them were concluded in the course of that year, except for two that were completed in the first quarter of 2016.

The technical and organisational efforts expended in the transition from assigning banks to servicers meant that turnover was reduced. With a view to stimulating the transition, specialised units were set up to support the OS migrations between assigning banks and servicers. Transformation units were also created in each servicer to coordinate the steps to be followed by each party in order to reach Objective Period I, giving rise to the operational and informational link agreed in the contracts.

In terms of marketing, Sareb has undertaken a matrix reorganisation involving a double parameter of products and servicer. The products side directs, guides and stimulates the various lines of business for all the agents, while the servicer side manages the implementation of business proposals and budgets in each servicer. In in this way, business activities are monitored and in particular, commercial activities are energised.

Continuing with what was started the year before, the focus is on the development of a series of technological projects (under the name of Hispalis) with a view to improving interaction with the new servicers' systems. The main projects are as follows: Medea – a data warehouse for holding information on operations carried out; Alejandría – a document management system dealing with the company's operations and assets; Colabora - channelling workflows (authorisations, communications, service levels, etc.); and Carcasa – implementing our own accounting system for real estate assets.

As far as regulations are concerned a significant event occurred in October when Circular 5/2015 was published by the Bank of Spain. This instruction laid down the central lines of methodology in terms of which the value of Sareb's assets is to be calculated. Its main points are set out in this report below. Its primary application called for setting up an important fund in respect of impairment of financial assets, and it would be safe to say that this impairment of asset value originated from when the assets were transferred to Sareb. As it was produced against profits and losses, it consumed all the initial equity and opened up the process of converting subordinated debt into capital in a very significant amount (see Note 11).

2016 saw the consolidation of most of its goals, the technological projects mentioned above and a gradual process of operational gearing between them and the servicers, which was concluded in 2017. Above all there was persistence and focussing on the task initiated in 2015 following the application of Bank of Spain Circular 5/2015 as regards improving information on asset status (their legal situation, possession status, location, characteristics, identification, etc.). This kind of information is important both for administration purposes and in order to direct the marketing approach so as to achieve the double goals of generating resources and maintaining margins.

Bearing in mind that practically the whole of our portfolio was valued according to the aforementioned Circular, basically in terms of the ECO valuation parameters, this involved an enormous effort as regards gathering information on the company's assets, in addition to the further task of valuing the immense portfolio of both our own and collateral properties (over 400 thousand assets identified in total). Along with these mass-scale refinements, lines of action have been reinforced with respect to refining legal aspects. Monitoring legal proceedings in course for the disposal of assets has been extended, thus broadening and specifying in more detail the underlying information available on loans and collaterals. The systems for monitoring prices and turnover for both the company and third parties were also upgraded.

In the course of this financial year the value-creation lines noted in the previous year were strengthened. These have also been important in subsequent years and comprise: implementing the tasks in hand received as real estate assets and support for the completion of work on properties given as collateral; land development and transformation; and pursuing residential and commercial leasing business.

Turnover was stabilised, given that decisions were affected by the regulatory value (as an approximation to the market value). This amount was difficult to beat or even get close to in a good number of the operations carried out.

Nevertheless, towards the end of the year RD 4/2016 was published. This Decree lays down that the impairment fund has to be noted as an equity adjustment fund rather than being set against the Income Statement. Its retroactive application gave rise to an aggregate re-establishment of equity capital, which had been substantially reduced during the previous year.

2017

Apart from the effect on equity, that change had (and still has) significant effects on our business inasmuch as it may influence decision-making as regards our operations. The book result for an operation will be that which matches the offer to the acquisition or transfer price, without any value adjustments. Therefore, we have to assess not only the evident (and guiding) relationship between the offer price and the market price of an asset but the accounting result as well because of its effect on the company's limited own resources. In this regard the first quarter of the year was affected by operations that had been approved months beforehand under the previous regulations. As these transactions were linked to market values, they gave rise to considerable losses on the books.

Accordingly, during the course of the year selling activities were intensified with a view to focussing on operations with greater margins so as to meet the company's structural costs. But since it was difficult to generate business, sales systems were implemented and promoted by Sareb with the assistance of the servicers. Special mention is made of the "showcases" in which a number of assets are offered to a select group of possible clients involving a competitive setup among them so that, if Sareb sees fit to do so, it can carry out its transactions at the best price on offer. In this way the seed is sown for an open asset market in the future with greater depth and more players.

As regards operational structure, many of the strategic projects involving transactional and informational relationships with the servicers have been concluded. Sareb has now initiated an internal programme to improve operational aspects (known as "OS17") which is oriented towards responding more speedily to business requirements. This project is designed not only to provide flexible answers to our servicers' initiatives but also to propose a framework of pre-approved prices for most of the assets in our portfolio. We have therefore continued to improve data collection and value assessment for our properties, with greater sophistication in approximating prices to the double objective of the market and maintaining value.

Moreover, in order to reinforce our lines of value generation noted in previous years, in 2017 we have set up a specific Real Estate Development Area, whose first task has been to broaden the range of assets to be developed and organise channels for them to be built and marketed.

Lastly, mention should be made of Socimi Témpore Properties, a vehicle created to channel our rental properties, but also, and above all, to seek out sales alternatives and energise markets through collective investment schemes.

Regarding the accounts corresponding to 2017 the following facts are worthy of mention:

- Pre-tax losses for the year stand at 534 million euros, compared to losses of 663 million in the previous year; as such, in both years the same rules for recognition of the impairment were applied.
- That amount is increased by 31 million euros, making 565 million euros, following the reversal of part of the deferred tax credits and assets from previous years.
- At 31 December 2017 and 2016, in application of the method for measurement established by Bank of Spain Circular 5/2015, the Company set up an impairment fund for its financial assets unit for the amount of 4,229 and 3,389 million euros, respectively. As there is no tax adjustment applicable, the provision for this fund is charged entirely against equity in a specific account for value change adjustments (the 2016 tax adjustment was for 99,814 thousand euros).
- It should be pointed out that the Company has replicated its Turnover from the 2,134 million euros of the previous year to the 2,144 million of the current year. The amount in terms of gross income is 3,817 of the current year as against 3,923 of the previous year. A certain asymmetry is seen as the figures for property sales improve, while the operations with loans have less impact.
- The following aspects are highlighted from the operating results:
    - The return to an operating profit of 7 million euros as compared to the 105 of loss for the previous year. This positive change originates in having obtained greater margins in the sale of financial assets by focussing on operations providing an accountable margin, due to changes in regulations. On the subtraction side, the expenses items show similar behaviour to that of previous years, and are therefore very stable.
    - Property sales for the amount of 1,132 million compared to 1,010 million euros of the previous year, with a gross margin of 154 million (representing 15% against 12% the previous year). The block of residential properties shares volumes and margins with the other types of assets (land, commercial premises, rentals, etc). On the other hand, the real-estate segment includes 49 million in income received from rental properties.
- In the branch of sales of financial assets, the Company has obtained around 5% less income, with an average margin of 9%. There has been a positive trend in the sale of singular collateral properties which went up by more than 20%, while the sale of residential collateral property has behaved in similar terms as the previous year and for over 500 million euros.
- Financial revenue for a total figure of 503 million euros (607 million euros in 2016), of which 724 million euros (891 million euros in 2016) related to accruals on loans and credits and 221 million euros of loss (284 million euros also of loss in 2016) with recoveries by way of collecting the nominal amounts of loans and credit acquired at a discount. The order of priority of the amounts recovered has to be taken into account, as it is first allocated to unpaid interest, which has brought about the increase under that caption on the income statement, to the detriment of the line of "Margin of recovery of loans and credit". The deterioration of the margin is caused both by a decrease in the interest rates, and also by the absorption, in the first quarter, of negative margins on operations approved at the end of the previous year prior to RDL 4/2016.
- The expenses for maintenance, amortisation/depreciation and structure stand at 762 million euros (766 million euros in the previous year), largely corresponding to the costs of property maintenance, local taxes (I.B.I.), management fees and commissions on the sale of assets, as well as the tax expenses arising from the foreclosure and dation procedures that Sareb cannot pass on. In any case, none of the lines has undergone any significant change.

From the aspect of cash generation, in its fifth year of existence the Company has managed to generate a cash surplus sufficient for amortising 1,526 million in that year in addition to the 672 million that were paid with a charge to the cash of the previous year. All of which after covering the corporate structure expenses, the asset maintenance expenses and the management and marketing expenses, and, particularly, the amount of over 531 million of finance charges associated to the senior debt and its hedge instruments.

In relation to the reduction of that senior debt, the Company's main business reference, in addition to the ordinary amortisation mentioned above, during the year it has cancelled bonds by way of rectifications made in the transfer process for the amount of 31 million euros. Taken as a whole, in 2017 the Company has reduced the volume of senior debt issued by 2,229 million, which, added to the 9,184 million euros from previous years, brings the amount of reduction to 11,413 million, i.e. 22.5% of the volume of original debt, a percentage that would increase to 23.7 % if we take into consideration the amortisation of 605 million made in February 2018, financed from the funds generated in the previous year.

Lastly, it is worth mentioning that the average payment period to suppliers in 2017 was 34 days, as described in Note 14. Payments to suppliers made in a period in excess of 30 days correspond to bills paid within the periods arranged with those suppliers, and do not exceed 60 days, as established by Act 11/2013 in amendment of the Insolvency Act (Act 3/2004 of 29 December).

2. Foreseeable evolution of the Company

The 2017 financial year represented a period of consolidation for the Company in terms of what had been achieved in previous years, with the migrations as protagonists. Its new structure (both internal and external) has been stabilised and strengthened, and the new servicers are fully operational both as regards their technical tasks and as regards taking effective control of the assets. The situation is now normal and these agents are able to dedicate greater efforts to sales and collecting payment.

At all events, the Company has an additional instrument in terms of margins that allows it to maintain its structural costs at the same time as generating sufficient cash funds to pay off the debt gradually.

With this, 2018 represents an exercise in reinforcing these messages, with greater demands in the sense that the portfolio may offer less room for liquidity than in previous years. The task is therefore to gather more information about the assets in the portfolio and divide them up so as to focus our commercial activities on those segments that are more suitable for transactions at competitive prices.

Linked to this sales goal is a strategic aim of consolidating corporate infrastructure so as to improve performance, optimise management and informational tasks and in general achieve better operational efficiency. The Company is determined to improve still more its decision-making both as regards the time involved and available information and to facilitate relations with third party buyers so as to generate a friendly corporate environment.

This inertia in a young organisation with many challenges to face, will continue to lead us down a dynamic path of adaptation to our environment with changes to our corporate set-up, a better focus on our goals and improved procedures to achieve stability. To that end we shall carry out restructuring and reorganisation of the various areas as necessary. Mechanisms of coordination will be extended. But progress will also be made on functional specialisation, the goal of our organisational strategy.

In 2017 the foundations were laid down for a better operational model both internally and with the servicers (known as project OS 17). In 2018 we will see a model of processes based on tasks as a basic unit so that, by means of incorporating them according to product, more agile schemes may be created both for daily management and to enable flexible modification and reinvention as the need arises.

As regards information on the Company's assets, the valuation requirements laid down by the Circular 5/2015 issued by the Bank of Spain have led to steady improvement in our data gathering. The aim of valuing all our assets in accordance with that methodology was achieved in 2016, so in 2017 we focussed on resolving any deficiencies. The refinement and opening programme for the files of all the Company's assets was concluded that year. It is important to note that we also initiated the first portfolio adjustments in terms of ECO valuation parameters, which lets us see how our assets are performing by geographical area and type. In addition there was the work involved in maintaining our assets, verifying their possession status, heat maps showing zones of greater traction, etc.

Our information strategy will not change in 2018, because gathering data on the portfolio goes much further than merely complying with regulations. This task, and this is its first and ultimate reason, must serve to streamline marketing by setting prices or values that become ever more transactional or failing this, at least serve as clear guidelines. The servicers will thus be able to find out to what extent their commercial operations will be endorsed at closure at the set prices and will therefore be in a position to optimise their commercial activities

These improvements in information management (more, better, higher quality, more granular) fuel the Company's Business Plan, which better identifies those assets (in segments and groups) upon which commercial activities should be focussed and also serves to facilitate the important development levers for the Company's own real estate property.

The Business Plan is updated annually. Its temporal horizon extends to cover the whole life of the Company. It is based on cash flow projections of the income derived from the orderly disinvestment of assets according to the amount that is expected to be recovered for each asset as at the date of disinvestment.

With a view to complying with the Company's long-term corporate targets the Business Plan focuses on the value-creation lines that were noted in previous financial years and are now being strengthened, namely: early marketing of those assets that have a limited expectation of price; improvement and refurbishment of assets that show stable increases in price; focalisation of development of the Company's real estate assets where they are more liquid; and reactivating development of land that has well-founded expectations. All this is based on the collection of more and better information on our asset portfolio, as stated above, to the extent that such action does not result in significant negative margins in the accounts.

As in the case of the business plans for previous financial years, this year's Plan incorporates in its cash flow projections the effects on equity that may be produced by variations in asset impairment, although these are not included in the Income Statements. Any losses will be incorporated into these cash flows as at the date of disinvestment. In this way the principle of offsetting the value of the assets and of their long-term valuation is applied to the Business Plan.

Turning now to the expected evolution of the market in 2018, it seems that, despite the fragmentation of the property market and a certain absence of government action during the first quarter of the year, there appears to be greater optimism now as regards a possible resolution to the political conflict in Catalonia. There has been a degree of recuperation of the market in general, with some movement in the case of residential properties in certain sub-markets, such as the provinces of Madrid and Barcelona and those along the Mediterranean coast, as occurred last year, but without extending to the rest of Spain. Although such movements would in principle suggest a better perspective for real estate property across the country, there are some bare patches in geographical terms as well as differences in the use and age of such assets, with the result that Sareb's rather idiosyncratic portfolio has not been unduly affected.

A more important factor so far is the Company is concerned is perhaps that the resolution of the two phases of uncertainty referred to above has given rise to greater confidence towards the Spanish market. The financial situation has improved and new players have appeared in the real estate market who are keen to invest. This has energised the market, creating more competition and therefore more demand. More real estate companies have also appeared on the scene with the intention of being listed on the stock exchange in the medium term. An example of this sort of company would be Socimis, in which Sareb is already a major player via Tempore Properties, which is now close to being listed.

In our view, as doubts about the international macro-economic situation have faded and the lack of political definition in Spain has been overcome, this has encouraged an upsurge in institutional investment and in the volume of units being acquired by final domestic buyers. Prices however have not risen significantly, due to the strong competition among sellers who are sitting on extensive stocks. Accordingly, we at Sareb are betting on a clear rise in the volume of transactions at national level in the course of 2018 compared with previous years. There has also been a slight growth in residential property prices. As we are aware that this increase is taking place in certain areas of Spain (e.g. in Andalusia, Catalonia, Valencia, Murcia and Madrid), the Company will reinforce its commercial activities in these regions, as well as in those others that show prospects of dynamism. Our intention (and this represents a fundamental means of creating value) is to focus efforts on the land market in areas that are not saturated or that show clear signs of development potential due to growing demand for new residential properties.

In sum, as a result of the consolidation of positive expectations in the macro-economic outlook, the infrastructure that is in place, the strong operational capacity of our retail sales channels, better information on our assets in terms of both segmentation and liquidity, and above all stimulation to commercial activity thanks to the servicers, now that they have taken effective control of the migrated assets, we are therefore looking at much improved turnover figures in 2018 compared with 2017 as regards both volumes and margins: This will help to maintain our goal of being one of the leading players in the Spanish real estate market.

3. Main business risks, risk management and use of financial instruments

In addition to the factors of financial risk and risk management described in Note 7 of accompanying annual accounts, the Company has in principle identified the following risk factors that might adversely affect our ability to achieve our targets:

- Crisis in the property market (prices, occupation levels, non-payment).
- Decrease in asset values (although recent movements in the real estate market suggest not just stabilisation but even a steadily upward path.
- Financial and liquidity crisis, which might affect potential buyers of the Company's properties. This risk is mitigated by a certain improvement in the Spanish economy on a macro-economic level although the effects on potential buyers are not yet clear. At Sareb, we perceive faint signs of a possible rise in interest rates, though more in the medium term than in the short term.
- Effects of possible changes in fiscal/legal legislation In this report, and particularly in last year's report, we have pointed out the effects of Royal Decrees nº 3/ and 4/2016 in accounting and fiscal terms. As far as Sareb is concerned, possible changes in tax laws may be important in improving the Company's financial situation, especially with regard to better conditions of compensation for negative tax bases. While the possibility should be borne in mind of certain changes to regional legislation that might affect the real estate market, over the past months there has been less uncertainty regarding new requirements on the part of regional authorities and even a possible return to past situations.
- Now that the Ibero process with the servicers (migration, taking over control) has been concluded, the risk of operational dysfunction has dropped considerably. So the challenge for this and following years will be to consolidate the expected levels of turnover in a situation where the accounting template (instead of book value without provisions) limits the possibilities of closing operations.

As mentioned in the Memorandum as regards the use of financial instruments for the purpose of interest rate risk hedging, in the 2017 financial year the hedging system that was implemented in 2013 was maintained, the aim of which is to reduce the possible negative impact of a rise in interest rates which might even put the viability of the Company at risk.

4. Acquisition of own shares

In 2017 the Company neither had carried out no transactions with its own shares nor it held any at 31 December 2017.

5. Information on related parties

Note 17 of the Annual accounts describes the transactions carried out with related parties. Most of these arise from financing agreements and their corresponding finance expenses and from management and sales commissions due during the year with the financing institutions that were entrusted with the management and marketing of the Company's assets.

6. Subsequent events

No further significant events have occurred other than those already mentioned in Note 19 of accompanying annual account.

The Socimi Tempore Properties is scheduled to be listed on the Alternative Stock Exchange in the first week of April. With this Sareb will then hold more close to 99% of its shares, as somewhat more than 1% has been distributed among minority purchasers.

7. Research and Development

No significant investments in research and development were made in 2017 due to the nature of the Company's business.

On 22 March 2018, and in compliance with the requirements established in article 253 of the Capital Companies Act and in article 37 of the Code of Commerce, the Board of Directors of Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A has sign off the Annual accounts and Directors Report at 31 December 2017, which comprise the attached documents preceding this statement.

Mr. Jaime Echegoyen Enríquez de la Orden
Chairman

Mr. Eduardo Aguilar Fernández-Hontoria
Director

Mr. Enric Rovira Masachs
Director

Mr. Javier García-Carranza Benjumea
Director

Mr. Antonio Cayuela Gil
Director

Mr. Jordi Mondéjar López
Director

Ms. Francisca Ortega Hernández-Agero
Director

Fund for Orderly Bank Restructuring
(represented by Mr. Jaime Ponce Huerta)
Director

Mr. Jaime Rodríguez Andrade
Director

Mr. Joseba Iñaki Goikoetxeta González
Director

Mr. Pedro Antonio Merino García
Director

Mr. Isidoro Lora-Tamayo Rodríguez
Director

Mr. José Poveda Díaz
Director

Mr. Francisco Javier Bartolomé Delicado
Director

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Sareb

Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A.

For more information, consult the Sareb website www.sareb.es or contact the company's Communications Office by calling +34 91 556 37 00 or at the email address: comunicacion@sareb.es

Sareb

Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A.

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