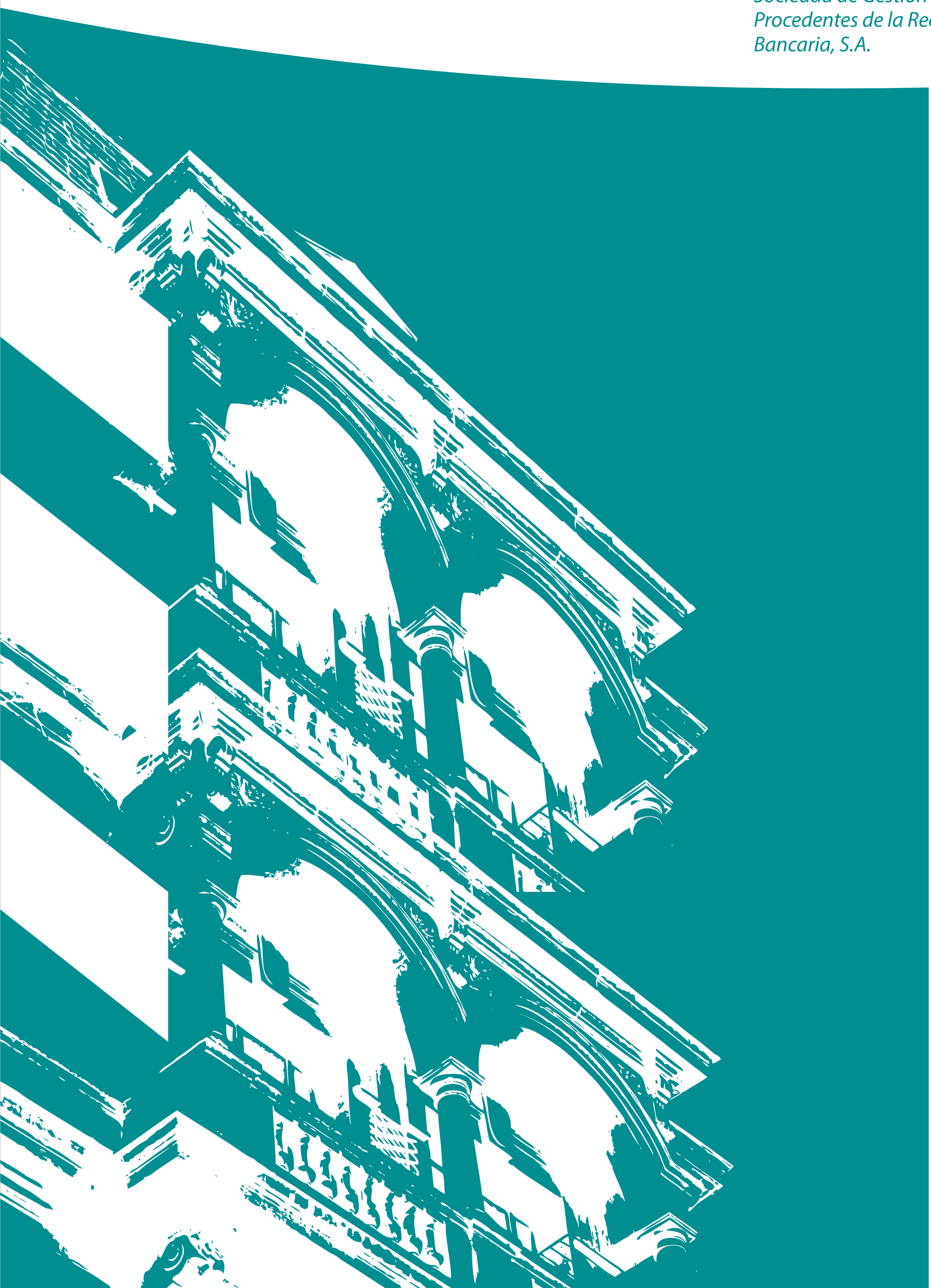
Sareb

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



ANNUAL ACTIVITY REPORT

2016

Sareb

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

ANNUAL ACTIVITY REPORT 2016

The photographs included on the front page of each chapter of this report were taken by Sareb employees.

Summary

Sareb

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

Chairman's letter

2016 was a very important year for Sareb, largely because we completed the first full year in the hands of our new partners, the servicers, managing our portfolio. Their work in sales growth and settling loans has been fundamental in boosting the company's revenue to nearly EUR 4,000 million and settling more than EUR 2,000 million of debt.

The revenue has been significant both because of the volume and the nature of the transactions made, some of which have been focussed on the assets least likely to be revaluated. In 2016, divestment of this part of the portfolio increased, under a regulatory framework defined by the Bank of Spain Circular 5/2015, and later by Royal Decree-Law 4/2016. This regulation has enabled the company to recover the reduced capital with the impairment losses of previous years, which has placed the capital and subordinated debt above EUR 4,000 million. With this recovered strength of equity, Sareb is undertaking its future strategy with greater guarantees of success.

The efforts in sales were reflected both in the commercial activity of the servicers, and in the campaigns launched by Sareb, which enabled it to close the year with the divestment of 14,000 properties. As regards financial assets, more complete knowledge of the portfolio streamlined the management of 10,500 proposals our borrowers sent us, up 16% from the previous year.

The initiatives that enable us to collaborate with our debtors in collecting the loans are especially significant, both through the sale of securities and through what we've called Sales Growth Plans (PDV). Since our inception, more than 2,100 companies –mostly SMEs– no longer have debt with us and are moving forward by themselves.

One strategic line that gained strength in 2016, and will be even stronger in the future, is the creation of value. We are aware that we've received a low-quality portfolio that requires investment in order to improve returns and recover the price paid. Our strategy, as stipulated in the latest review of the Business Plan, establishes as the key objectives land management for urban development, finishing construction halted in areas where the market advises it, and especially property development on owned or co-invested land with professionals from the sector who provide local knowledge.

The mosaic of initiatives launched shows the entrepreneurial nature that dominates Sareb's management, which has been designed to succeed in an increasingly complex scene. It must not be forgotten that we do not operate by ourselves. There are other financial and banking agents in the Spanish market that have a portfolio of properties and failed loans on their hands similar to the size of Sareb. In their case, unlike ours, they have additional sources of revenue to offset the results obtained from liquidating their property exposure.

In this environment of stiffening competition, Sareb is openly committed to innovation in plans, such as the creation of a loan sales platform that will be launched in 2017. Currently, our teams are working on implementing this platform with the objective that it provides quality information about these assets and streamlines them being removed from the company's balance sheet.

The magnitude of the achievements made in four years of efforts is reflected in the balance sheet reduction of more than EUR 10,600 million –21% since the start– in addition to the repayment of more than EUR 9,800 million of debt issued with the Spanish government-backed guarantee –19.4% of the total. In addition, the intense commercial activity in these nearly four years has enabled us to record EUR 16,800 million of revenue.

Sareb's contribution to the country's economy goes beyond its own business figures. Currently, the company stands as an important contributor to the different administrations by paying more than EUR 600 million in taxes. At the same time, it has invested more than EUR 230 million in the upkeep and the good condition of its housing stock. In four years of existence, Sareb has contributed around EUR 14,700 million to society for different items (repaid Spanish government-backed debt, taxes, community association charges, transfer of social housing, etc.).

Sareb's form of management has become a reference for countries that, like Spain four years ago, are facing the need to create a vehicle to heal their financial sector and drive economic growth. We are offering our experience and collaboration to them.

I don't want to conclude this brief summary without mentioning our commitment to society. This area was not explicitly planned in the initial design, but

> *"The intense commercial activity undertaken during these nearly four years has enabled us to record EUR 16,800 million of revenue"*

quickly turned into an important line of work for Sareb and society. Since the Board of Directors took the first steps in 2013, Sareb has already committed a stock of 4,000 houses to transfer to public authorities and earmarked them for social rents. 8,000 people have benefited from the agreements signed with ten autonomous communities and five city councils up to today. Furthermore, I'd like to reiterate our commitment to the Ten Principles of the United Nations Global Pact, which we have been adhered to since 2013. This report contains our advances regarding human rights, employment standards, the environment and the fight against corruption.

We've been through four very intense and fruitful years. The echoes from the economic crisis are being left behind, and today, Sareb has established itself as a catalyst of recovery and professionalisation of the property sector, although there's still a long way to go.

We are aware of the immensity of the mission before us: to manage assets that nobody has ever been able to sell, which burdened the Spanish financial system. In order to fulfil this task, we must work better and search for opportunities no matter where they are. We lack neither the excitement nor the determination to face up to the challenge.

Jaime Echegoyen
Chairman

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

1

OVERVIEW

1.1 Milestones

2012

November

28 Sareb's incorporation

December

28 First subscription of subordinated debt

31 Receipt of the assets from BFA-Bankia, Catalunya Banc (CX), Banco de Valencia, Novagalicia Banco and Banco Gallego

2013

February

4 Sareb starts the sale of assets through the transferor institutions

23 Second subscription of subordinated debt: Sareb completes its capital with EUR 4,800 million (EUR 1,200 million of capital and EUR 3,600 million of subordinated debt)

28 Receipt of assets from Liberbank, Caja 3, CEISS and BMN

March

20 Approval of the Conflict of Interest and Related Party Transactions Policy

May

20 Approval of Sareb's Code of Conduct

August

6 First institutional transaction completed: award of the Bull portfolio

September

25 Adhered to the United Nations Global Compact

October

22 Sareb's corporate website launched

31 Housing stock created to transfer social rents to the autonomous communities (2,000 homes)

December

31 Sareb closed its first year with revenue of EUR 3,800 million, repaid debt of EUR 2,000 million and sold over 9,000 properties

2014

February

3 Appearance before the Catalan parliament

23 Appointment of the Chairman

March

27 Sareb announces writedowns of EUR 259 million to its loan portfolio

April

1 Appearance before the Spanish parliament

22 Ibero Project: tender of the asset servicing contract

May

26 First institutional sale of land plots

July

14 Signing of the first agreement to transfer homes to an autonomous community (Generalitat de Catalunya)

October

27 Appearance before the Spanish Senate

November

3 Ibero Project: first award of assets to Solvia

December

4 Ibero Project: award of assets to Haya, Servihabitat and Altamira

31 Sareb closed the year with revenue of EUR 5,255 million, repaid debt of EUR 3,400 million and sold over 15,000 properties

2015

January

26 Handover of the Sareb Chairmanship

February

28 Ibero Project: start of asset migration from transferors to the new servicers

March

31 Sareb announces writedowns of EUR 719 million to its loan portfolio

May

13 Sareb announces a new structure focussing on servicers

July

2 Appearance before the Spanish parliament

October

2 Bank of Spain Circular establishing the valuation criteria for Sareb's asset portfolio

19 Appearance before the Spanish Senate. The social housing stock doubled up to 4,000 and the transfer to large city councils was also authorised

November

24 Sareb announces the development of 13 land plots

December

16 Signing of the agreement to transfer homes with a CityCouncil (Barcelona)

31 Sareb closed the year with revenue of EUR 3,886 million, repaid EUR 2,051 million of debt and sold 11,256 properties

2016

March

31 Additional write-downs to its portfolio with provisions of EUR 2,044 million, requiring it to convert EUR 2,171 million of its subordinated debt into capital

April

4 Ibero Project: end of the asset migration from the transferors to servicers

May

3 Sales campaign of land plots with average discounts of 15%

6 Approval to convert EUR 2,171 million of subordinated debt into capital, to handle writedowns to its portfolio

27 Launch of the first commercial campaign of halted work

September

27 Sareb announced the selection of 19 land plots to develop in collaboration with the development sector

October

6 First sale of completed homes from the unfinished works received

December

2 Changes in the accounting regulations allow reflecting the deterioration against equity, instead of recognising them on the profit and loss statement

12 Rental campaign of nearly 1,100 homes

22 First entity with public capital to certify its prevention model with AENOR recognition

30 The largest institutional operation is completed with the sale of the 'Eloise' portfolio, consisting of loans for a nominal amount of EUR 553 million

31 Closed 2016 with EUR 3,923 million of revenue, repaid EUR 2,169 of debt and sold nearly 14,100 properties

1.2 Sareb in figures

Revenue

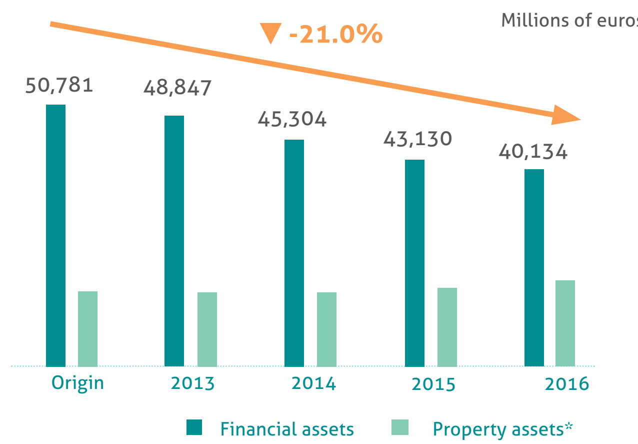
2016
3,923 million in revenue earned

Cumulative
16,864 million in revenue earned

Portfolio divestment

2016
2,996 million divested

Cumulative
10,647 million divested

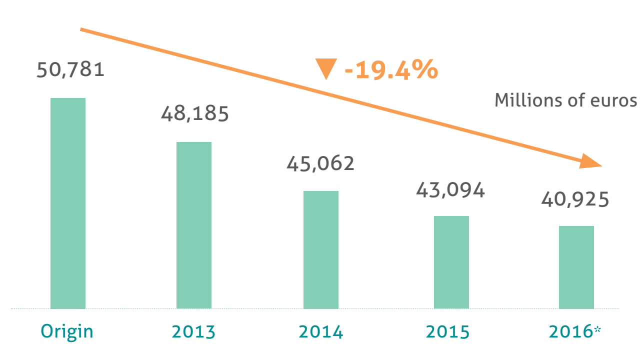


* The figures of property assets do not include their accumulated depreciation

Repayment of senior debt

2016
2,169 million of repaid debt

Cumulative
9,856 million of repaid debt



* EUR 671.6 million of repaid debt are included in 2017, booked to 2016

BUSINESS

Management of loans

2016
10,500 — 16% more proposals from debtors managed than in 2015

Cumulative
38,200 — Proposals managed

Properties sold

2016
14,097* Properties sold

* Includes 8,368 owned properties and 5,729 securing loans

Cumulative
50,000 Properties sold

land	residential in 2016	tertiary
10%*	85%*	5%*

* % on owned units sold in 2016

Property development

2016
1,606

Total:
3,813

Properties (residential and tertiary assets) for rent

2016
1,231

Total:
4,603

OTHER INFORMATION

Social

4,000 homes committed with social purposes

Nearly 8,000 people benefit from these homes

Other

356 employees Sareb + 500 employees *servicers*

42% women / 58% men (Sareb)

560 suppliers

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

2

OUR NATURE

Since November 2012, Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria (Sareb) has worked to liquidate the asset portfolio it received from financial institutions that needed government assistance due to their high exposure to the property sector.

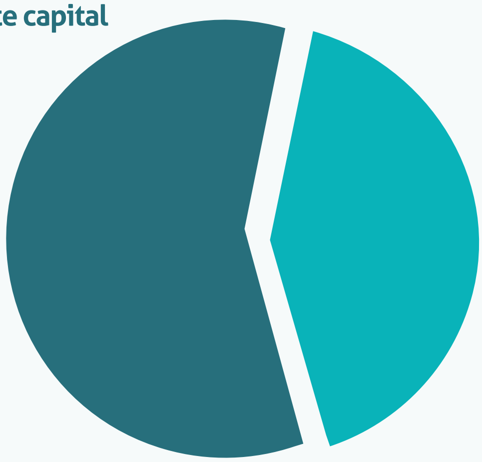
Sareb took shape based on Law 9/2012, after the Memorandum of Understanding on Financial-Sector Policy Conditionality (MOU) that the Spanish government signed with its European partners in mid-2012. This document determined the obligation to set up a manager to which the property and financial assets would be transferred from the institutions with difficulties and liquidate them in an orderly manner, with a maximum deadline of fifteen years, until 2027. The company, a cornerstone of the financial restructuring, was constituted with 55% of its capital from private entities, while the Fund for Orderly Bank Restructuring (FROB) provided 45% of the capital.

Sareb received nearly 200,000 property and financial assets (80% in loans to developers and 20% in homes, land plots, offices, premises...) valued at EUR 50,781 million. To handle this acquisition of assets, Sareb issued debt with a Spanish government-backed guarantee, which will be progressively redeemed, so it is at no cost to taxpayers.

The portfolio received by Sareb has been transformed by intense divestment activity during its existence of over four years. During this time, property assets have been gaining emphasis compared to financial assets, due to the progressive and natural transformation of the balance sheet.

Capital 2

54.1%* **Private capital**



Sareb is a cornerstone in restructuring the Spanish financial system

45.9%* **Public capital through FROB**

*Actual distribution of capital, which slightly differs from the initial distribution due to the effect of converting subordinated debt

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2.1 Mission, vision and values

The organisation's strategy is focussed on its commitment to the recovery of the financial and property sector, and in general, to the adequate and sustainable functioning of the Spanish economy.

In this way, its mission, vision and values embody the guiding principles that will enable it to act and the manner in which it attempts to successfully complete the tasks.

Sareb

Mission:

Divest its assets within 15 years, whilst maximising their value. Sareb must ensure its viability as a company in order to fulfil its commitments to its shareholders, investors and society as a whole.

Vision:

Sareb is a private company committed to fulfilling its mandate, thereby contributing to the clean-up of the financial system and the Spanish economy. As part of this process, it is essential that its employees are professionally and ethically competent.

Values:

- **INTEGRITY:** Means that the actions and behaviour must conform with the ethical standards of Sareb's business culture.
- **TRANSPARENCY:** Sareb is committed to open communication with regard to its policies and procedures and is conscious of the fact that it acts under the watchful eye of society as a whole.
- **CIVIC DUTY:** The company operates under ethical standards and with socially responsible criteria.

2.2 Governance bodies

Sareb has two governance bodies: the General Board and the Board of Directors. The General Board is made up of Sareb shareholders, and is in charge of deliberating and agreeing on the matters of their competency, in accordance with the Articles of Association and the Spanish Limited Liability Companies Law, acting under the principles of transparency and with adequate information.

In 2016, two general meetings were held:

May 5, an Ordinary Board Meeting was held, which among other matters, approved the 2015 annual accounts and the conversion of subordinated debt.

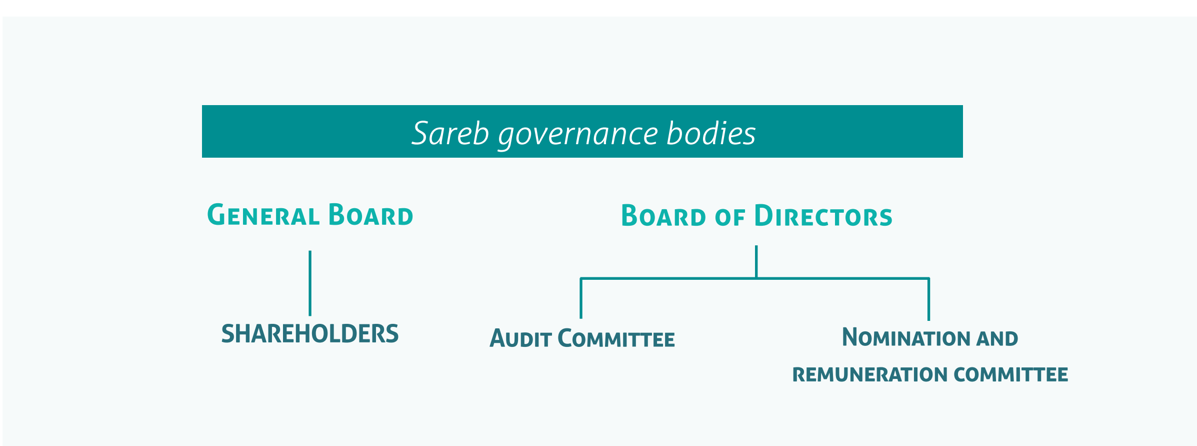
November 28, an Extraordinary Board Meeting was held to renew the positions on the Board of Directors.

The Board of Directors, the body of representation, administration, management and control of the company, consists of 15 directors. Given its importance, it has a balanced composition, with an ample majority of non-executive directors and an adequate proportion between proprietary and independent directors, the latter of which represent a third of its members.

Sareb's Board of Directors has an Audit Committee and the Nomination and Remuneration Committee, both of which are chaired by independent directors and are made up of eight members, all of whom are non-executives and the majority are independent. Last year, these Committees met on 10 and 13 occasions, respectively.

The composition, structure, operational rules and main duties of the Board of Directors, Audit Committee and Nomination and Remuneration Committee are set out in their respective Operational Regulations, which can also be found on the Company's corporate website (www.sareb.es).

In addition, Sareb has a number of Support Committees, comprised of members from its management team and representatives of the company shareholders, the main duty of which is to assist the Board of Directors. These committees met 11 times in 2016, and are as follows: the Management Committee, Risk Committee, Investment Committee and Assets-Liability Committee.



2.3 Supervisory regime

Sareb was incorporated as a public limited liability company, with certain special features relating to its unique purpose and the public interest associated with its activity. Therefore, it must act at all times with transparency, commercial honour and professionalism, and is subject to a rigorous supervisory regime carried out by the Bank of Spain, Spanish National Securities Market Commission (CNMV in Spanish) and Monitoring Committee.

The Bank of Spain examines the fulfilment of Sareb's sole purpose, inter alia, the specific requirements that are established for the assets and liabilities, in addition to the standards regarding the transparency, creation and composition of the governance bodies.

In addition, Sareb is supervised by the Spanish National Securities Market Commission (CNMV) in relation to its business activity as an issuer of fixed-income securities.

Finally, the Monitoring Committee that monitors Sareb's fulfilment of its general objectives includes a representative from the European Central Bank (ECB), who attends as an observer, and four members, respectively chosen by the Ministry of Economy, Industry and Competitiveness (which presides over the Committee), Ministry of Finance and Public Administration, Bank of Spain (which acts as secretary) and CNMV. In 2016, this Committee held four meetings in which it analysed the Business Plan and its possible deviations, in addition to the plans of divestment and repayment of secured debt.

The Bank of Spain, CNMV and Monitoring Committee are the institutions in charge of strictly monitoring Sareb

Sareb makes a half-yearly report on its activity, which is issued to the Bank of Spain and the Monitoring Committee, and is made available to the public via Sareb's corporate website (www.sareb.es). In addition, it is subject to an annual Compliance Report prepared by an independent expert.

2.4 Ethics and governance

Sareb follows the best practices of corporate governance applicable to listed companies. The regulations are even stricter than those applicable to standard public limited liability companies. In addition, the company imposes some demanding behaviour regulations on all of its employees, which are contained in its Code of Conduct (available at www.sareb.es), whose ethical standards are based on the values that embody Sareb's business culture.

In addition, Sareb has a Conflict of Interest and Related Party Transactions Policy to regulate those situations involving personal interest, direct or indirect, of the company and the directors or the people to whom it applies, in addition to the transactions it makes with directors or people related to them. Specifically, this policy was applied 48 times in 2016.

Sareb continues to adopt advanced corporate governance practices that are consistent with the good governance recommendations widely acknowledged in international markets, based on business transparency and mutual trust with shareholders and investors.

The Conflict of Interest and Related Party Transactions Policy was applied 48 times in 2016

ETHICS CHANNEL

Sareb's Internal Audit department administers the process established by the Audit Committee to communicate irregularities or ethically questionable situations, together with the mechanisms ensuring the confidentiality of the process.

Its activities include verification of whether the Ethics Channel has been communicated sufficiently and whether the servicers[1] –as the property platforms are called that manage the Sareb portfolio (Altamira Real Estate, Haya RE, Servihabitat and Solvia)– have procedures in place to ensure the identification, analysis and communication to Sareb of any complaint in relation to the management and administration of assets.

2.4.1 Policies and procedures

A significant element in fulfilling Sareb's objectives is the application of a regulatory framework of operational rules that guide the divestment of assets and relationships with servicers. After four years of operation, Sareb has a strategic reference of 12 general policies, 60 procedures and other instructions for servicers and activity principles.

Throughout 2016, the approval of procedures related to servicers increased, in order to adequately control, authorise and monitor them.

In addition, a new initiative was promoted, focussed on the simplification and streamlining of operations. In order to carry out this project, multi-disciplinary teams have been created that work to create ideas that allow reducing the time of transactions (see Time is cash information on the following page). The proposals created are analysed, and if they are viable, they are implemented immediately.

After four years of operation, Sareb has a strategic reference of 12 general policies, 60 procedures and other instructions for servicers and activity principles

[1] For more information about servicers, see Chapter 3.

TIME IS CASH

If time is a significant factor for all companies, it is even more significant for Sareb, whose divestment mandate has a limited period of time. Therefore, in 2016, a project that puts special focus on the simplification and streamlining of transactions was launched in order to ensure the protection of the legal mandate. More than 50 people from the entity form the seven work groups are committed to create initiatives that allow reducing the internal transaction times and those resulting from the relationship with servicers. The work is focussed on three processes that make up Sareb's main activity:

- Conversion of non-performing loans (NPL) into liquidity.
- Transformation and implementation of secured collateral loans.
- Property asset sales.

In the first stage, more than 100 initiatives were identified, of which nearly 50% are now implemented or are in the implementation phase. In parallel, a considerable effort is being made in the establishment, analysis, improvement and monitoring of a group of operational indicators that evaluate the measures adopted.

2.4.2 Compliance and regulations

SYSTEM OF INTERNAL CONTROL OVER ETHICAL STANDARDS (SCIR, in Spanish)

This includes all the policies, manuals and procedures that contribute to the company carrying on its activities ethically, not just in accordance with current legislation but with integrity, and the ultimate aim of safeguarding its reputation and establishing a business culture based on its ethics.

As per the Risk Management and Control Policy, in 2016, controls continued to be carried out with respect to the SCIR. The areas managed by the SCIR are the competency of the Internal Control Body (OCI, in Spanish), which is assigned with the designing, evaluating and monitoring compliance with the associated regulations. The OCI is a body delegated by the Audit Committee, to which it periodically reports its decisions/activity.

In 2016, Sareb strengthened the development of the control model on ethical regulations in several areas. The most noteworthy actions performed were as follows:

- CRIMINAL LIABILITY: Sareb has a Risk Detection and Prevention Model. In November, Sareb successfully culminated the Aenor certification process regarding criminal risk and received a certification for its Criminal Prevention in Organisations Management System (No. 2016/0002). Sareb is one of the few entities with public capital that had this certification at the date of releasing this report.
- MODEL OF PREVENTING MONEY LAUNDERING AND FINANCING TERRORISM: In 2016, Sareb implemented a new computer application to prevent money laundering.
- CONFLICT OF INTERESTS: In 2016, the Company worked both internally and with servicers to analyse and ensure compliance with the regulations and procedures on the prevention, detection and management of conflicts of interest.
- MANAGEMENT STRATEGY AGAINST REPUTATIONAL RISK RESULTING FROM CONTAGION: In 2016, Sareb continued to work with servicers to align their policies and procedures on prevention and detection.
- DATA PROTECTION: Sareb has reviewed and established new processes to advance in correctly handling information and guarantee that Sareb's activities are done in compliance with the regulations.
- PROTOCOL POLICY ON RELATIONSHIPS WITH THIRD PARTIES: In this period, Sareb applied the aforementioned Protocol and notified servicers of the requirements to be met.
- TRAINING PLAN: In 2016, Sareb carried out actions in accordance with the Training Plan regarding Compliance. This year, it has given courses to all of its employees, focussed on the detection and prevention of criminal risks, policies of conflict of interest, code of conduct and relationships with third parties.

2.4.3 Internal control

SYSTEM OF INTERNAL CONTROL OVER BUSINESS RISK MANAGEMENT PROCESSES (SCIR, in Spanish)

This comprises the control procedures that mitigate typical operational risks (errors in processes, individuals or systems) arising from business or support processes (excluding financial reporting).

In 2016, the Internal Control function was revised to be better aligned with Sareb's business and operating structure, reinforcing some functional aspects:

- EXECUTING CONTROLS FOR COMMERCIAL AREAS:
- GUARANTEEING THE CONTROL ENVIRONMENT IN NEW OPERATING AREAS:
- QUARTERLY MONITORING CONTROLS IN NORMAL PRACTICES.
- COORDINATION WITH THE INTERNAL AUDIT FUNCTION with respect to the standardisation of the risk map and the shared focus on prioritising the processes.

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INTERNAL CONTROL OVER FINANCIAL REPORTING SYSTEM (CSIIF, in Spanish)

This is comprised of the control procedures to mitigate the risks of obtaining and creating financial reporting, aligned with the requirements of the Circular 5/2015, of 30 September.

In 2016, tests were carried out on the controls in two phases (June and December) corresponding to the half-year and year-end accounts.

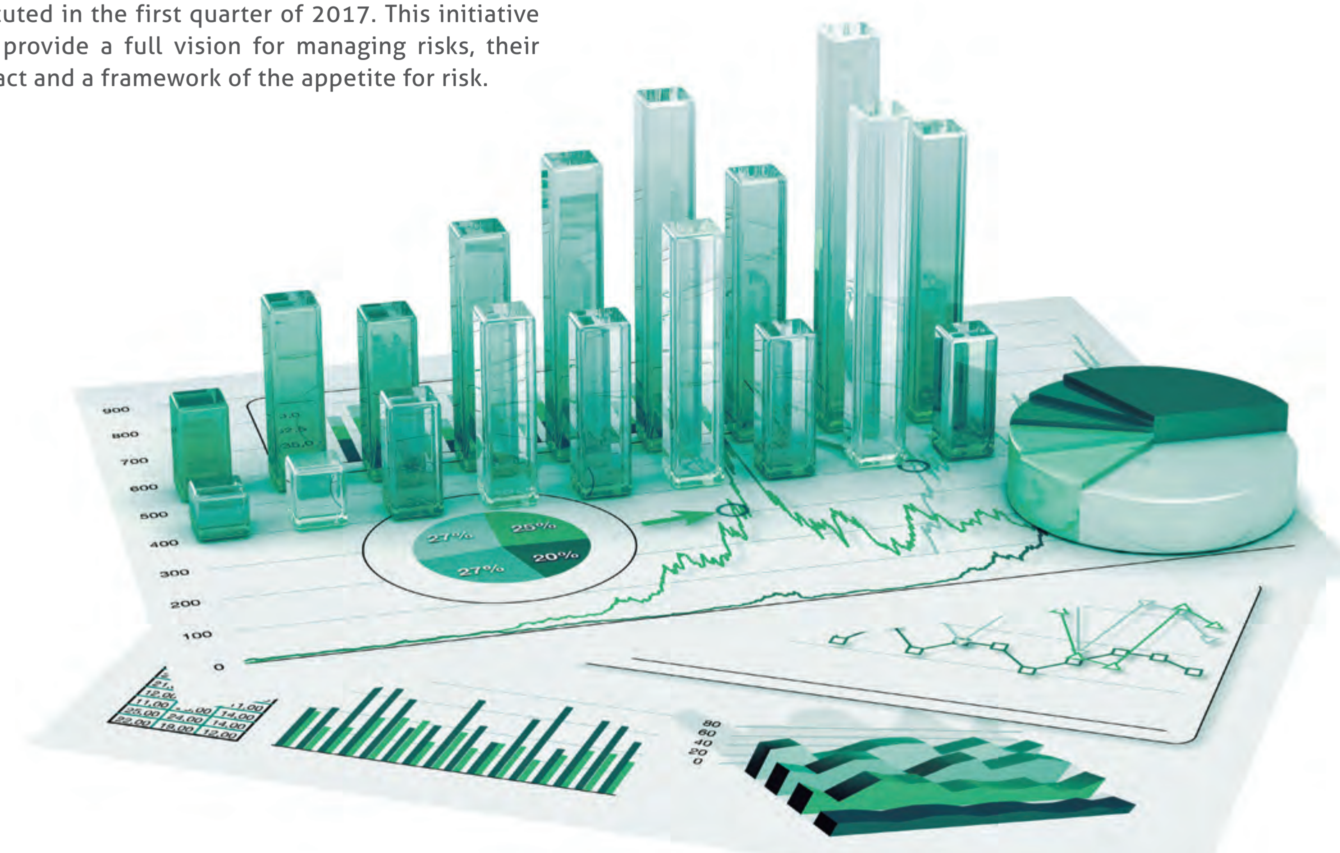
RISK MANAGEMENT AND CONTROL GROUP (GGCR, in Spanish)

In 2016, the Company continued with the GGCR meetings, in which it agreed to revise the definitions of the risk methodology in order to later be taken to the Board of Directors. At the same time, validations have been presented by independent experts for the accounting models used to report Sareb's accounts.

This year, it also carried out a review of the types of risks and approved a project to implement a framework of full risk management that will be executed in the first quarter of 2017. This initiative will provide a full vision for managing risks, their impact and a framework of the appetite for risk.

In addition, in order to support the design of the Valuations project, which is focussed on filtering the information about assets and their valuation process, controls have been defined that allow achieving greater quality of the data of the asset inventory.

In 2016, a full risk management project was approved that will be implemented in 2017



2.5 Internal audit

Sareb's Internal Audit area comes under the Board of Directors, through the Audit Committee, and reports directly to the Company chairman in the daily performance of its duties. Its primary aim is to provide Sareb's directors and senior executives with an independent and reasoned view of the following:

- THE RISKS to which the Company's business and activities are exposed.
- THE QUALITY OF THE INTERNAL CONTROL SYSTEMS, the cornerstone of the management and administration of Sareb's activities.
- THE PROCESSES associated with the company's governance.

The internal audit is structured around three key elements:

- THE RULES, governing the audit function that define the object, authority and responsibility of its activity.
- THE THREE-YEAR MASTER PLAN,as a tool used to align its structure and strategy with the organisation's medium- and long-term aims.
- THE ANNUAL AUDIT PROGRAMME, which establishes the audit function's priorities for 2015.

Ever since Sareb's first years of activity, it has been developing a Risk Control Model:

Ethical Standards Internal Control System

Compliance with standars and legislation

SCISNE

- **Integrity risks**

Risk management

SCIR

- **Credit risks**
- **Market risks**
- **Liquidity risk**
- **Operational risks (non-technological)**
- **Technology risks (non-strategic)**
- **External risks**

Financial reporting

SCIIF

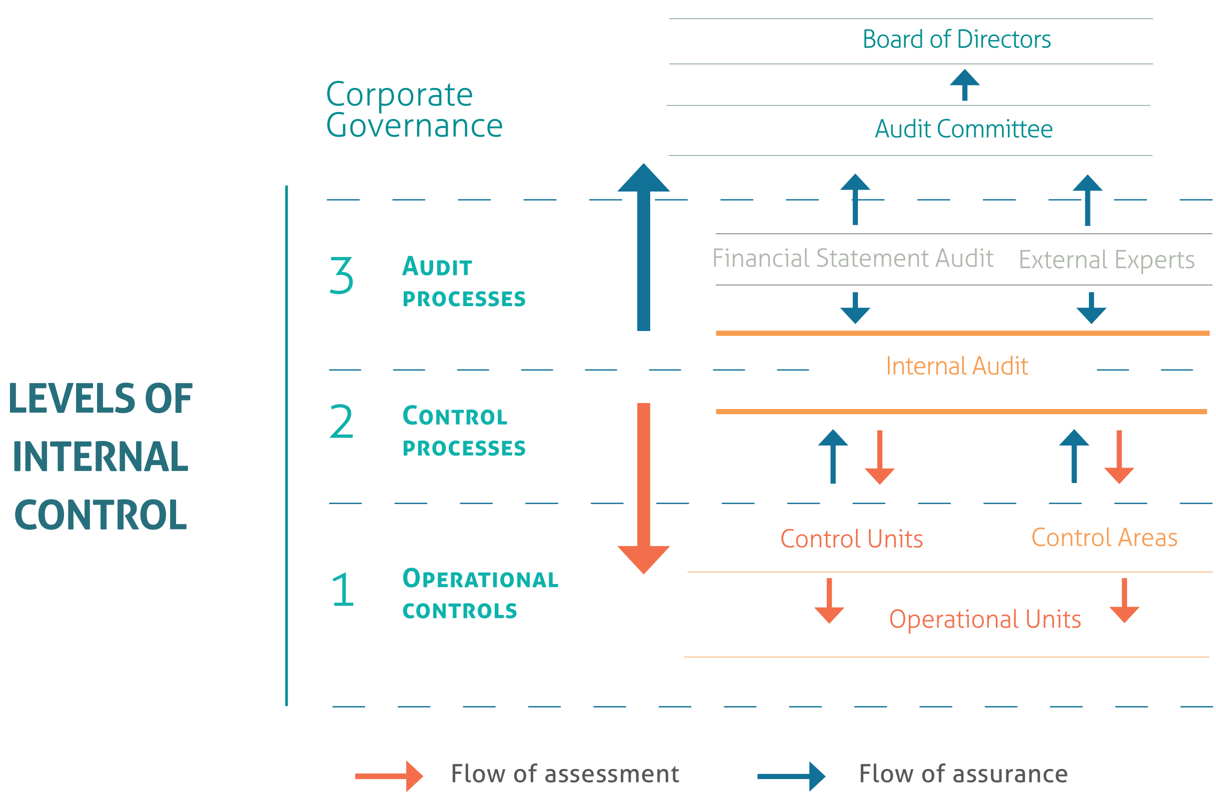
- **Risks relating to the reliability of financial reporting**

OVER STRATEGIC

- Strategy design risks
- Development and implementation risks
- Technology risks (Strategic)
- Reputational risks

Sareb seeks to create a corporate assurance system in order to facilitate ongoing assessment of the effectiveness of the internal controls that operate in the processes taking place at Sareb and its servicers.

Corporate Assurance System



In November 2016, the Policy on Reports and Recommendations Linked to Internal Audits was approved, which seeks to communicate the general framework of the report management process of Internal Audits and the related recommendations, including both for the audits at Sareb and for those done by servicers on the company assets.

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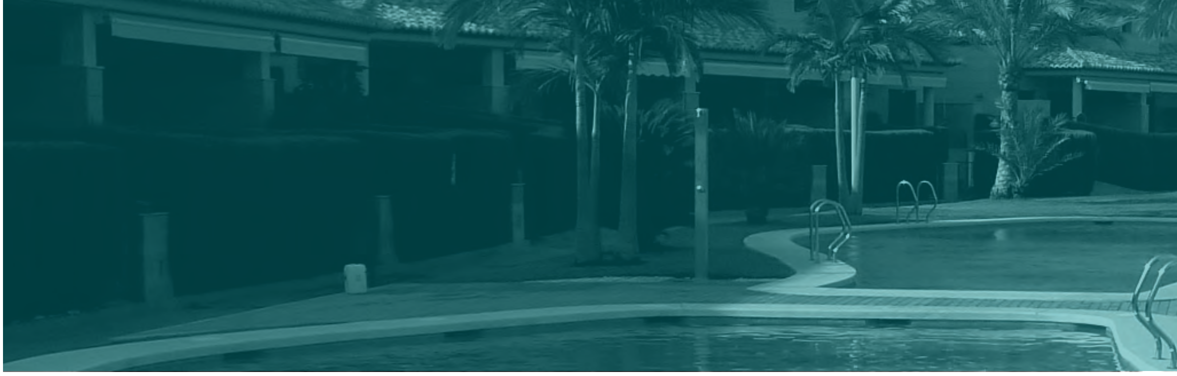
3

OUR MODEL



3.1 Business Model

Sareb's business model is determined by the nature of its mission, the management and liquidation of the assets received, maximising their value before the end of 2027. Thus, it maintains the particular features of an asset management company with a finite duration under the conditions and principles set forth in Law 9/2012 (RD 1559/2012 of 15 November).

Basic characteristics of the Sareb business model:

- Business mission established and product determined by Law.
- Private company with a private (54.1%) and public (45.9%) shareholder structure.
- Finite company.
- Higher gearing ratios.
- 2 business activities: management and sales.
- 2 types of products: loans to developers and properties (residential, tertiary and land plot).
- Extended enterprise: its functions are performed externally based on a common interest.

EXTENDED ENTERPRISE

The decision to opt for a model based on the externalised management and sale of its assets is due to the temporary nature of the project. This model of an "extended enterprise" consists of a structure in which the entities that participate in it share a common economic interest.

To carry out its mission, Sareb has a broad network of suppliers[1] including four servicers –Altamira Asset Management, Haya Real Estate, Servihabitat and Solvia– that act as a management/commercial network for the company.

WHAT DO THEY MANAGE?

Sareb's main activity consists of the active and efficient management of a received portfolio. On the one hand, it involves maximising the recovery or sale of outstanding debt with more than 15,000 developers/debtors, and on the other, managing and selling property (residential, land plot and tertiary) that it has received.

In addition, and based on the quality-price of the assets it has received, it needs to find formulas to increase the value of its portfolio. It achieves this, for example, through profitable property development proposals in collaboration with the sector and completing half-finished work that it received. Its loan divestment strategy encourages, for example, finding profitable business proposals for both parties (creditor and debtor), such as the Sales Growth Plans (PDV)2, that involve collaboration with debtors, the majority of which are SME's.

WHO ARE ITS CLIENTS?

The majority of Sareb's business is done in the retail channel through its four servicers. In late 2016, 88% of its revenue came from transactions made with individuals and SME's, while the rest derived from operations with institutional clients.

WHAT IS THE CORNERSTONE OF THE MANAGEMENT?

Sareb's portfolio is in continuous transformation, due to the change from financial assets (loans) to property assets, which is the result of dations in payment or foreclosures that allow transforming a less liquid asset into a property, which is easier to sell on the market.

Many times, the transformation is interrupted when the sale of the loan or repayment of existing debt occurs. The active management of the balance sheet is contributing to increase the volume of assets available for sale.

Of course, this balance sheet management strategy is oriented toward complying with the priorities

1 See Chapter 3.2. 2 Through PDVs, Sareb reaches agreements with its debtors to sell the secured loans from the developer's balance sheet.

marked by the Business Plan, either through sale of a specific type of assets or managing the times to transform assets with a high commercial interest. These functions require intense collaboration with servicers, as well as Sareb's different management and control areas.

From the point of view of active loan management, there are four main actions Sareb carries out through its managers:

- Collecting interests on loans current in their payments.
- Redemption and repayment of loans by the debtor.
- Sale and repayment of the loan.
- Initiating actions to liquidate the collaterals or securities, as is the case with PDVs.

When a dation or judicial foreclosure process occurs, the properties that appeared as securities for the recalled loans become part of the property asset portfolio and are added to those initially received by the company.

With the transformation process, the properties securing the loans become part of the portfolio of property assets

In this regard, they enter a preparation process for marketing and sale, or to be integrated, for example, into projects that create value related to property and rental development, both on the market and in the company.

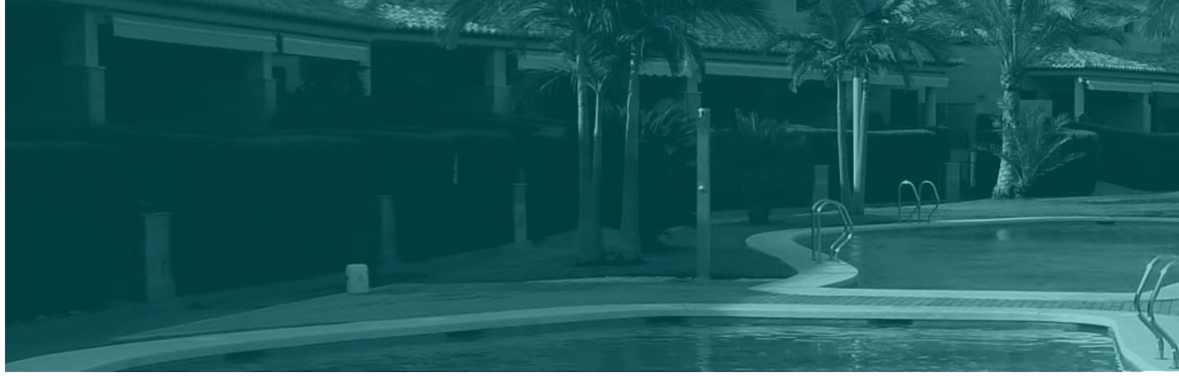
THE TRANSFORMATION PROCESS

Sareb pilots the conversion process of the unpaid loans on sellable properties, which involves carrying out three basic activities

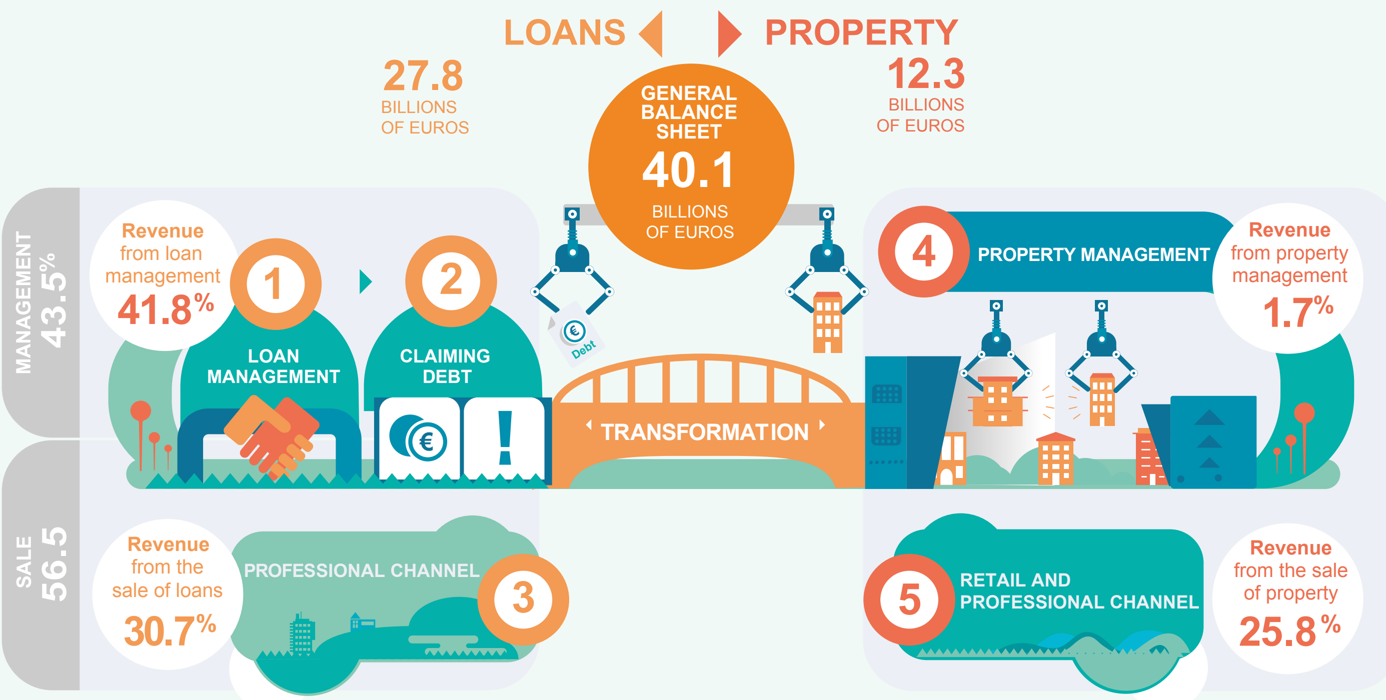
1. Going to court when there is no collaboration by the debtor.
2. As a last resource for the debtor, recover the debt by acquiring the property to later be sold to the public.
3. Post the properties for sale.

To carry out this strategy, it is important to take into account several conditions. One of them is the importance that the legal action and business actions are coordinated, also being aware that it is preferable to collect the loan in cash than go to court to foreclose the property. Likewise, in this process of transforming the portfolio, Sareb must combine the short-term vision –which seeks pure fulfilment of the budgetary objective– with the long-term vision, which takes into account the strategic lines marked in the Business Plan.

The transformation process involves asset to asset monitoring, analysing the phases the loan goes through from the start of the judicial claim until its total conversion into a property. The Transformation and Balance Sheet Management teams actively participate in this process, which coordinate the different actors, legal matters, network managers and servicers. It is complex teamwork that works under three premises: impetus, coordination and monitoring.



BUSINESS MODEL



1. **LOAN MANAGEMENT:** Active loan management is focussed on actions related to redemptions and repayments, liquidation of secured property through formulas like Sales Growth Plans (PDV's), in addition to collecting interest.

2. **CLAIMING DEBT:** Defaulted debt results in a formal claim, which starts a judicial process. This is one of the ways to transform loans into properties.

3. **LOAN SALE AND REPAYMENT:** Sareb actively works with its debtors-promoters to repay debt directly or through related third parties, in addition to investors for their sale to unrelated third parties.

4. **PROPERTY MANAGEMENT:** The active maintenance of the portfolio, writedowns and administrative management, in addition to generating value through rent and property development.

5. **SALE OF PROPERTIES:** The company fulfils its divestment mandate through an attractive offer of homes, tertiary assets and land plots sent both to professionals and retailers.

3.2 Organisational structure

The importance of the role of servicers in Sareb's business model has meant that the company has adapted its organisational structure to this model, in line with its vision of an extended enterprise.

In the first half of the year, two general sub-directorates were created (the General Sub-directorate of Finance, Strategy and Management Control and the General Sub-directorate of Resources) to enhance operations with asset

managers, in addition to efficiency in the new accounting framework. These new general sub-directorates complement the general directorates of Business, Control and Risks. Orienting the entire organisation toward business is guaranteed by the Products and Services area, which defines management strategies and the network where the four servicers are integrated.

In addition, since early 2016, Sareb has placed more emphasis on the 'Sareb-servicer offices', managed by the Business and Operations managers, which channel and prioritise tasks to gain efficiency.

General Sub-directorate of Finances, Management Strategy and Control | General Business Directorate | General Control and Risk Directorate | General Resources Sub-directorate

PRODUCTS AND SERVICES:
PL MANAGEMENT
NPL MANAGEMENT
SALES MANAGEMENT
RENT MANAGEMENT
VALUE CREATION

SAREB-SERVICER OFFICE NETWORK

Servicers

RSC | Internal Audit | Communication | Property Management | Investor relations

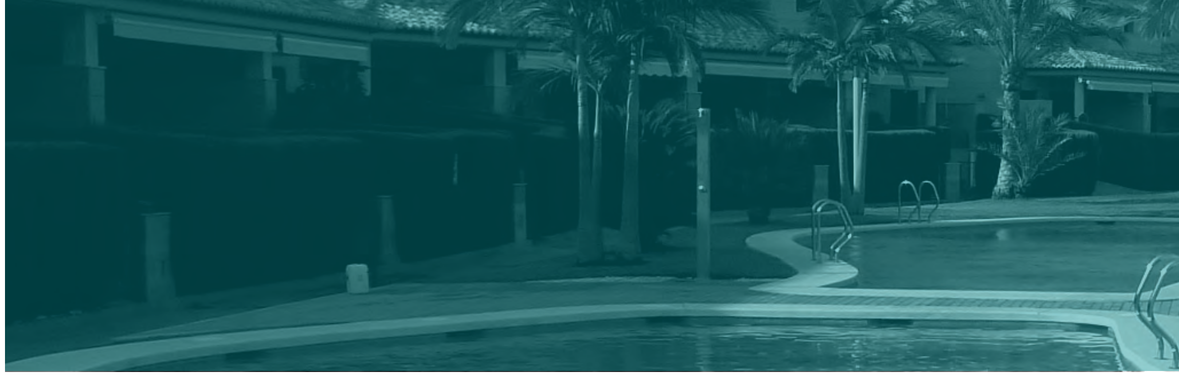
3.2.1 Servicers

Altamira Asset Management, Haya Real Estate, Servihabitat and Solvia are the Sareb suppliers for management, administration and asset-selling services. These professional property management platforms were those awarded in the tender called 'Ibero' that concluded in late 2014 and enabled Sareb –under the principles of competition, transparency and best practices– to choose who their managers would be. In this way, the servicers under the management, support and control of Sareb replaced the Spanish Government-backed institutions (transferors) in a commercial and management task that was initially assigned to them temporarily.

Valid for between five and seven years, the servicing contracts awarded the management of 177,000 assets, between properties and loans. Next, it was necessary to carry out a process of technological migration—complex and unprecedented in Spain—between the former transferor entities and the servicers, which was executed between February 2015 and April 2016.

After concluding the migration process, they were assigned to manage the asset portfolio, according to the following breakdown:

- **Altamira Asset Management** was awarded the complete portfolios of Catalunya Caixa, BMN and Caja3.
- **Haya Real Estate** received the loans linked to the property sector originally from Bankia and subsequently acquired by Sareb.



SAREB-SERVICER COMMUNICATION CHANNELS

The correct management of a company's assets makes it necessary to have a communication model between Sareb and its four external managers, which provides transparency and efficiency. In this regard, the main objectives were:

- Guaranteeing the availability of information.
- Homogenising the execution of operations, taking into account the unique features and knowhow of each one of the four companies.
- Providing a digital documentation repository that supports the information about assets.
- Centralising the requests and needs of direct communication between the users.

With that in mind, a model was defined in which the servicers were necessarily integrated. The Sareb-Servicers Communication Model is based on three fundamentals:

1- Information System – Medea

- Information repository and centraliser. Designed to allow information to be sent between the different systems, establishing protocols of common communication.
- Ensures that the information exists and is correct, thus allowing the use of data, generation of information and supporting the rest of Sareb's applications from an informational point of view.

2- Asset Management System – Colabora

- Application that sets a series of standards in asset management and automating activities. Through it, operations related to each process are carried out.
- Its functions are twofold, given that it facilitates organising and ordering the service requests, by centralising the communication channels.

3- Document Management – Alexandria

- It has the objective of storing, structuring and administering the flow of documents of the assets, also allowing information to be recovered for any management phase of financial and property assets.

- **Servihabitat** absorbed the entire portfolios of Banco de Valencia, NovaGalicia Banco and Liberbank.
- **Solvia** was awarded the portfolios from Banco Gallego and Banco Ceiss, as well as the property assets from Bankia. The parameters of the portfolios of each servicer are those awarded at the end of 2015.

ONE OF THE SERVICERS' GOALS IS TO STRENGTHEN THE RETAIL MARKET; AN AREA THAT SAREB CONSIDERS STRATEGIC.

The agreements entered into with the new servicers include specific commitments to make the sales activity more dynamic, manage the land on a more hands-on basis and boost the retail market, an area considered strategic by Sareb. In addition, the framework of action also requires more intense management of the loans, more direct contact with the property developers that hold the loans with Sareb, and specifically, swifter proposal processing.

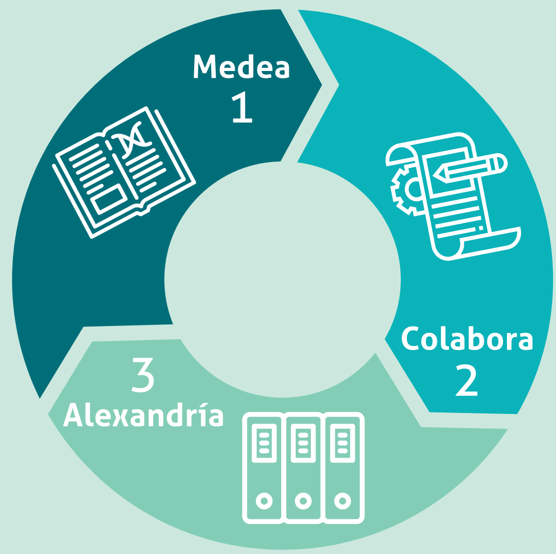
From the operational point of view, servicers' activity provides key management indicators, called a Service Level Agreement (SLA). In 2016, along with its four servicers, Sareb undertook the calibration process of those SLA, which provided measurement values with the objective of adapting them to the reality of the evidence obtained in the measurements.

- It also seeks to establish document management policies, standardising the criteria and guaranteeing the availability of all necessary documentation.

With different functions, the three axes are complementary and are fed back from others in order to guarantee the correct achievement of activities that make up managing Sareb's portfolio of loans and properties.

Communication between Sareb and the servicers is vitally important. Thus, they have different channels and systems that guarantee the efficiency and transparency of their activities.

In this way, the integration of the servicers is not done independently in the three systems, but globally and coordinated, adapted to each one of their needs.



Throughout 2017, the four servicers in charge of managing the assets are expected to be completely integrated into the systems and applications that make up this communication model.

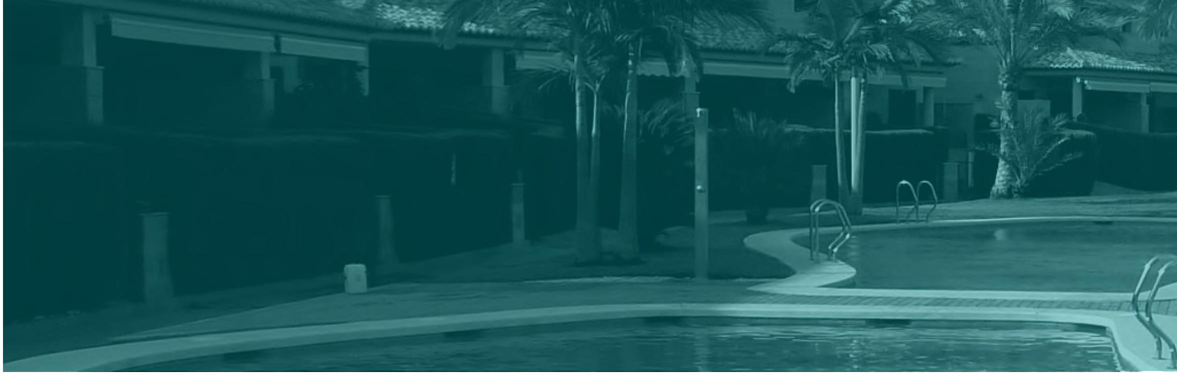
At the same time, Sareb has worked along with the four servicers to identify and implement the lines of action necessary for improving the service received.

3.3 Innovation capacity

In its four years of activity, Sareb has demonstrated that it is a catalyst and revitaliser of professionalism and innovation in the Spanish property sector. There are important references of asset management companies (AMCs) internationally, but the creation of such a company in Spain is unprecedented. Sareb is innovating with its action in the following areas:

- **Servicing:** Sareb's business model enables it to establish new professional agents in the Spanish property market, such as servicing platforms that offer financial and property administration and management services.

- **Retail management of financial assets:** The need to look for business viability for Sareb's debtor



companies has involved launching very profitable initiatives, such as the Sales Growth Plans (PDVs).

- **Institutional sale of debt:** Sareb works to actively search for new ways to market and sell its debt portfolio, a product aimed at a professional audience. In late 2016, the company has been working to develop a new loan platform that allows providing the market access to its offering, and thus streamline its sales. The project involves creating a display of Non-Performing Loans (NPLs) that is accessible to selected investors and contains the information needed to make decisions.

- **Property development and value creation:** The resumption of halted property projects and launching new value-creating proposals, such as developing land plots, has enabled Sareb to design new co-financing and receive formulas that push forward renewed strategies in the sector.

- **Development of innovative management tools:** The use of information from the Sareb portfolio, enhanced by other external data and more than 1.2 million references around the world, has enabled the company to develop innovative tools aimed at the complete management of properties, loans and debts.

A notable example of these tools is Atlas, a platform that allows completely evaluating loans and properties, and represents a valuable source of information about the behaviour of the property market. It allows crossing market data with socio-economic indicators (population, rent…) and is capable of creating maps for risk analysis, valuations and other market information.

3.4 International reference

Currently, several European countries, like Italy and Portugal, are trying to promote and implement asset management companies that alleviate the load on some of their crisis institutions and restructure their respective financial systems. Sareb is serving as a clear reference for those projects.

In the recent history of the European economy, we can find companies with functions similar to Sareb that have successfully carried out or continue to carry out their mandate, such as Sweden, Denmark, Germany, Switzerland, Slovenia and Ireland.

In reports[3] from 2016 about the reforms and restructuring that the Spanish financial sector has undertaken, the European Committee has mentioned the important role that Sareb has played in resolving the crisis that the Spanish banking industry suffered at the beginning of the decade. "Sareb (…) has played an important role in the recovery of the Spanish financial sector". For the European Committee, Sareb was created "efficiently", and its "fast start" was important in being able to remove doubts that once existed about the Spanish financial sector.

In previous references from 2015[4], the International Monetary Fund (IMF) highlighted Sareb's role as a catalyst in developing a secondary national market of damaged assets. "Sareb's experience is worth learning from… The announcement of the initiative was a trigger for other banks […] to adjust the value of their assets and start to sell their non-performing loans".

In addition, in their reports this year, the Committee assessed the appropriate choice of the asset group

[3] *Evaluation of the Financial Sector Assistance Programme. Spain 2012-2014 y What makes a good 'bad bank'? The Irish, Spanish and German Experience.* [4] *A strategy for resolving Europe's Problem Loans.*

SAREB, INTERNATIONAL REFERENCE 3

01 SWEDEN
Retriva and Securum
- Creation: 1992
- Perimeter: Property assets
- Nominal value: 5,800*

02 DENMARK
Financial Stability Company
- Creation: 2008
- Perimeter: Developer loan
- Nominal value: 2,280*

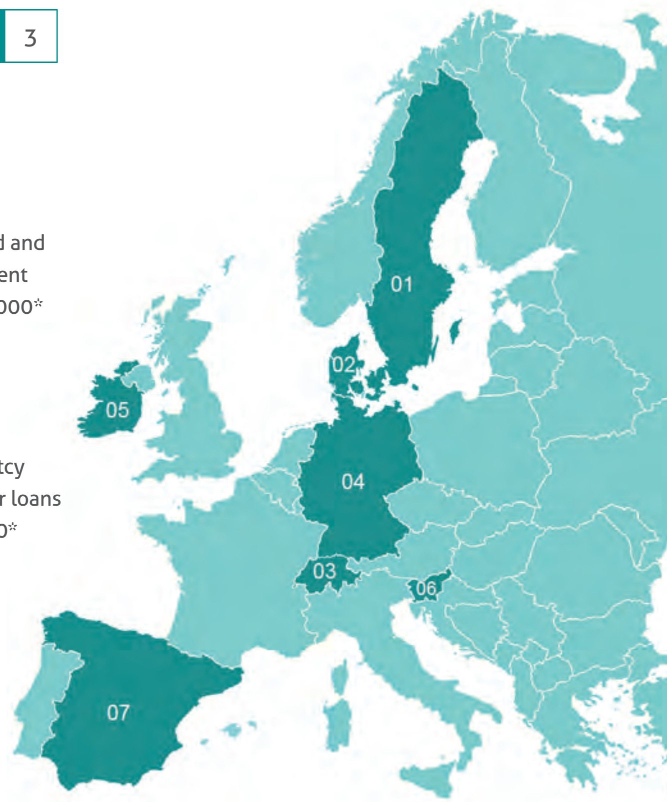
03 SWITZERLAND
SNB StabFun
- Creation: 2008
- Perimeter: Subprime mortgages, CREE and securitised loans
- Nominal value: 30,000*

04 GERMANY
FMS
- Creation: 2006
- Perimeter: All types
- Nominal value: Obj.: 70,000*

05 IRLEAND
NAMA
- Creation: 2009
- Perimeter: CRE, land and property development
- Nominal value: 74.000*

06 SLOVENIA
BAMC
- Creation: 2012
- Perimeter: Bankruptcy loans and developer loans
- Nominal value: 3.300*

07 SPAIN
Sareb
- Creation: 2012
- Perimeter: 80% Developer loans and 20% property assets
- Nominal value: 107.000*



*Millions of euros

transferred to Sareb –only those linked to the property sector, without including individuals' mortgages– because it allows a "reasonable balance between efficiency and financial stability".

In its comments from September, the European authority also indicated that the rate of asset divestment is progressing and is occurring along with the recovery of the Spanish property market.

> Sareb has become a reference among European asset management companies

Sareb

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

4

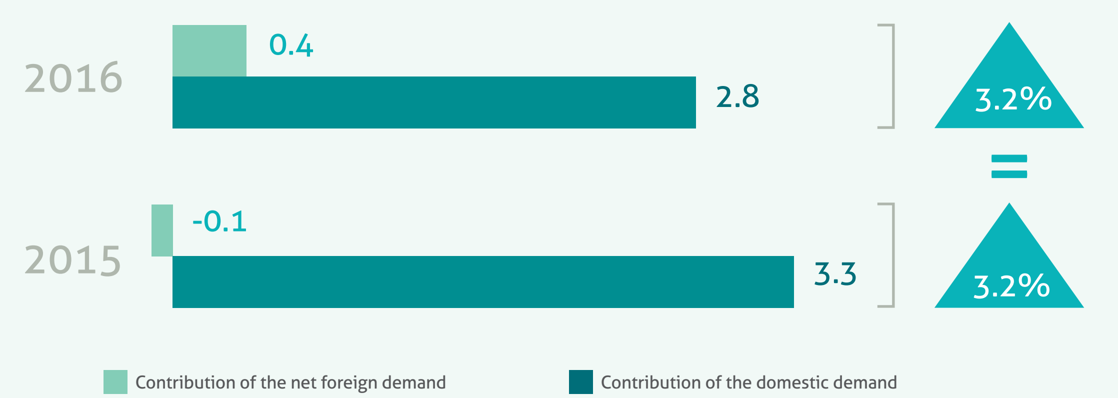
OUR ACTIVITY

4.1 Economic and industry context

4.1.1 Economic situation

The Spanish economy closed 2016 with an average GDP growth of 3.2%, with sustained growth rates of 0.8% in the first and second quarters and 0.7% in the third and fourth. Domestic consumption has contributed 2.8% to that growth, due to consumers' improved confidence in job creation and maintaining favourable financial conditions that allow access to financing. In addition, it shows an increase of the weight of foreign demand against previous years, although it is still vulnerable to economic policies in the current international context.

GDP GROWTH AND INTERNAL AND EXTERNAL CONTRIBUTION (%) 4



Source: Bank of Spain

Inflation experienced a turnaround in the second half of the year. A negative rate has been maintained since the second quarter of 2014, mainly due to decreased petroleum prices. However, in the last quarter of 2016, the negative percentages (-0.2%) changed to positive (1.6%). The main cause of this change was due to the increased price of petroleum, as a result of the agreement signed in November 2016 by OPEC, and increased gas and electricity prices. The other CPI components are less volatile and have seen more moderate variations in prices. In fact, the underlying inflation in December 2016 was 1.0% while the additional 0.6% corresponded to the increased prices of fuels and energy products.

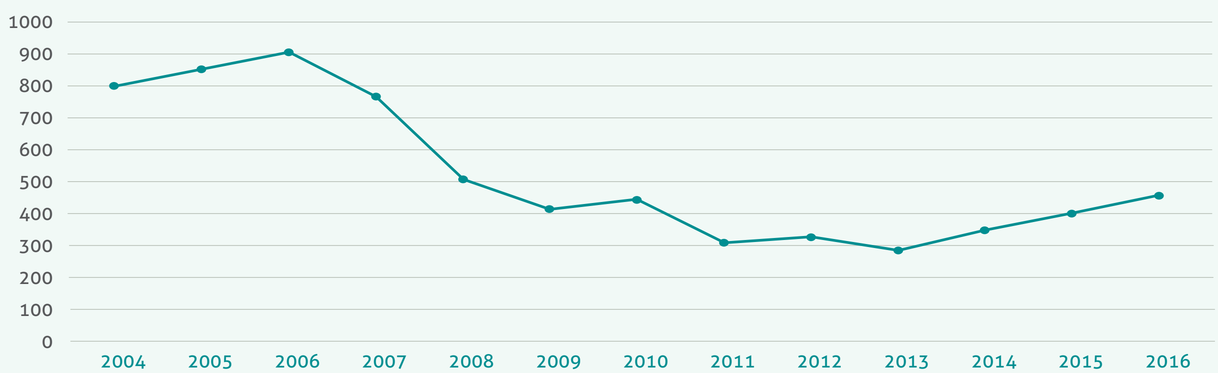
On the other hand, the labour market has continued to show signs of improvement. After the maximum unemployment rate of 26.0% was recorded in 2013, the average unemployment rate this year is 19.6%, six percentage points lower. The latest data observed set the year-end unemployment rate at 18.6%, 2.3 percentage points lower than in December 2015. As regards the number of unemployed people, it has dropped by 11.3%, with 542,000 fewer people unemployed.

4.1.2 Residential market

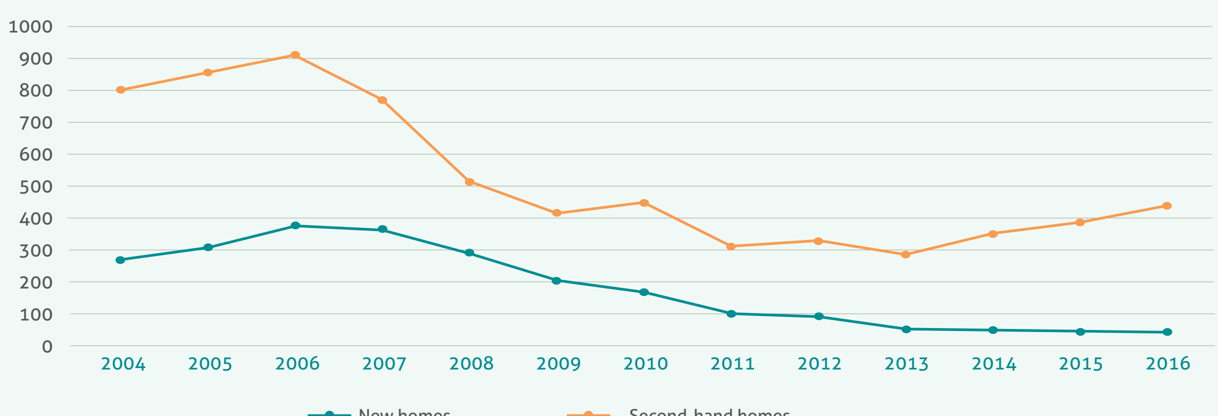
HOMES
CHANGE IN TRANSACTIONS

In recent years, the residential market has been strongly rebounding, and in 2016 reached a volume of transactions close to that of 2008, with a total of 457,689 homes sold, 13.9% more than in 2015. This market has grown more than 50% since the minimums in 2013 when 300,568 transactions were recorded.

UNSUBSIDISED HOUSING TRANSACTIONS - total in Spain (thousands of units) 5



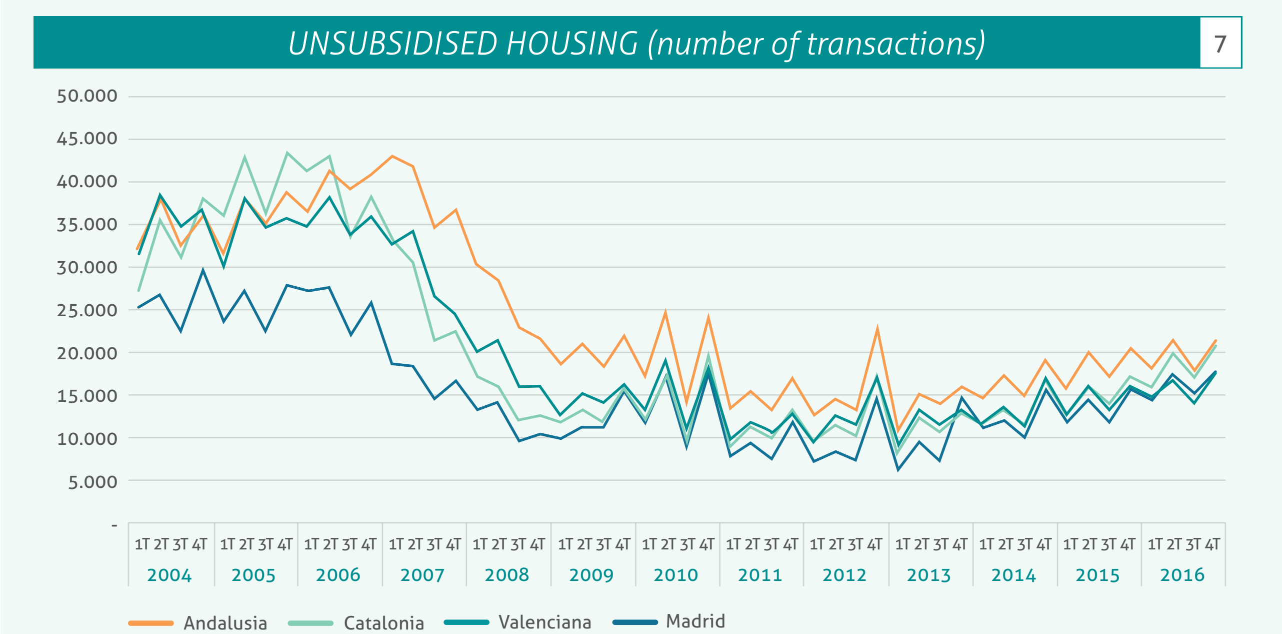
NEW AND SECOND-HAND HOUSING TRANSACTIONS (thousands of units) 6



Source: Ministry of Public Works

Despite the sustained growth in recent years, the sale of second-hand homes is notable, which has continued an upward trend since 2013.

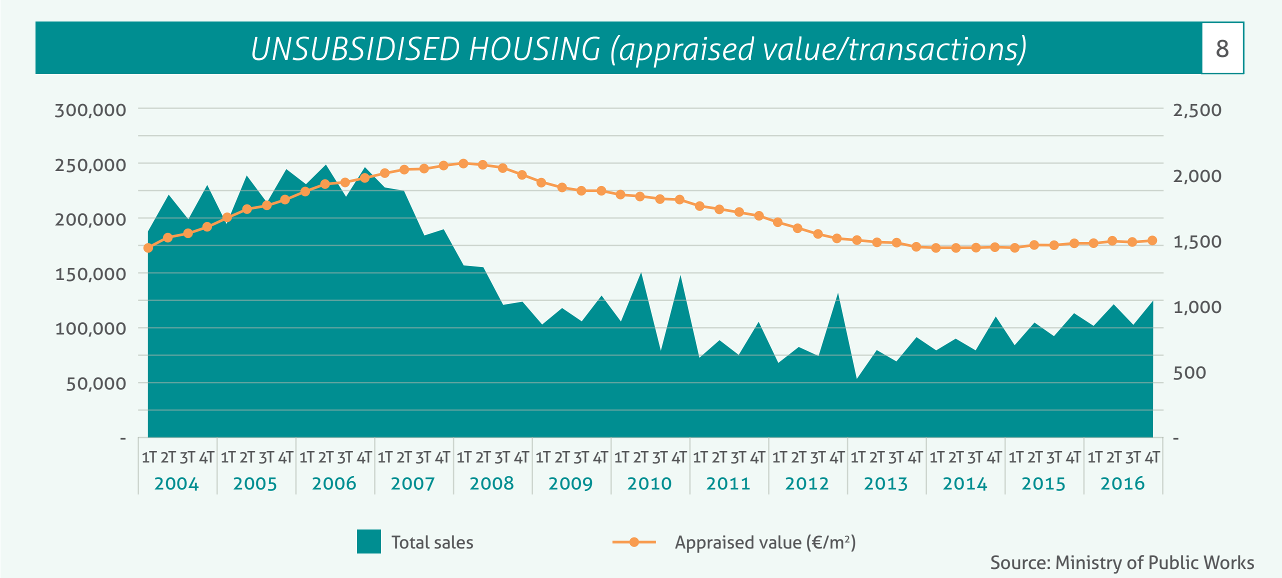
Andalusia, Catalonia, Valencia Community and Madrid have been the communities with the highest number of transactions, where 64.4% of homes sold in 2016 were concentrated. These four autonomous communities have experienced an average sales growth of 15.1% with respect to 2015. Catalonia is especially notable, with a growth of 23.1%, moving from 59,946 sales in 2015 to 73,814 in 2016.



Source: Ministry of Public Works

FLUCTUATION IN PRICES

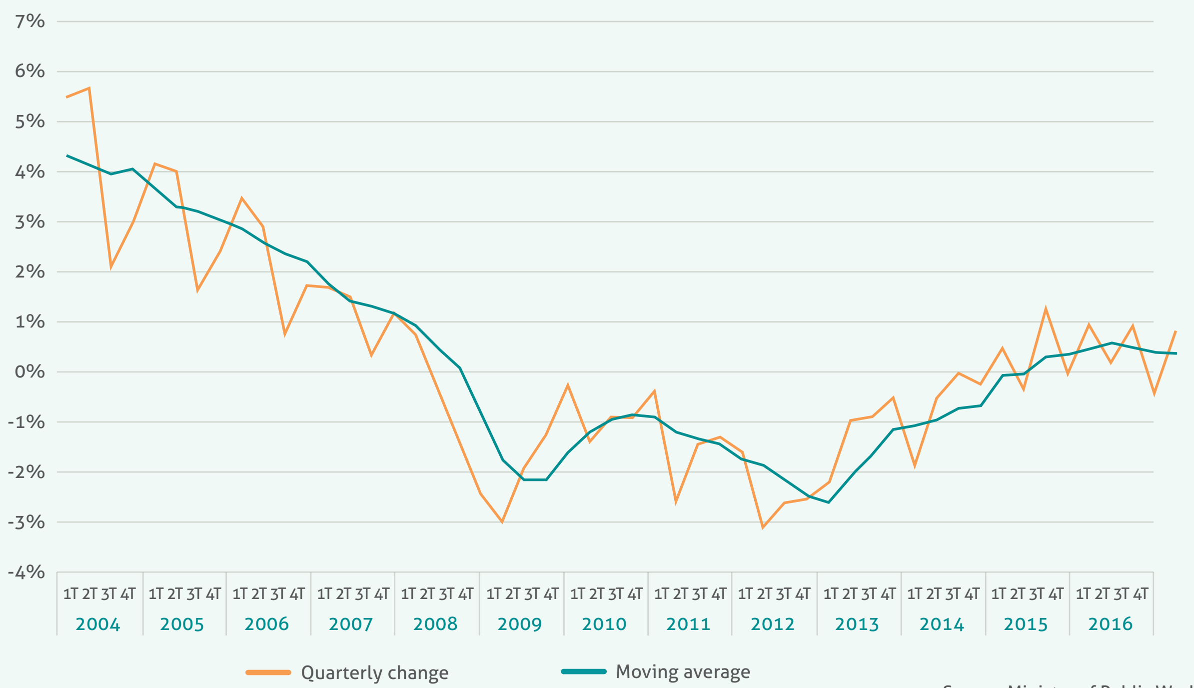
Despite the sustained increase of transactions in recent years, the value of properties sold in 2016 was maintained relatively stable and has recorded growth of 1.8% According to the data published by the Spanish Ministry of Public Works, the average value of homes reached their peak in the second quarter of 2008, with a value of 2,096 €/m², and their minimum in the third quarter of 2014 (1,456 €/m²). After that time, a trend started toward the recovery of average prices, which in 2016 reached 1,503 €/m².



Source: Ministry of Public Works

In the graphic, you can see the turnaround since 2012, and the positive quarterly changes in the last two years.

AVERAGE CHANGE IN THE VALUE OF UNSUBSIDISED HOUSING TRANSACTIONS - National 9



Source: Ministry of Public Works

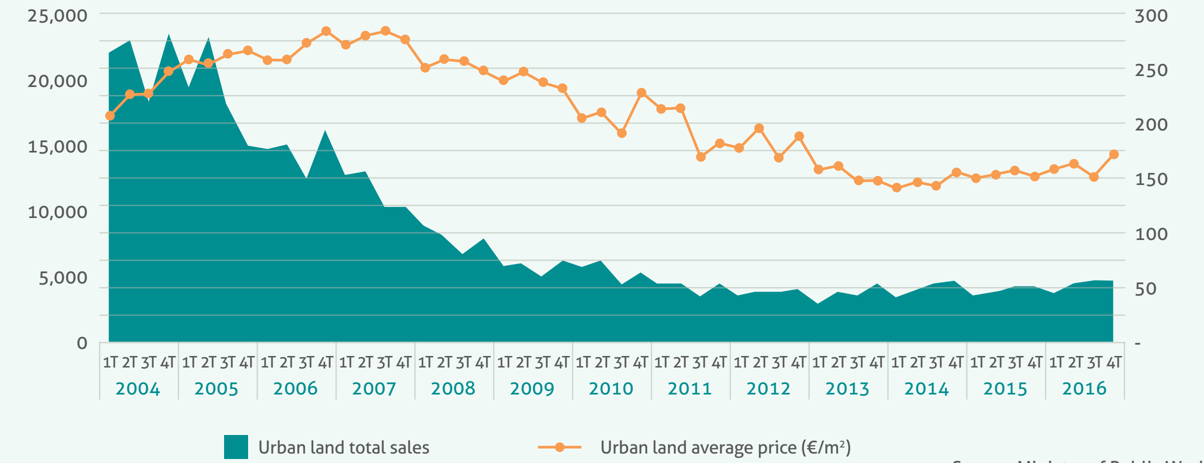
Even though the residential market has experienced a turnaround, it has not been geographically homogeneous. Of the four communities with the greatest volume of sales, Catalonia and Madrid experienced above-average price growths, with increases greater than 4.5%. However, Andalusia and Valencia remained stable.

LAND
CHANGE IN PRICES AND TRANSACTIONS

The land market has experienced a change similar to the residential market. In terms of prices, the turnaround has been taking place since 2015, where an average increase of 4.3% has been observed, reaching 153 €/m².

The number of land transactions in the last three years, has continued an upward trend. Throughout 2016, 10.7% more land was sold in the entire sector than in 2015, with a total of 17,396 units, a much higher figure than the minimums registered in 2012 and 2013, with 14,908 and 14,555, respectively.

URBAN LAND (price/transactions) 10

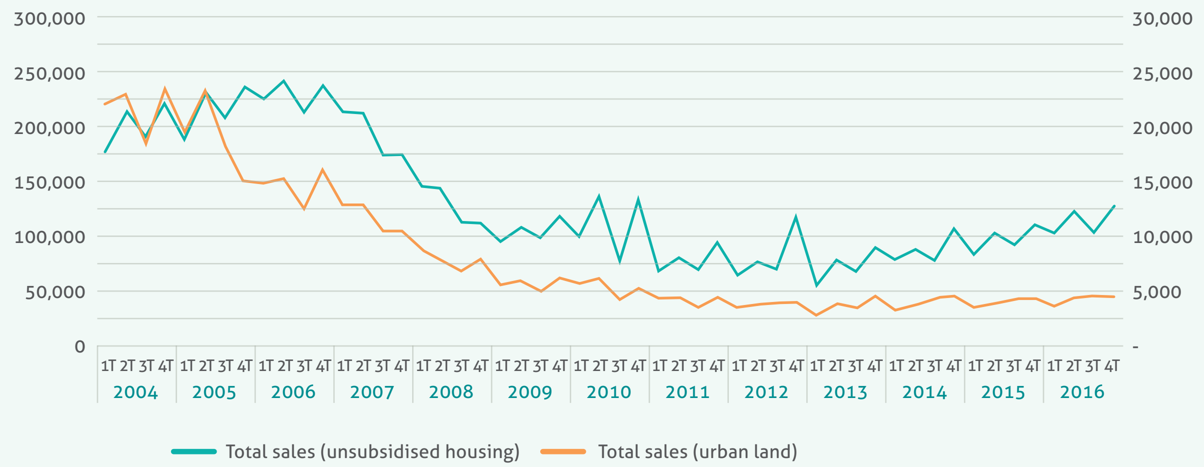


Source: Ministry of Public Works

As can be observed in the graphic, both the residential and land markets recorded minimums in 2013. However, the residential market has grown faster than the land market.

While the residential market has experienced an average increase of housing transactions of 60% with respect to the minimums, the land market has been 20%.

HOUSING TRANSACTIONS (No.) 11



Source: Ministry of Public Works

4.1.3 Non-residential market

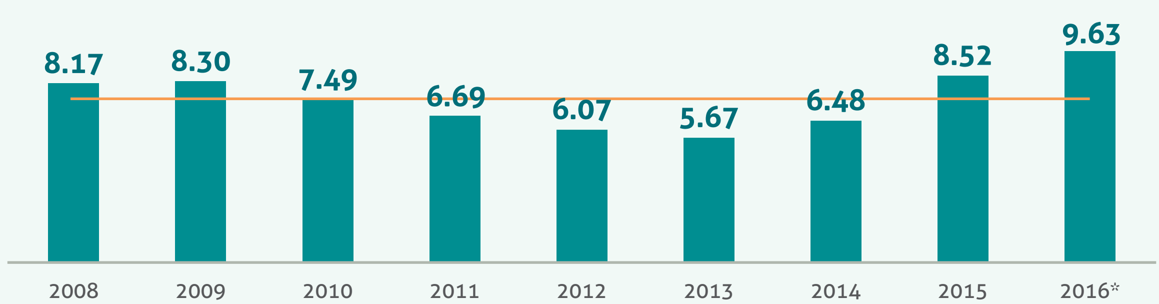
In general terms, the improved figures of the Spanish economy has benefited the results of the non-residential market, which mainly includes offices, industrial buildings, logistics, shopping centres, commercial premises and hotels. For analysing this section, the reports from the study departments of specialised consultants have been taken into consideration for each type of product.

OFFICE MARKET

The years of crisis caused a significant impact on this segment of the property market, which was at minimums in 2012. Since 2014, a slight recovery has started which continued to be consolidated in 2016. Although this slight dynamism has not reactivated the development activity in the segment, many property owners in city centres have tagged 2016 for the rehabilitation of their portfolio, improving the quality of stock, and favouring contracting levels along with it.

After reaching a minimum in 2013 (5.67 €/m²), the average monthly rent in Spain started to increase after 2015, until recovering to the 2008 levels (7.45 €/m²). This change has continued, and in 2016, the average rent exceeded 9.63 €/m², which represents 13.1% growth.

AVERAGE RENT OF OFFICES (€/m²/month) 12



* Estimates in 2016

Source: Spanish Real Estate Market Annual Statistics - RR de Acuña & Asociados

On the other hand, the capitals with the greatest volume of investment and rent transactions are in Madrid and Barcelona. The stock of offices in Madrid has not changed in the last year. The lack of quality product available is notable in the business district, which has caused demand to deviate toward the periphery due to the lack of spaces of this kind and due to the increased rent in this area. In Barcelona, contracts have been made in the city centre, but the stock is expected to be exhausted, and therefore, a deviation of part of the demand toward the periphery. Rents are continuing an upward trend, mainly in the prime areas.

While the services, insurance and technological company sectors have stood out as the main seekers of offices in 2016. As regards investment, this mainly comes from Spanish developers, institutional funds and insurers.

COMMERCIAL AND SHOPPING CENTRE MARKET

The retail sector continues to be attractive for investors and the number of transactions signed continues to increase even though the volume of investments has decreased in relation to 2015. Also notable is the change in the demand of the surface area size of the premises acquired.

In this regard, the average rent of commercial premises in Spain has been 10.03 €/m² per month from 2008 to 2016. In 2012, the lowest average rent recorded was 7.25 €/m², and it started to rebound until reaching 11.81 €/m² in 2016.

Specifically, the rents are trending upward in the 'high street' areas in the big cities. The highest rents are in Portal del Ángel (Barcelona) and Preciados (Madrid), which are classified among the 15 most exclusive streets in Europe. The secondary areas have greater turnover, more stable rents and greater demand from smaller operators. The main investors in the sector in 2016 were investment funds, Spanish Real Estate Investment Trusts ("SOCIMI", in Spanish), private investors and insurance companies.

On the other hand, the e-commerce trend continues to boom, and although it may represent competition for physical stores, synergies are being created between both. In fact, operators that were exclusively dedicated to e-commerce are opening their physical stores.

As regards the new format of demand, new openings of flagship stores are expected in the commercial areas of cities where the big brands are looking for representative stores with striking architecture and department stores to make their brand more visible.

The best financing conditions are accompanied by an increase in consumption and the consumer's growing confidence in the national economy, and thus, investment projects in shopping centres are more attractive. The development of these complexes is rejuvenating, and in 2016, a total of 250,000 m² was developed, of which 97% corresponds to new developments. The rest belongs to expansions of existing complexes.

AVERAGE RENT OF COMMERCIAL PREMISES (€/m²/month) 13

* Estimates in 2016

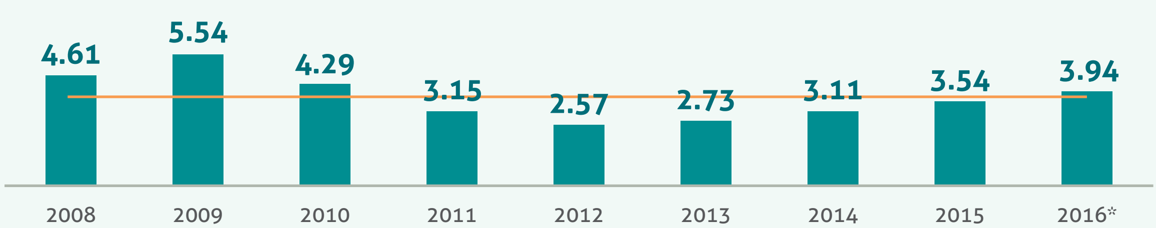
Source: Spanish Real Estate Market Annual Statistics - RR de Acuña & Asociados

INDUSTRIAL AND LOGISTICS MARKET

The industrial and logistics sector was badly punished during the years of crisis, mainly due to reduced production and consumption. With the improvement in national activity, this sector has been rebounding. In the last year, the contracting levels of logistical buildings have grown in the main cities, especially Barcelona with a growth of 34% and Madrid, with an average of 5%. This boom also entails reduced availability, which creates an investment opportunity for the main developers and funds.

From 2008 to 2016, the average rent of industrial buildings in Spain was 3.72 €/m²/month. Rents dropped until 2012, when they reached minimum levels of 2.57 €/m² and started to rebound until in 2016, rents reached 3.94 €/m², with a 11.3% increase.

AVERAGE RENT OF INDUSTRIAL BUILDINGS (€/m²/month) 14



* Estimates in 2016

Source: Spanish Real Estate Market Annual Statistics - RR de Acuña & Asociados

The new business models are generating new needs to adapt to the strong demand and scarcity of specific products, creating new attractiveness for national and international investors for their growth possibilities. Large platforms far from cities and urban platforms of smaller dimensions that allow efficiently satisfying the delivery and return of products are needed.

4.1.4 Outlook

The positive growth of the main socioeconomic parameters and optimistic predictions are inspiring national banks to participate in large property transactions that until now were focussed on retail clients.

The residential market is consolidating its growth, and next year this trend will grow. In addition, with the slight increase in prices, it is expected that in the coming years, new homes starts to be purchased due to the lack of stock, mainly in city centres. However, the weight of second-hand homes will continue being the most significant in the coming years.

In the office sector, the culmination of several rehabilitation projects stands out (Azca in Madrid, and the Central District in Barcelona). As regards the retail sector, it must be taken into account that the new sociodemographic scene of the coming decades, characterised by the ageing of society, is going to be a determining factor in demand. The new business and consumption models will require the tertiary sector to adapt to new technologies to offer new and better services, staying up to date with the needs of the digital consumer.

4.2 Portfolio performance

In 2016, the activity carried out by Sareb has allowed reducing the perimeter of the portfolio it manages by EUR 2,996 million. This means that since the start of its activity, Sareb has divested 21% of the assets it received, up to EUR 40,134 million.

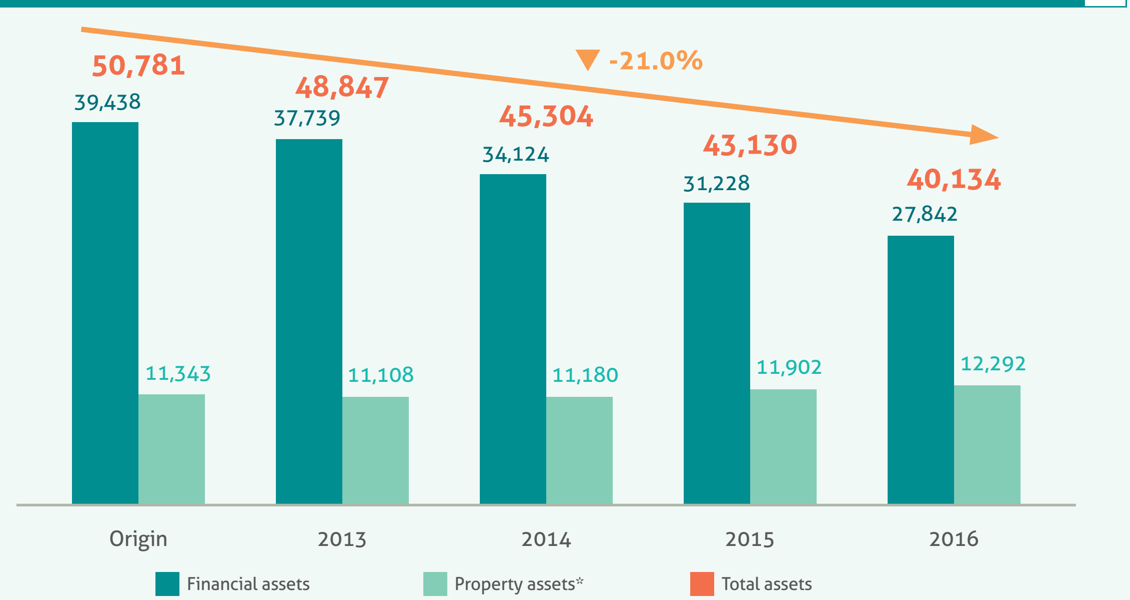
The activity in 2016 was marked by a closer collaboration with servicers, once the migration process of the portfolios was completed. With full control of the assets in the hands of these platforms, Sareb has been able to create specific management and sale strategies for each type of product, and therefore, develop specific initiatives of loan recovery, property asset sales, and new investments intended to increase the value of some properties.

In parallel, it has advanced in consolidating the business processes through providing tools that contribute to guaranteeing the budgetary compliance of each servicer.

The asset divestment process occurs mainly through the retail channel, which constitutes its means of management and divestment. In fact, in 2016, 88% of the total revenue –both the sale and management of properties and loans– came from this channel, in which the servicers' activity is fundamental.

For Sareb, this retail channel includes sales of collateral, the agreements reached for full repayment and sale of loans, retail sales and sales of singular assets, and rental income. The transactions at the end of the year were especially dynamic, when a high volume of loan repayments and sales were completed. Sareb's portfolio performance at the end of 2016 and the details are shown below:

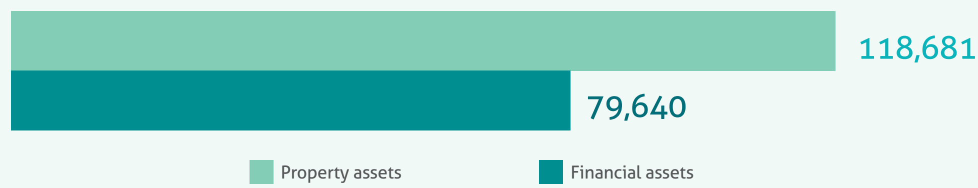
PORTFOLIO PERFORMANCE 15



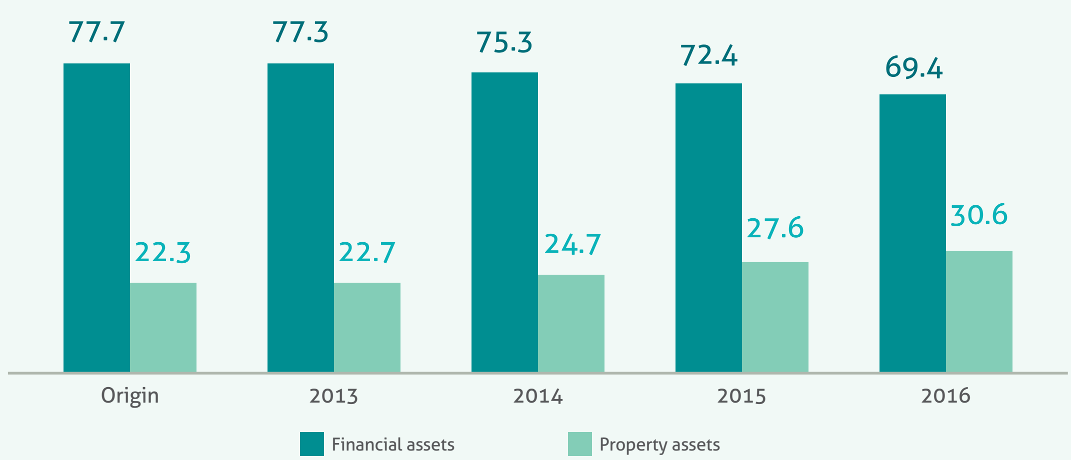
*The figures of property assets do not include their accumulated depreciation

*Millions of euros

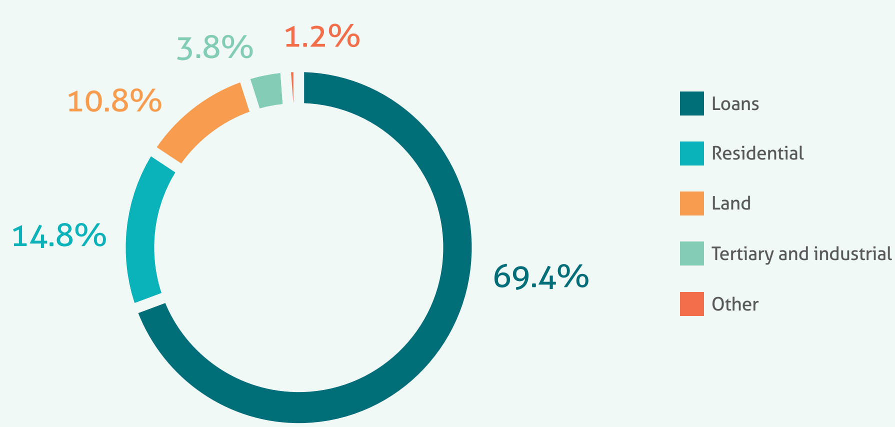
PORTFOLIO (no. of assets) 16



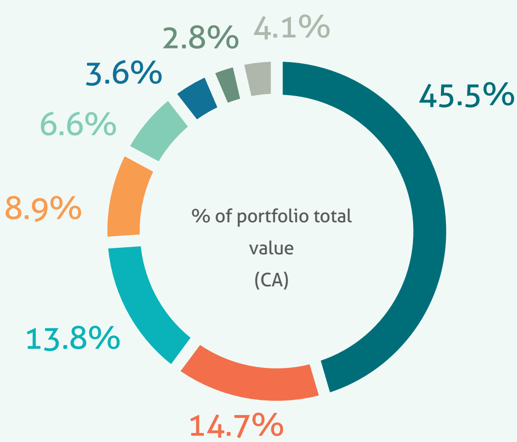
PORTFOLIO DETAIL (% of total portfolio value) 17



DETAIL BY TYPE OF ASSETS (% of total portfolio value) 18

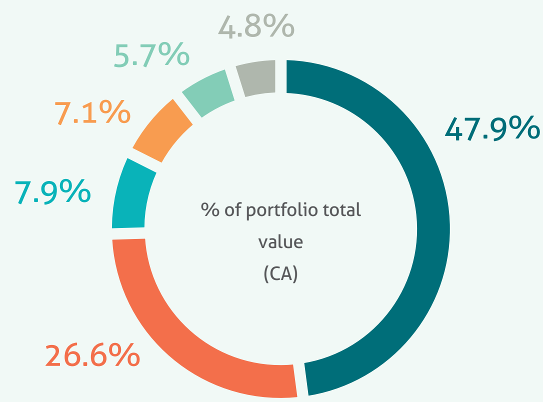


PROPERTY ASSETS BY TYPE 19



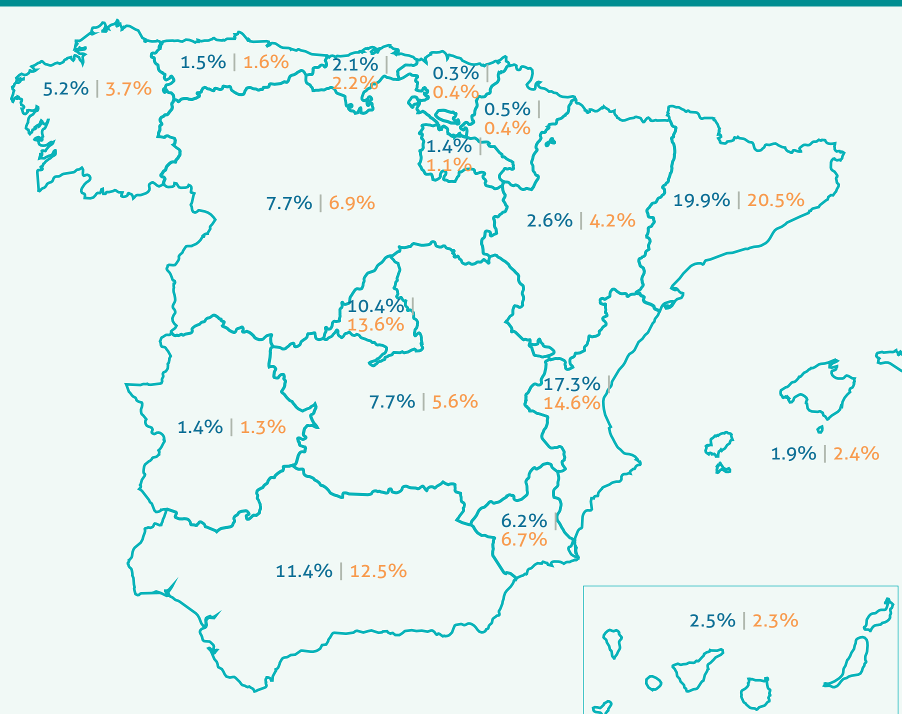
- Housing
- Land under development
- Land ready to build
- Tertiary
- Rural land plots
- Industrial
- Ancillary
- Others

FINANCIAL ASSETS BY TYPE OF SECURITY 20



- Residential
- Land
- Work in progress
- Commercial
- Unsecured
- Mixed collateral

PROPERTY ASSET PORTFOLIO 21

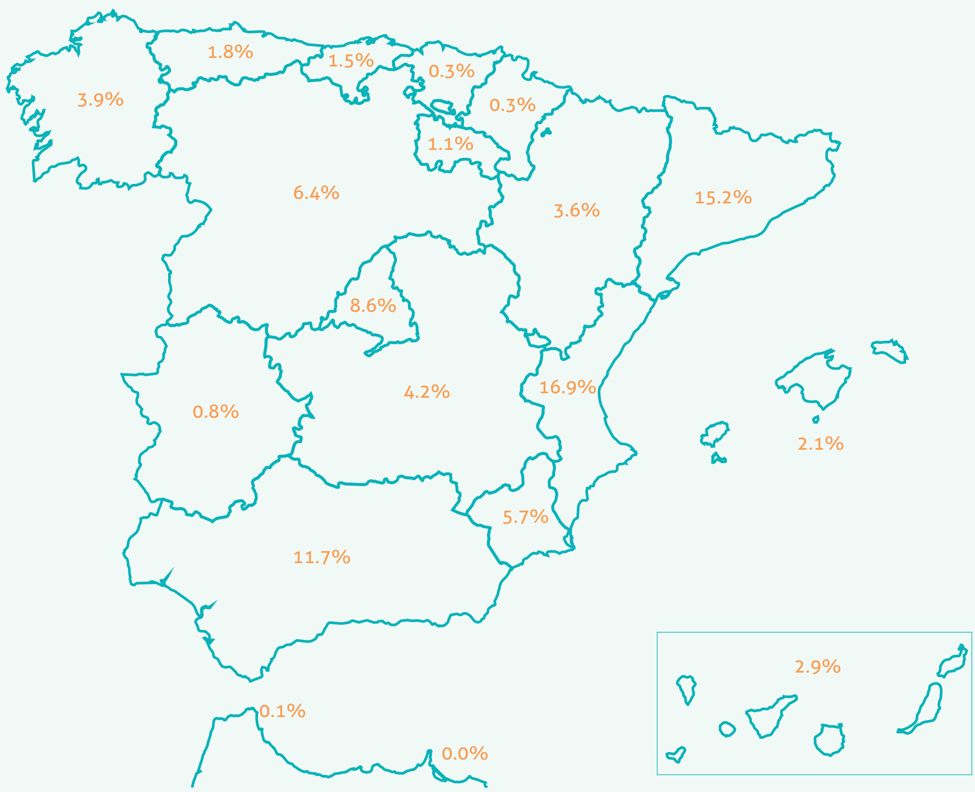


- % of units
- % of CA

CA: Carrying Amount
(*) Figures based on agreements until December 2015 are temporarily offset in a certain way on the accounting information.

PRIMARY BORROWER PORTFOLIO *
% of portfolio total value (based on debt)

22



* 13.1% of debt is not assigned to a specific autonomous community.

4.3 Management and sale of loans

Given that loans make up the largest part of Sareb's portfolio, nearly 70%, it is logical to think that they also concentrate the largest part of the company's activity and many of their efforts in the sale and management of this type of asset.

Financial assets reported EUR 2,843 million in revenue through the different lines of activity, which have been developed in direct collaboration with the servicer managers. In section 4.6 Financial information each one of the lines of revenue from loan management is broken down.

Among the main initiatives launched with the services, the following are most significant:

- **Loan settlement plans from the sale** of collaterals of all kinds, identified as being the most liquid due to location, at values that enable profit generation for Sareb.
- **Identification of borrowers with the best payment capacity** to focus recovery initiatives, both with the borrowers themselves and with guarantors of the transactions.
- **Loan marketing processes** in which negotiation and agreements for repayment did not succeed, and in which there are investors interested in acquiring Sareb's positions.
- **Loan revision plans** aimed at reviewing developer loans and collateral, with the aim of reaching agreements with borrowers for the settlement of their debts by selling the collateral at market conditions; They are called Sales Growth Plans (PDVs).

Loan management has been affected by changes in the accounting regulations (see section 4.6.3 Accounting regulation and fluctuation in equity), which has required Sareb to analyse and adapt the loan recovery strategies, with the objective of obtaining a better result.

In addition, it has worked to improve the efficiency of the internal processes, which has favoured a better rate of accepting proposals, shorter waiting time and increased success in formalisation, even though additional progress is expected in all areas.

One of the main advances has occurred in the portfolio segmentation, through indicators such as collaterals, the experience of collaboration with the borrowers and the progress of court or insolvency proceedings, which has facilitated the classification of the operations and assigning a more precise recovery strategy.
At the same time, this systematisation has allowed a more active management of all borrowers in a clear contrast with the management carried out in the past by transferor institutions, which was more focussed on large volume debtors.

As can be observed, the work model with the servicers ensures that all borrowers, regardless of the volume of debt, number of transactions and complexity of them, are allocated a manager who is responsible for managing each one of the debtors.

All managers are required to keep in regular contact with the debtors and to review the recovery strategy. This monitoring process gives rise to the proposals that the servicers present to Sareb and which enable recovery of the investment made. In 2016, more than 5,600 borrowers made proposals, which represents 37% of the total from all holders.

The detail of Sareb's portfolio shows the complexity in managing a volume of 15,200 debtors, which offers significant disparities due to the volume of debt and level of risk concentration. Specifically, 39% of borrowers have exposures lower than one million euros and there is a certain concentration in terms of debt, given that the 860 largest borrowers represent approximately 40% of the debt.

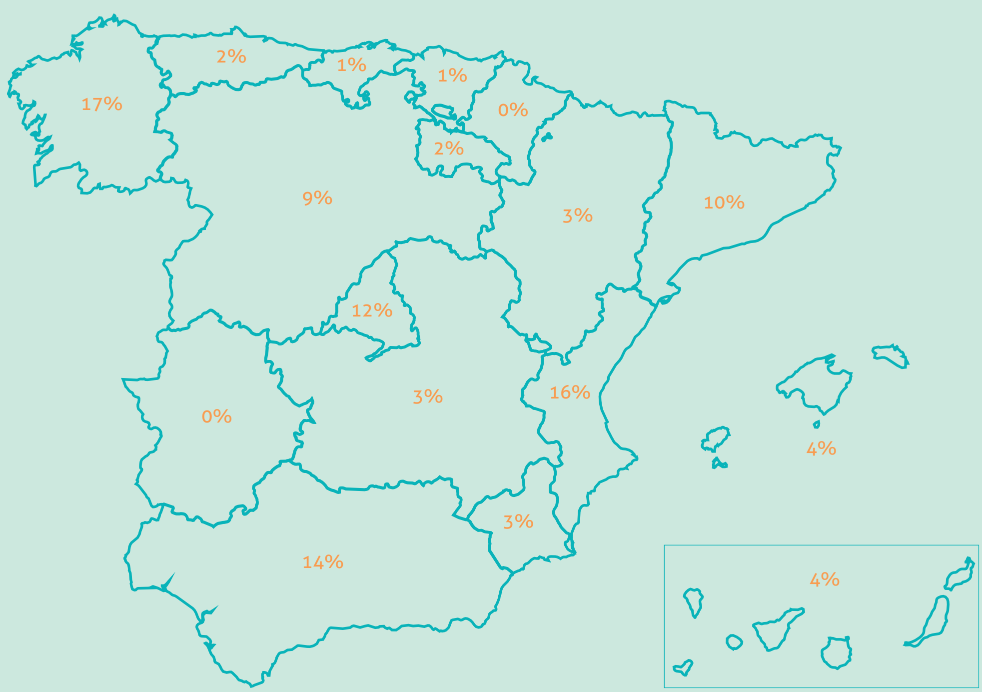
SALES GROWTH PLANS (PDVs)

The Sales Growth Plans (PDVs) are an important line of activity at Sareb, which facilitate the sale of properties that represent a security from the company's debtors. Of those, 80% belong to SMEs, which in these transactions see a satisfactory path to repay their debt.

In total, more than 1,100 transactions of this kind have been sanctioned, which represents 11% of the total.

With this strategy, Sareb sold a total of 5,729 properties directly from the balance sheet of their borrowers, both residential assets, as well as land and tertiary. These transactions (see geographical detail) provided revenue from sales of EUR 820 million.

PDV SALES (% of number of assets sold) 23



In terms of composition by amount of debt, 42% of loans have more than EUR 2 million of debt, and 39% have exposures less than EUR 1 million of debt. This disparity requires a greater systematisation and industrialisation of the management processes.

24

Debt range	% debt_range	%
Debt <= 0.5 M	3,128	20.6%
Debt > 0.5 M	2,755	18.1%
Debt > 1 M	2,848	18.7%
Debt > 2 M	6,470	426%
Total	**15,201**	**100%**

Percentile	No. of Borrowers
20%	483
40%	862
60%	2,101
80%	11,722
100%	15,168

25

The collateral and PDV liquidation transactions provided revenue of EUR 820 million

Sareb started 2016 with a portfolio of 80,710 loans worth EUR 31,228 million in total debt from 15,835 borrowers. The weight of the loans on the total portfolio was slightly above 74%, and has continued drop to just under 70% thanks to the liquidation process and foreclosure of assets or dation in payment.

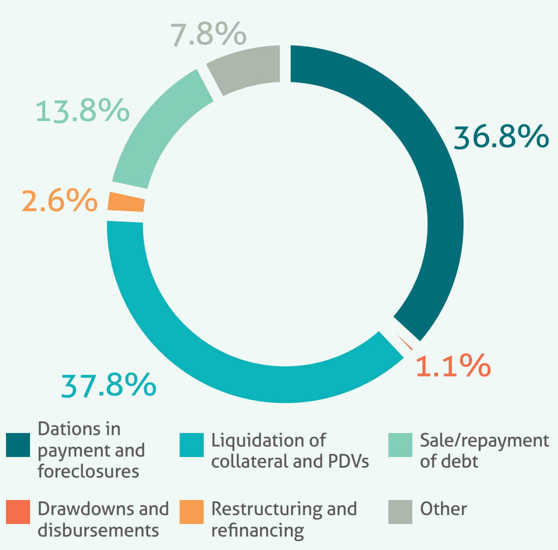
During this period, the pace has rebounded after a slight slowdown caused by the migration process and 10,500 proposals have been sanctioned. In numbers, the largest proportion of the proposals sanctioned that generate liquidity were collection procedures by means of the realisation of the collateral from the debtor's balance sheet, which may consist of completed developments, remains of developments or other 'singular' assets (land, commercial premises, offices). These initiatives included 3,970 proposals, around 38% of the total managed. Of these, the collateral liquidations increased to 2,870, 27% of the total, while the PDVs involved 1,100 transactions, 11% of the total.

These actions enabled Sareb to recover the value of the mortgaged collateral through the sale thereof without incurring the costs and time that could result from a mortgage foreclosure process, enabling the developer to maintain its activity, an on occasions, to contribute funds for recovery at the time of selling the properties or in the future when the company recognises the debt, which will be settled following the sale of the properties. These collateral and PDV liquidation transactions provided revenue of EUR 820 million.

Note should be made of the volume of proposals managed for the sale and repayment of debt, which reported revenue of more than EUR 730 million, and involved the management of some 1,450 procedures, nearly 14% of the total.

On other occasions, the agreements with the borrowers led to negotiating restructuring operations that can provide more value to Sareb than other strategies. This type of proposal, which is usually associated with large companies with more complex transaction and collateral types, over those that Sareb maintains interests with, numbered more than 270 in 2016.

NO. OF PROPOSALS BY TYPE (%) 26



1,450 procedures have been managed for the sale and repayment of debt, nearly 14% of the total

According to the new regulations, the adjustment of accounting values to those of recovering loans has allowed reconsidering transactions that were discarded in the past, due to the impossibility on Sareb's behalf of recovering their investment with the price they could obtain for the sale of assets that secured the loans. With that, and taking advantage of promoting the management of servicers, a collaboration strategy with debtors has been pushed forward to optimise tax costs and shorten recovery periods.

Finally, where collaboration with debtors to carry out the sale of assets was not possible, strategies are applied that allow taking them over through foreclosures, or in other cases, dations that do require said collaboration. This type of proposals represented 37% of the total, with more than 3,800 procedures managed.

These actions activate the portfolio transformation process, from the least liquid assets on Sareb's portfolio –loans– to those with the highest liquidity for sales –properties– (see Chapter 3.1 about the transformation process).

In any case, the start of a mortgage foreclosure process does not limit the search for other paths of recovering the investment.

In fact, on some occasions, agreements are also made with debtors, who search for new alternatives after starting the foreclosure. On other occasions, the sale of the loans is made directly to investors that are interested in owning the properties through the foreclosure process and value the reduction of the periods in processes already started.

4.3.1 The institutional channel

The greatest part of transactions made by Sareb in the institutional channel have corresponded to the sale of loans. Sales generated revenue of EUR 474 million, 90% of which was concentrated in the second half of the year. This evolution is a result, in part, of the average periods required to prepare, market and close portfolios with these characteristics. It is also due to the uncertainty of the British referendum process regarding Brexit, which delayed the interest of buyers in the first part of the year.

One of the main challenges in 2016 has been integrating this activity into the task being performed by servicers, searching for greater collaboration and efficiently coordinating the study of new transactions and search for investors.

In this year, a total of 19 transactions has been closed, mainly for the sale of debt and collaterals. Some of the most significant actions were the "Eloise Project", a portfolio of loans sold for EUR 260 million, and "Argent 1", which represented more than EUR 45 million of revenue.

Throughout 2016, the relationship with possible institutional buyers was intense. A total of 127 meetings were held with investors, 70% international, mainly from the United States, but residing in London or Madrid.

In addition, five roadshows were held in London, in which fifty meetings were organised and Sareb participated in 23 events and seminars, not just with institutional investors, but also with analysts and investment fund managers.

Institutional sales generated revenue of EUR 474 million, 90% of which was concentrated in the second half of the year

BANK ASSET FUNDS (FABS, in Spanish)

After selling all of its assets and later liquidating FAB 2013 Corona and FAB 2014 Crossover, Sareb is currently participating in three Bank Asset Funds: 49% of the FAB 2013 Bull, 15% of the FAB 2013 Teide, and 5% of the FAB 2014 May.

- FAB Bull: Created in 2013, has 1,687 assets (homes, premises, storage rooms and garages) distributed throughout Spain. At the end of 2016, there was a total of 156 assets available for sale in the fund (50 homes, 72 garages, 21 storage rooms and 13 premises), which means that 78% of the initial portfolio has already been sold for a total amount of EUR 99 million.
- FAB Teide: Since its creation in 2013, 2,225 units have been sold (1,023 homes, 786 garages, 394 storage rooms and 22 commercial premises), which represents EUR 151 million in sales. In addition, this FAB is developing two land plots in San Sebastián de los Reyes (Madrid) and in San Juan (Alicante), where it is expected to deliver homes in the first half of 2017.
- FAB May: Created in 2014, this fund has urban land plots located in Madrid, Barcelona, Alicante and the Balearic Islands. In 2016, it started to be marketed and has already closed the sale of one of the 17 land plots that make up the fund. Two more are expected to be closed in the first half of 2017.

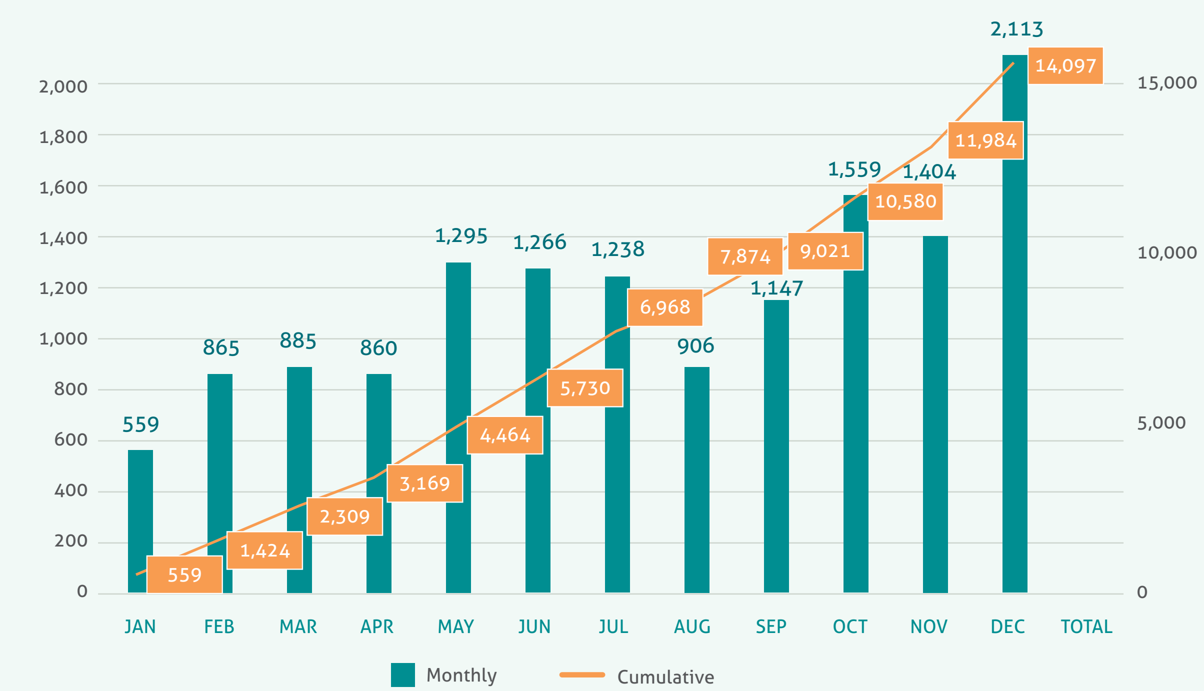
4.4 Property sales

Property asset sales represent an important part of Sareb's revenue. Last year, the company reported EUR 1,053 million, 26% of the total revenue.

There was a difference in the performance of the revenue from property transactions in two lines of action. On one hand, the sale of residential stock has performed positively with a substantial growth of revenue up to EUR 545 million. From these figures, it can be deduced that the property market recovery is gaining momentum.

On the other hand, the sales of non-residential stock and land plots have achieved similar results in 2015 with a volume of EUR 466 million. The figures[1] reflect that this economic activity is in a more gradual recovery due the uncertainty of the duration and intensity of the recovery of the sector, and the large investment impetus of last year should start to translate into more development and less new purchases.

PROPERTY ASSET SALES (No.) 27



[1] In addition, revenue from property assets include EUR 42 million from rent paid.

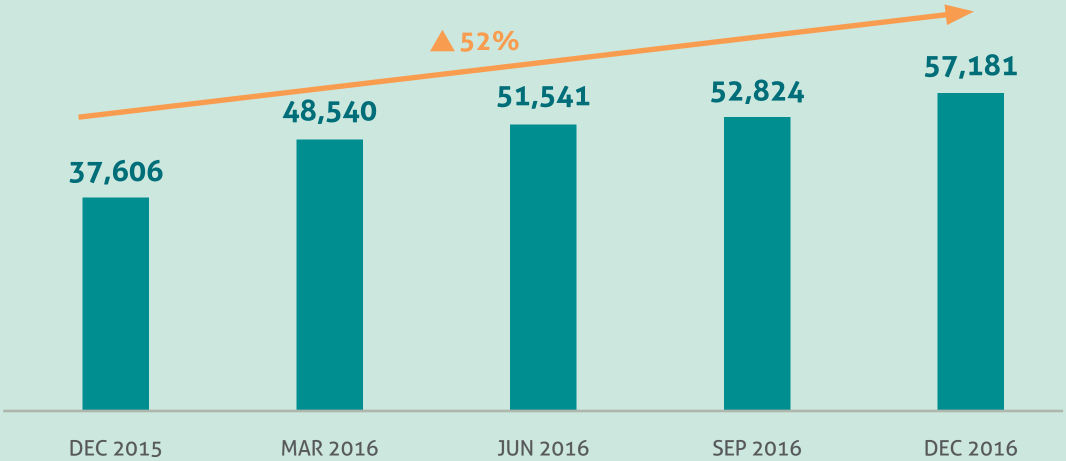
PROPERTIES UP FOR SALE

To carry out this divestment process efficiently, Sareb should work according to the product preparation process to start marketing, especially for property.

The efforts are directed toward streamlining these processes and increasing the number of assets posted on the corporate website of Sareb and its servicers, and on property websites.

Specifically, the company' properties up for sale reached 57,181 at the end of 2016, versus 37,606 at the end of 2015, which represents a 52% increase in one year.

ASSETS FOR SALE (millions of euros) 28



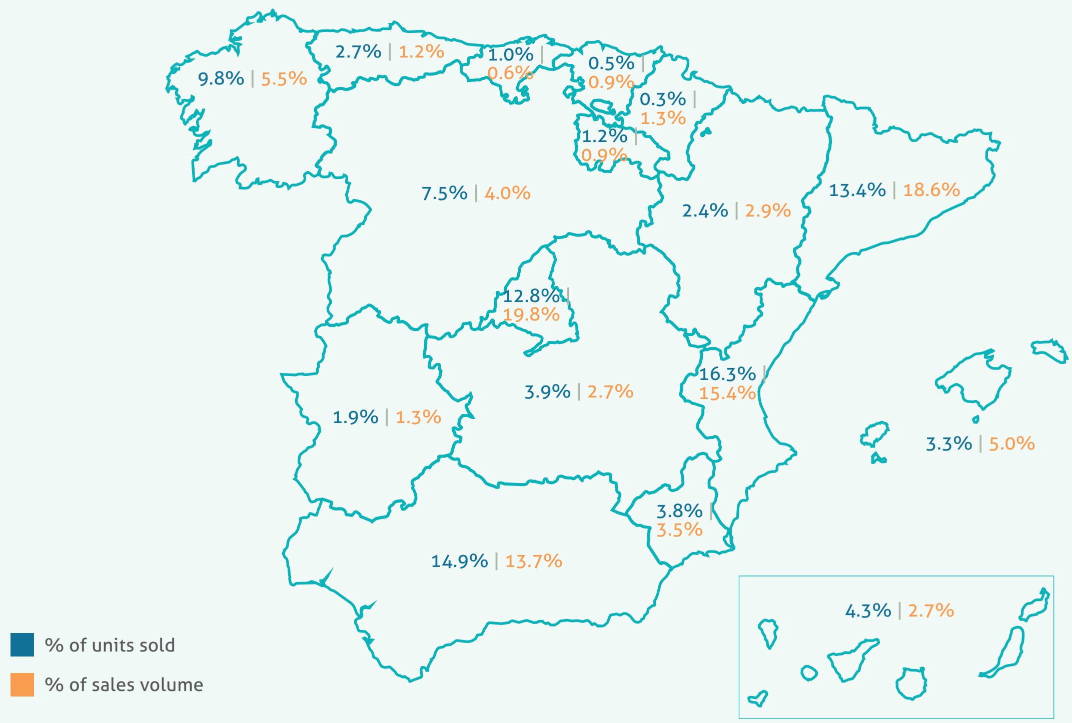
The 57,181 properties for sale represent 48% of Sareb's total portfolio of property assets.

During this year, the company has sold 14,097 properties –including homes, land plots and tertiary assets– which represents an increase of 25% with respect to 2015. Of those, 8,368 were properties owned by Sareb, while the other 5,729 corresponded to secured loans that developers transferred from their own balance sheets through bilateral agreements, such as Sales Growth Plans (PDVs).

The majority of revenue comes from residential assets (52%), which provided more than land plot sales (38%), which is different than what occurred in 2015.

SALE OF OWNED PROPERTIES BY TYPE 29		
	% of sales volume	% of units sold
RESIDENTIAL	52%	84%
LAND	38%	12%
TERTIARY	10%	4%

PROPERTY ASSET SALES 30



RESIDENTIAL

The sales of Sareb's residential units (homes, garages and outbuildings) grew 14.5% with respect to the previous year, supported by good economic growth, the growing action of Sareb's commercial managers, and the company's dynamism in launching commercial campaigns.

Throughout 2016, and taking into account the entire retail channel, Sareb was able to sell a total of 12,067 residential assets, which represent nearly 85% of the total properties sold in the year.

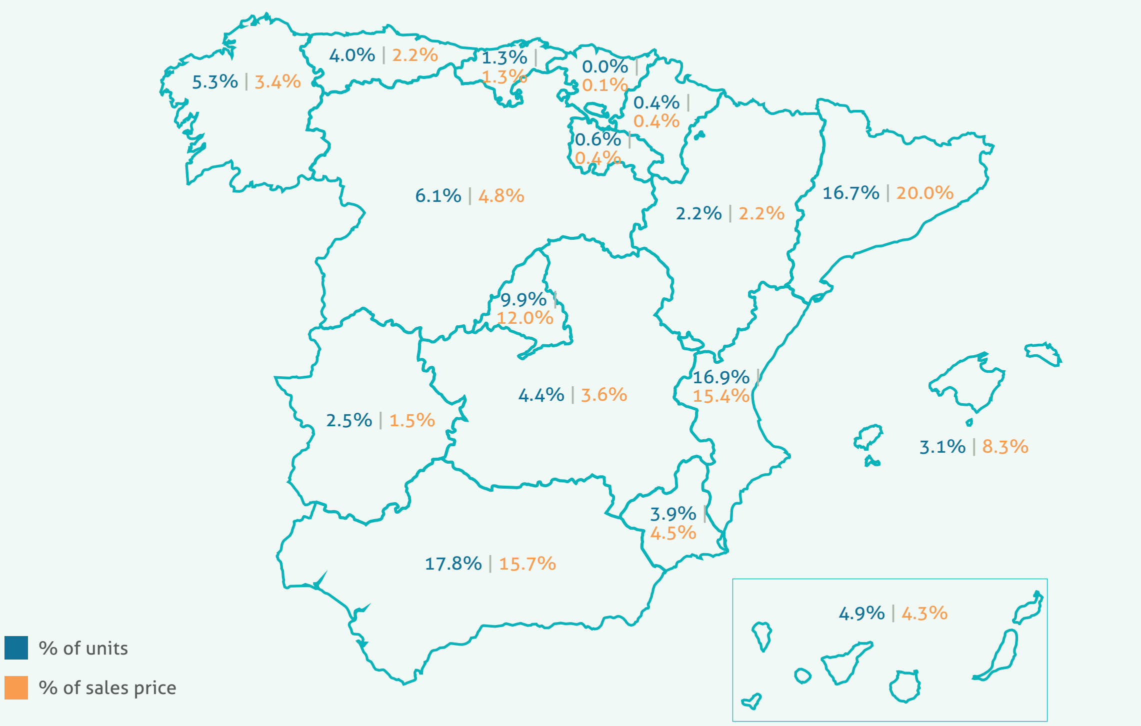
More than half –7,112– corresponded to homes owned by Sareb, and the rest –4,955– corresponded to Sales Growth Plans (PDVs).

The sale of owned residential properties, including the works in progress, have contributed revenue of nearly EUR 544 million to Sareb, 65% more than in 2015.

Of those properties sold, 63% were generated in four autonomous communities: Catalonia, Andalusia, Valencia and Madrid.

The average price of homes sold by Sareb in 2016 was EUR 121,304.

OWNED RESIDENTIAL SALES 31



As regards properties sold from developers' balance sheets, nearly 87% of the units corresponded to residential assets and most of these were done through PDVs. The most significant sales were in Galicia, Andalusia, Valencia, Madrid and Castilla y León[2].

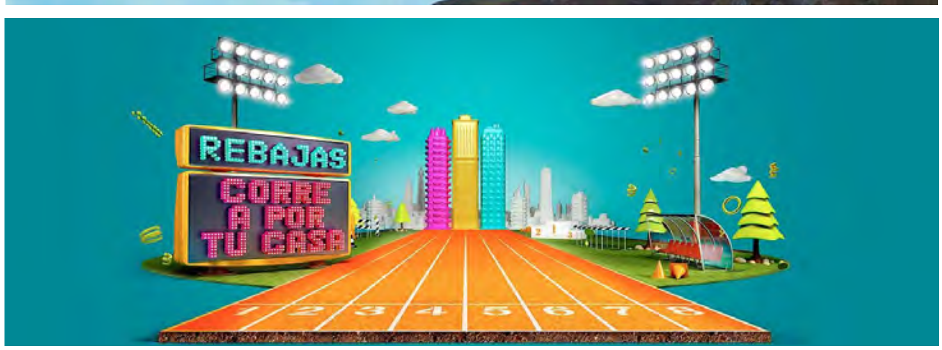
Throughout 2016, Sareb was able to sell in a retail channel a total of 12,067 residential assets that represented nearly 85% of the total properties sold in the year

[2] See section 4.3

COMMERCIAL CAMPAIGNS

Throughout 2016, Sareb has launched nine marketing campaigns that cover more than 20,000 assets, with a sales value of approximately EUR 2,200 million, doubling the results from 2015 up to EUR 222 million.

Of those campaigns, the excellent results of the following were especially significant: "Tu casa a toda costa", which revolved around cost and featured more than 600 homes sold for a value of EUR 53 million; "Casas de estreno", focussed on new construction works, with which more than 350 homes were sold in just three months for a value of EUR 34 million; the "MAD-BCN" campaign, with which 400 homes were sold in the two main Spanish cities for EUR 28 million, and the discount campaign "Corre a por tu casa", which at the end of the year, reported EUR 25.5 million for 350 homes sold.

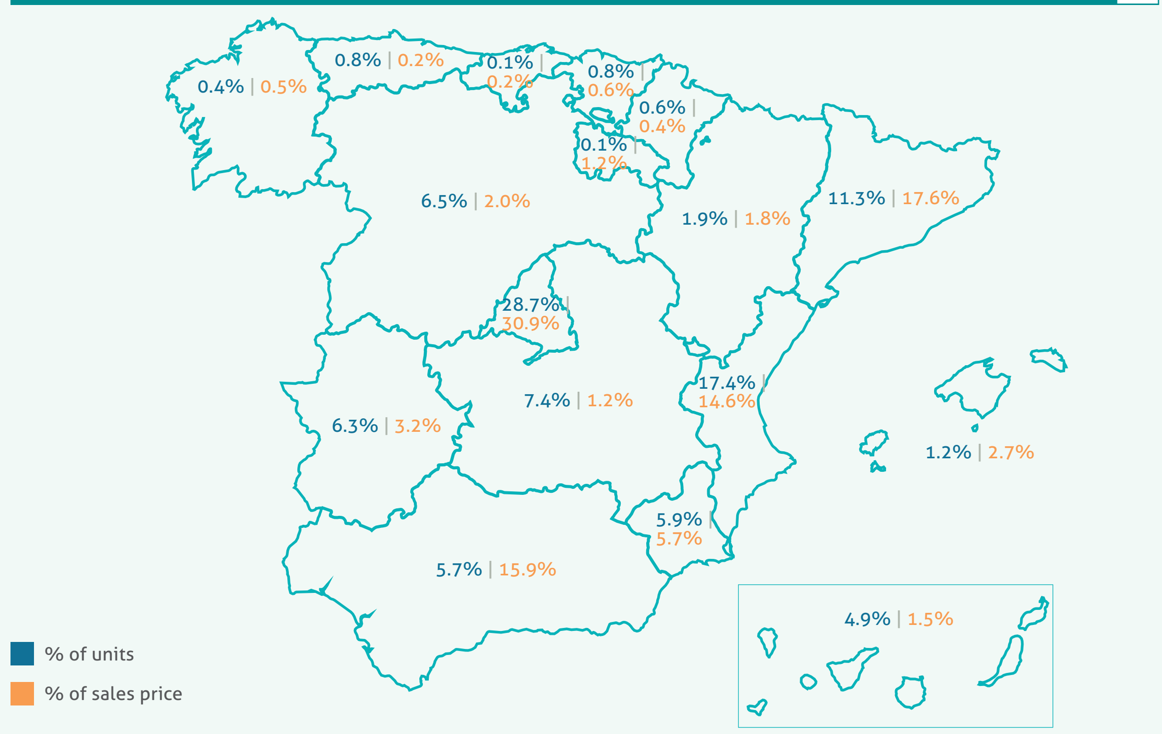


LAND

In 2016, the company sold 927 owned units of land, which reported revenue of EUR 366 million. More than 500 units transferred from developers' balance sheets should be added to these figures. 60% of the owned land units sold in 2016 were concentrated in Madrid, Valencia and Catalonia.

The case of Andalusia is significant, whose transactions represented 5.7% of the total, but contributed 15.9% of all revenue from the sale of owned lands.

SALE OF OWNED LANDS 32

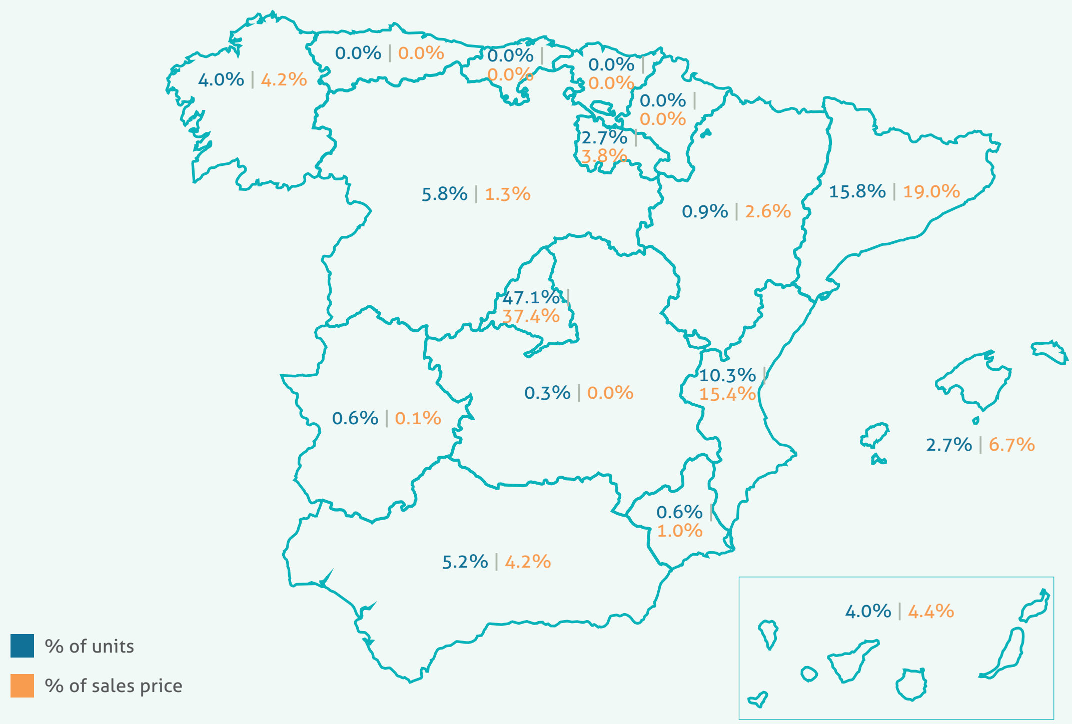


TERTIARY

The recovery in economic activity has favoured the sale of offices, commercial premises and industrial and logistics assets. In total, Sareb has sold 329 owned units of tertiary assets, which represents an increase of 8% with respect to 2015, and revenue of EUR 100 million.

The non-residential market in Madrid has been especially active, where nearly half of these assets have been sold. Catalonia was a distant second, with 16% of the total units sold in this period.

SALE OF OWNED TERTIARY ASSETS 33



GREATER VISIBILITY OF THE PORTFOLIO

Sareb has launched its new website (www.sareb.es), which features all of the institutional and corporate information in one place, such as property up for sale. It is a website with a renewed interface that provides greater visibility and transparency to the portfolio Sareb received, and that currently is sold through servicers.

The new website has a search tool that facilitates locating assets in any area of Spain. One of the main new features it offers is it positions assets on a map, through which users can access the area of interest thanks to the Google Street View technology.

In addition, it has been developed in a responsive format, enabling the user access through their smartphone or tablet.

Users interested in any asset can request information and channel it directly from the Sareb Responde service (sarebresponde@sareb.es) to the servicer's Contact Centre, which allows channelling the commercial activity of assets from our website to our partners.

4.5 Property management and value creation

4.5.1 Rental property

Sareb's rental strategy has a double objective: create greater value for divesting certain assets –tertiary, commercial, residential– and the recovery of costs in those properties in which there is no demand in the market that can return investments made.

With this premise, and taking into consideration the migration of managers to new servicers, Sareb has worked to define a portfolio of assets that can be earmarked for rental properties, both residential property and tertiary –offices and commercial premises. At the same time, progress has been made in adjusting the portfolio of rental property that was obtained in the transfer, included in Sareb's balance sheet and in receiving payments for property already leased.

Creating a rental portfolio will put properties on the market that, once leased, have greater value, such as commercial premises and offices, and obtain profitability of those residential properties where Sareb has the greatest difficulties to sell without incurring losses. This scope is defined using an efficiency-based approach, also trying to ensure that maintenance costs are suitable.

For marketing these properties, there are selection criteria for similar types of tenants that are applied by the servicers in an attempt to ensure that the possible late payment of rent is in line with the market situation.

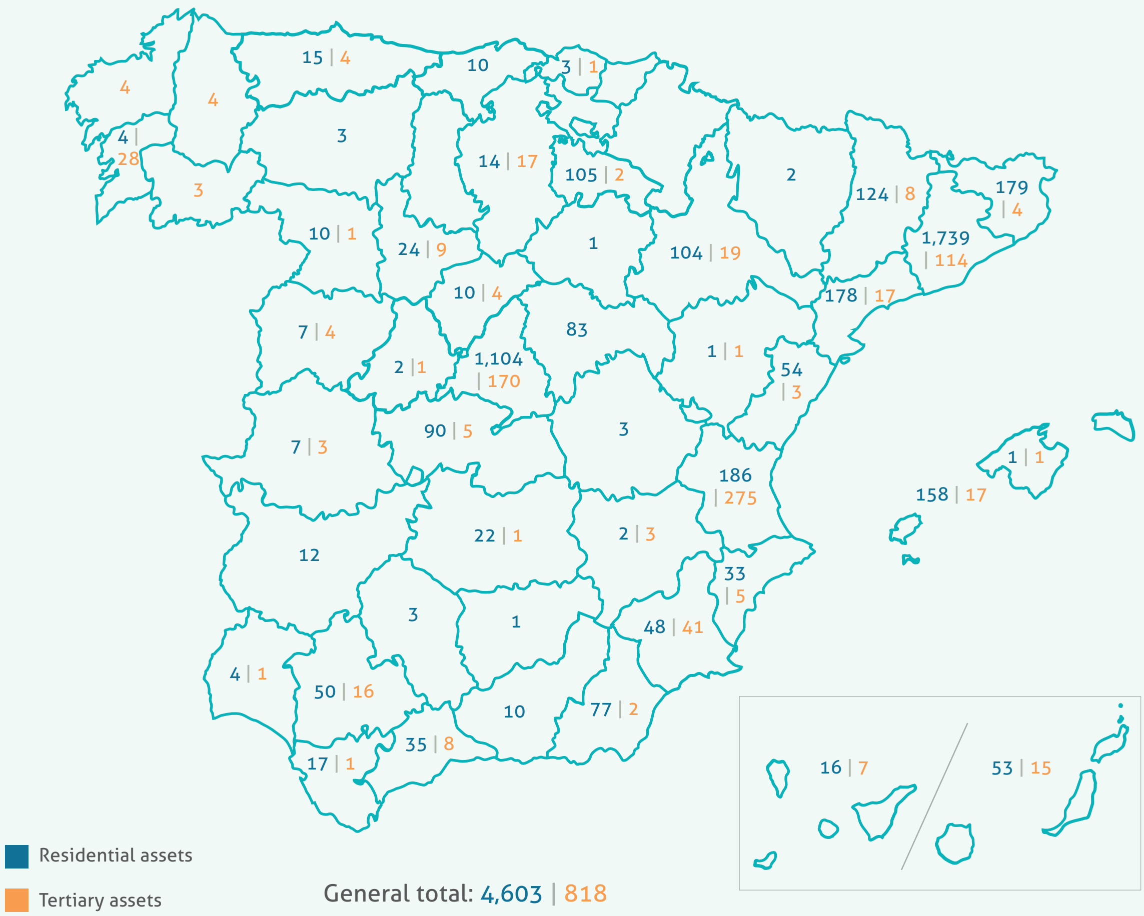
In 2016, Sareb worked to defined a portfolio of assets that can be earmarked for rent, both for residential property and tertiary

INCREASED PORTFOLIO OF RENTED PROPERTIES

The portfolio of rented properties increased with respect to the previous half-year from 3,733 homes to 4,603. If we also includes the homes earmarked for social rents through agreements signed with autonomous communities and city councils, this figure could reach 6,500 homes. This portfolio also includes 818 tertiary properties.

Rental activity will allow selling properties during the coming years on better terms than those currently offered by the market.

LEASED PROPERTIES 34



4.5.2 Property development and land management

COMPLETING UNFINISHED DEVELOPMENTS

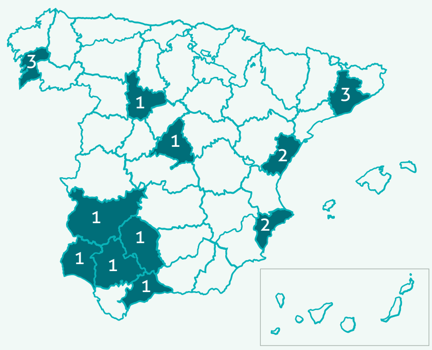
In 2016, Sareb completed 17 developments it had received in different stages of completion, which enabled it to put 150 homes on the market this year that are already likely to be registered. Since its inception, Sareb has completed some 1,039 homes it received incomplete, of which 368 homes have already been sold.

In addition, the completion of another 19 developments was approved in 2016 (836 homes).

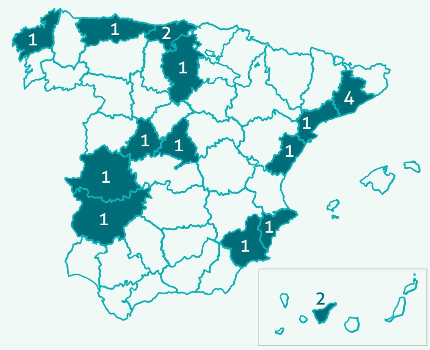
Completing these developments will involve an investment of EUR 32.9 million.

In total, and since Sareb decided to conclude the unfinished developments received to provide value to its portfolio, the company is concluding a total of 86 construction works, which involves putting a total of 2,237 new homes on the market that were originally unfinished works.

17 COMPLETED DEVELOPMENTS IN 2016 (150 homes) 35



19 NEW DEVELOPMENTS APPROVED IN 2016 (836 homes) 36



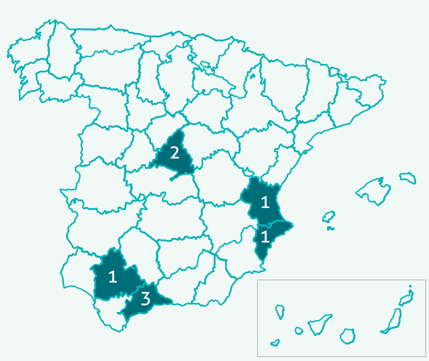
NEW DEVELOPMENTS

In 2016, Sareb has continued working on obtaining licenses to start developments in commercially interesting locations, and that will allow increasing the value of the assets in the portfolio.

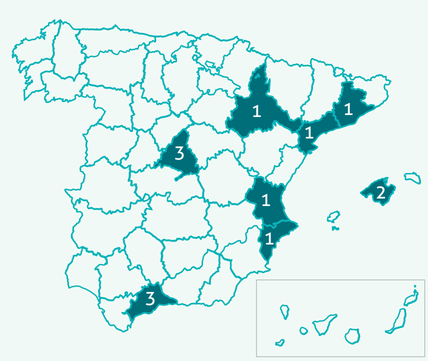
In 2016, construction work began on eight of the total 27 land plots (1,576 homes) that Sareb has selected for development. These eight land plots will result in the construction of 424 homes. In addition, the sale of part of these newly constructed homes has begun. Specifically, 597 homes have been put up for sale in 2016, of which 81% have already been reserved.

As part of its development activity, Sareb has launched the Tormes project, which has involved the development of 13 land plots in collaboration with the development sector, through different formulas of collaboration and co-investment. In total, it will involve an investment of EUR 55 million for Sareb.

8 CONSTRUCTION WORKS STARTED 37
LAND PLOT DEVELOPMENT ON



13 LAND PLOTS IN THE TORMES PROJECT 38



4.5.3 Maintenance of the properties and insurance

Sareb earmarks an important part to the improvement and maintenance in optimum conditions of the property stock it has received. For example, this includes the cleaning of land plots, establishing adequate safety measures for the works in progress or unfinished developments, and adapting the homes for sale or rent.

As can be seen in the detail of expenses, last year, Sareb earmarked EUR 90 million to this purpose, which also included more than EUR 36 million dedicated to paying maintenance and service charges.

As regards insurance coverage, Sareb covers the risks arising from its activity that may affect its assets by taking out various insurance policies that cover any damage that may be caused to its property assets. In addition, the company also covers its civil liability for damages of any kind caused to third parties within its activity, including those derived from the decisions of Directors and Executives.

The Company's risk policy also requires providing extensive coverage with low deductibles and arranging policies with highly solvent companies. Following these criteria, in 2016, Sareb renewed its insurance programme "Material Damages, General Civil Liability" and "Responsibility of Directors and Executives", the "Full Construction Risk" coverage, in addition to the "Warranty" policy. The contracting, both from insurance brokers and insurers, is adapted to the most rigorous selection procedures, under criteria of publicity, competition and equality.

To favour a more efficient and fluid management of accidents, Sareb has Accident Management Protocols that were modified in 2016 to adapt them to the new asset management system after the migration to new servicers. After the corresponding selection competition for providing brokerage services (advising and intermediation in insurance), the broker selected started to provide services in January 2016.

Every year, Sareb revises the insurable* risk map in order to determine what risks concern them and thus verify that the insurance coverages contracted are adequate at all times. In addition, in 2016, the coverage of other potential risky events was analysed so that the company could provide new coverage tools for other risks.

Sareb covers the possible risks arising from its activity that may affect its assets by taking out various insurance policies for any damage that may be caused to its property assets.

(*) For more information, see section 2.4 Ethics and governance.

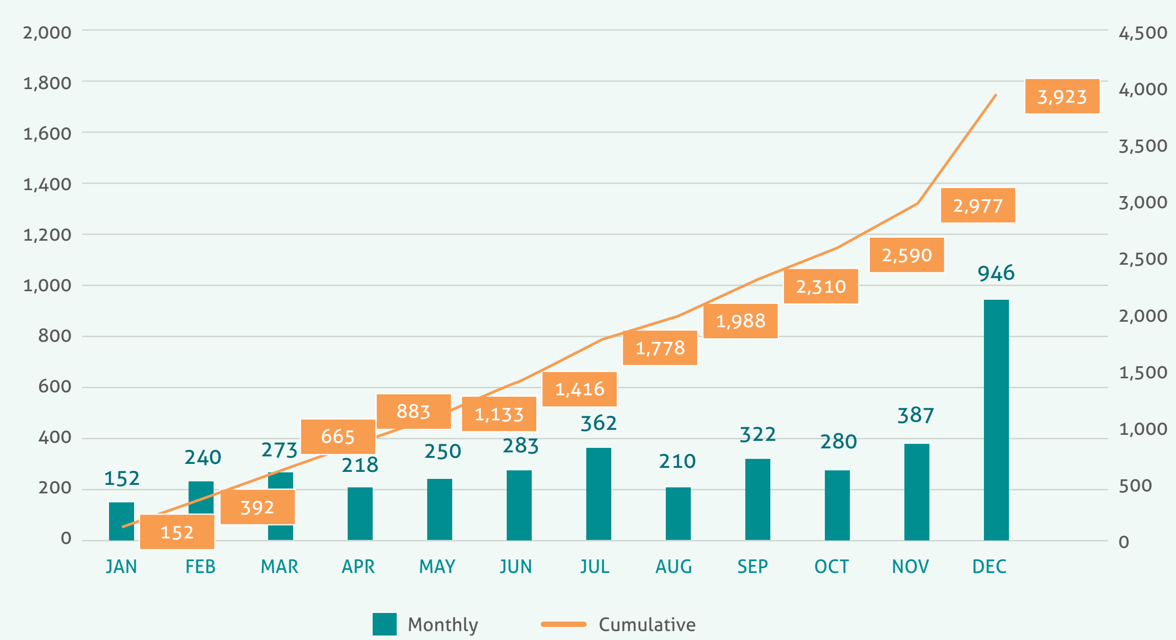
4.6 Financial information

4.6.1 Results from the year

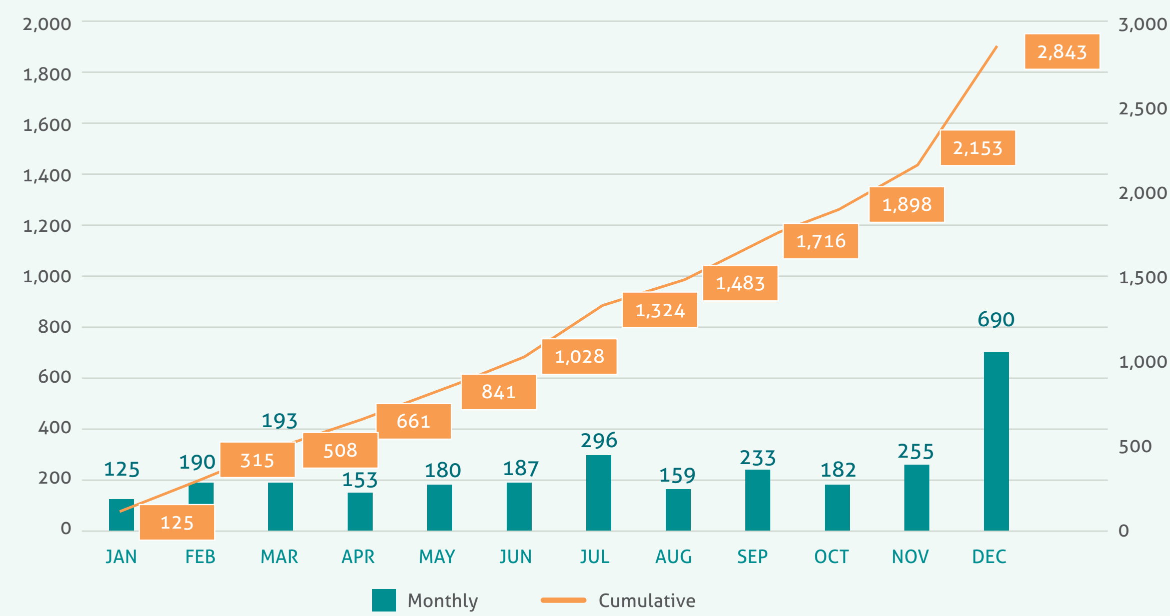
2016 closed with a total revenue of EUR 3,923 million, 1% above the figure reached in 2015, with a gross margin of EUR 664 million. Of the total revenue, EUR 2,843 million correspond to the financial asset transactions, EUR 1,053 million to property assets, and EUR 27 million to other revenue.

The first half of the year was marked by a slow pace of activity, with just 36% of the total revenue, even if the year finished at a frenzied pace, with a cumulation of 24% of the total revenue in December alone.

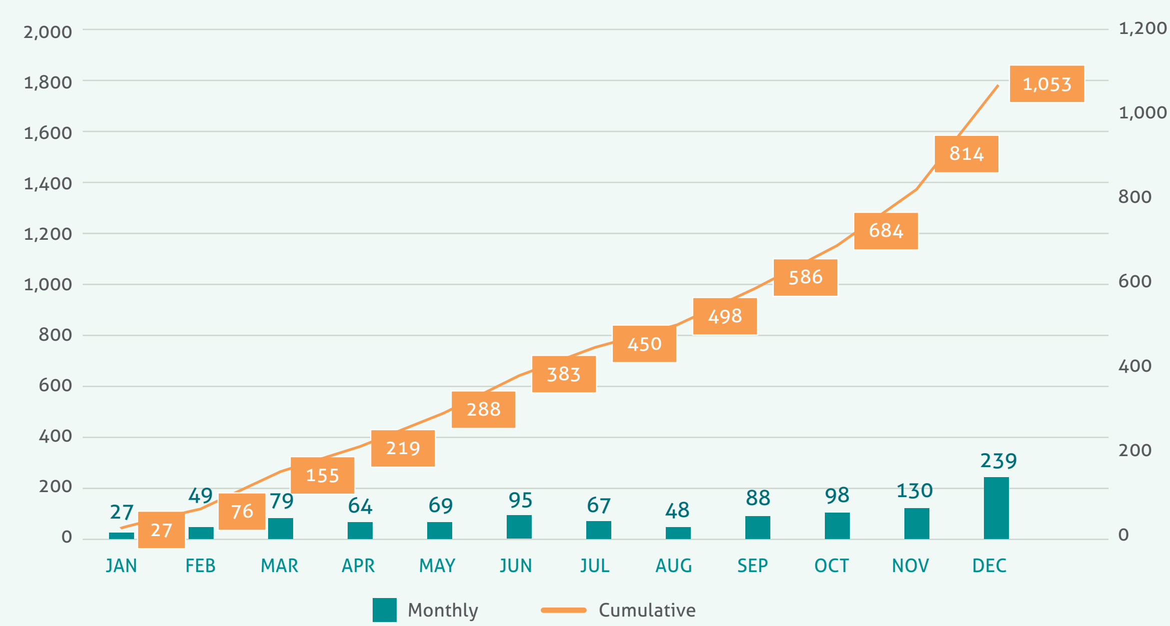
REVENUE (in millions of euros) 39



FINANCIAL ASSET REVENUE (in millions of euros) 40



PROPERTY ASSET REVENUE (in millions of euros) 41



(*) The revenue from FABs is the net amount

The 2016 statement of profit or loss is shown below, compared with the one from 2015, which has been restated by virtue of RD-Law 4/2016:

ACCOUNTING STATEMENT OF PROFIT OR LOSS (MILLIONS OF EUROS)		42
	2016	2015 restated
Revenue	**2,134**	**2,202**
Property assets	**1,053**	**835**
Property asset sales	1,010	783
Rental income	42	42
FABs and other	1	9
Financial assets	**1,081**	**1,367**
Financial asset sales	474	396
Interest income on loans (margin)	607	971
Cost of sales	**-1,497**	**-987**
Financial assets	-593	-370
Property assets	-904	-617
Gross margin	**637**	**1215**
Other operating income	27	6
Management, marketing and maintenance costs	-683	-611
Depreciation and amortisation charge and other	-85	-36
Profit from operations	**-105**	**574**
Net financial loss	-558	-709
Loss before tax	**-663**	**-135**
Income tax	0	33
Net profit (loss)	**-663**	**-103**

The previous account follows the guidelines of the Spanish National Chart of Accounts (PCG), which in relation to certain transactions made with financial assets, does not consider the total amount received, but only the margin obtained with them.

However, when considering all of the amounts received and accrued by Sareb, the revenue obtained by the company in their property and loan transactions increased to EUR 3,896 million.

The gross margin amounted to EUR 637 million, and is detailed in the next section (Fluctuations in margins). An additional EUR 27 million would need to be added to other line items related to the Company's activity as Value corrections, revenue from terminating contracts and collecting assets in servicing.

Thus, the management revenue in 2016 increased to EUR 3,923 million, as mentioned at the beginning of this chapter, with an increase of 1% with respect to the previous year. The margin obtained amounted to EUR 664 million.

	Revenue	Gross margin	43
Financial assets	2,843.2	488.1	
Property assets	1,053.0	149.2	
Subtotal	**3,896.2**	**637.3**	
Other revenue	26.5	26.5	
Total business management	**3,922.7**	**663.8**	

in millions of euros

FLUCTUATIONS IN MARGINS

As can be seen in the table, Sareb obtained a business volume in 2016 similar to the previous year, but the sales margin was notably lower. The margin of property assets dropped EUR 69 million to 149.2 million, while for financial assets, which include interests collected and accrued, the drop was more significant, moving to EUR 488.1 million –509 million less than the previous year. This change reflects the impact of credit sales on the negative margins, in an area marked by the application of the accounting regulation.

As indicated in section 4.6.3 Accounting regulation and fluctuations in equity, the Bank of Spain Circular 5/2015 unchained the individual valuation of all Sareb assets that were assigned a value close to the market price, which we call a 'regulatory price', and for much of the year, became a main reference for Sareb transactions.

This effect of valuating each asset made the cases of unrealised losses more visible, because the market value was below the price originally paid by Sareb. It is a part of the portfolio that, independent of its valuation, cannot be separated from the company's divestment mandate, and therefore, should be subject to an active and responsible management.

In 2016, Sareb advanced in divesting this part of the portfolio with transactions that, although made at market value –which reflected the adequacy of the price agreed– did not exceed the acquisition cost, and so negative margins were generated. On many occasions, they were assets with scarce potential of revaluation, but possible to be put on the market at those times.

Taking into account the framework created by RD-Law 4/2016, the objective was to sell not just those assets with a positive margin on the statement of profit or loss, but also those that can reduce the figure of unrealised losses in the company's equity.

In summary, Sareb is advancing in the divestment process, looking for the optimum equilibrium between margin and equity.

However, despite the complexity of the regulatory and market areas in which Sareb is involved, the Company was capable of obtaining a total positive margin of EUR 664 million.

Property assets 44

	Revenue	Gross margin
Total	**1,053.0**	**149.2**
Residential	544.8	82.6
Singular/tertiary	466.0	24.5
Rental income	42.1	42.1

Financial assets 45

	Revenue	Gross margin
Total	**2,843.1**	**488.1**
Loan sale and repayment	730.3	14.9
Partial repayment and recovery	416.9	137.7
Interest	401.4	401.4
PDVs and liquidation of colla-teral	820.2	52.9
Institutional sale	474.3	-118.8

in millions of euros

HIGH ASSET MAINTENANCE COSTS

As the owner of a significant portfolio of properties, each year Sareb has a significant disbursement of costs for maintenance, security, maintenance and service charges, municipal tax and management fees.

For example, in its four years of existence, tax payments have amounted to EUR 600 million for Sareb, including property tax (IBI). In addition, to date, the Company has

disbursed more than EUR 180 million in maintenance and service charges.

In 2016 alone, as shown in the following table, Sareb incurred operating costs of EUR 683 million, which practically consumed the positive margin obtained in the divestment activity.

Overhead costs	46
	2016
Management and marketing fees	**236.9**
Management	104.4
Marketing	132.4
Taxes (IBI, VAT, gains and others)	**197.2**
IBI, gains and others	92.5
VAT	104.7
Costs derived from foreclosure and dation processes	**22**
Technical reports - registration costs and others	**8**
maintenance and service charges	**90**
Service	53.7
Maintenance	36.3
Overhead costs	**66.5**
Staff costs	**39.4**
Other operating costs	**21.9**
Other continuing management costs	**1.4**
Total costs	**683.4**

in millions of euros

Approximately one third of the costs correspond to the fees paid to companies that carry out the management, administration and marketing of Sareb's portfolio –the so-called servicers. In addition to the upkeep and maintenance of the property assets, there are other items, like those related to efforts in appraisals to close the valuation process of the entire portfolio.

Financial costs are nearly entirely represented by the senior debt service that Sareb issued to acquire their assets, which last year amounted to EUR 577 million, versus 724 million from the previous year. Revenue of EUR 19 million obtained mostly as revenue derived from participation in Bank Asset Funds (FAB) were included in this cost. This item also includes revenue for the active management of the Company's unrestricted cash, through liquidity auctions.

NET RESULT AND REPAYMENT OF EUR 2,169 MILLION IN DEBT

The narrow business margins, and high operating and financial costs have led the company to recognise net losses of EUR 663 million in 2016, versus EUR 103 million in the previous year.

The activity carried out by Sareb in 2016 enabled it to advance in its main commitment –the repayment of debt– to which 92% of its unrestricted cash was earmarked. In 2016, the company repaid a total of EUR 2,169 million.

4.6.2 Performance of the Spanish government-backed debt

In 2016 Sareb continued to fulfil its payment of the debt it issued to acquire its assets, amounting to EUR 50,781 million, which is backed by the Spanish government.

In addition to meeting the interest payments generated by this debt, Sareb repaid a total of EUR 1,842.1 million of its senior debt in cash in 2016. One part, EUR 382 million, was redeemed in February, with a charge to the

cash generated in 2015. The rest, EUR 1,460.1 million was redeemed in December, with a charge to the cash generated in 2016.

To analyse the total redemption corresponding to the 2016 cash flows, the redemption made in February 2017 (EUR 671.9 million) must be added, which amounts to a total of EUR 2,132 million, a figure that does not take into account the corrections made.

In both cases, the redemptions were concentrated on the securities of the 3-year bonds Sareb issued, which were the issuances that made the 3-month Euribor spread higher.

The detail of the bonds redeemed in cash in 2016 and 2017 appears in the tables below. Group 1 refers to the bonds issued with the first transfer of assets to Sareb in December 2012, while Group 2 reflects those that were issued in the second and final transfer in February 2013.

REDEMPTION OF BONDS 2016. THOUSANDS OF EUROS 47

	Maturity	Total
	31/12/2018	
Group 1	**1,460,100**	**1,460,100**
	28/02/2017	
Group 2	**382,000**	**382,000**

REDEMPTION OF BONDS 2017. THOUSANDS OF EUROS 48

	Maturity	Total
	28/02/2019	
Group 2	**671,900**	**671,900**

The following tables show the performance in 2016 of the different bonds issued and delivered to the different institutions of Group 1 (Bankia, Banco de Valencia, Catalunya Banc and NCG Banco-Banco Gallego) and those of Group 2 (CEISS, Liderbank, Caja 3 and BMN).

GROUP 1 49

Nominal amount issued	Balances at 31 December 2015	Actual maturity date	Actual coupon	Corrections	Redemptions in cash	Balance at 31 December 2016
11,008,100,000	10,262,600,000	29/12/2017	Euribor 3M + 0.030%	-		10,262,600,000
16,512,600,000	13,918,000,000	31/12/2018	Euribor 3M + 0.040%	-		13,918,000,000
9,173,600,000	6,569,700,000	31/12/2018	Euribor 3M + 0.389%	-	1,460,100,000	5,109,600,000
36,694,300,000	30,750,300,000			-	1,460,100,000	29,290,200,000

GROUP 2 50

Nominal amount issued	Balances at 31 December 2015	Valid maturity date (after 2017 issuances)	Actual coupon (after 2017 issuances)	Corrections	Redemptions in cash	Balance at 31 December 2016
4,225,900.000	4,084,500,000	28/02/2018	Euribor 3M - 0.010%	11,200,000		4,073,300,000
6,339,200,000	6,103,700,000	28/02/2019	Euribor 3M + 0.070%	17,600,000	382,000,000	5,704,100,000
3,521,600,000	2,537,900,000	28/02/2019	Euribor 3M + 0.516%	8,400,000		2,529,500,000
14,086,700,000	12,726,100,000			37,200,000	382,000,000	12,306,900,000

(*) In February 2017 there were additional redemptions of EUR 671.9 million of Group 2 bonds.

In accordance with the underwriting agreement, on the maturity date of the various senior bond issues, the Company redeemed at maturity the Sareb 2014-3 and Sareb 2015-3 issues by issuing new senior 2-year and 1- year bonds, maturing on 31 December 2018 and 29 December 2017, respectively. The spreads set for these issues were 4 basis points and 3 basis points, respectively, as compared with 42.8 basis points and 19.9 basis points, respectively, for the redeemed bonds.

CORRECTIONS

In 2016 Sareb continued to correct assets transferred incorrectly to the Company, since they did not meet the requirements to be included in any of the related asset categories in accordance with Article 48 of Royal Decree 1559/2012, of 15 November, and with the Resolution of the Governing Committee of the FROB on the conditions of the transfer.

In other words, these assets did not fall within the scope of transfer on the effective transfer date and, therefore, were outside the scope of the legal duty of transfer established in Additional Provisions Eight and Nine of Law 9/2012 on which the transfer agreement is based.

In 2016, no correction was made that affected the bonds of Group 1. As regards Group 2, the nominal amount of the bonds was reduced by EUR 37.2 million.

The detail of the bonds redeemed by means of correction in 2016 is as follows:

CORRECTIONS OF BONDS IN 2016. THOUSANDS OF EUROS 51

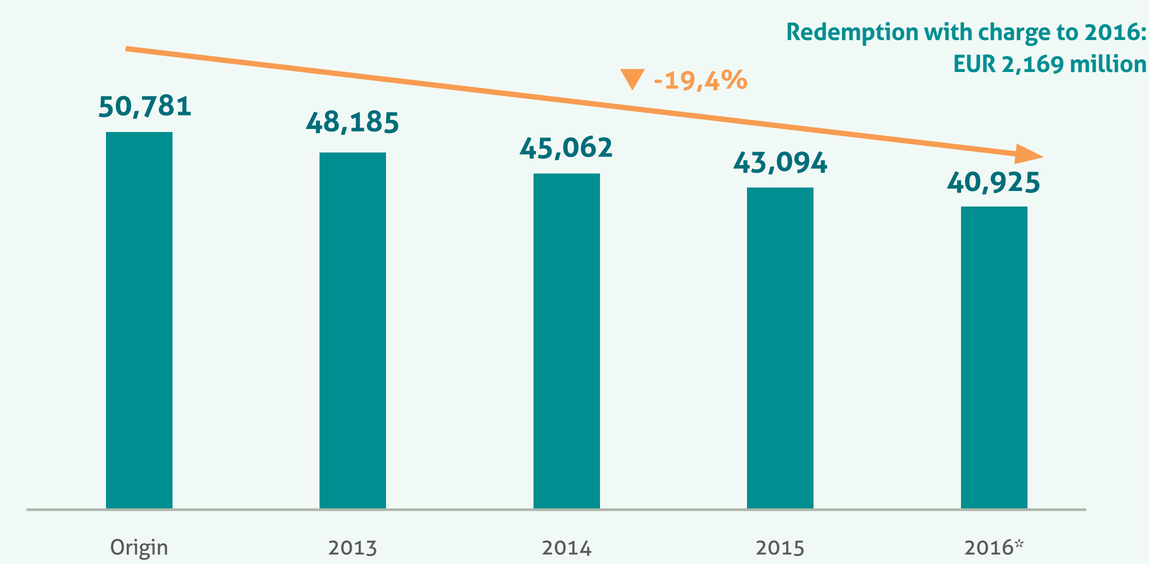
	Maturity		Total
	28/02/2018	28/02/2019	
Group 2	**11,200**	**26,000**	**37,200**

PERFORMANCE OF SENIOR DEBT OVER SAREB'S EXISTENCE

The activity Sareb has carried out in its four years of existence through the sales of its various assets and the collection and recovery of financial assets have enabled Sareb to generate sufficient cash to redeem 18.1% of its senior debt, a figure that increases to 19.4% when taking into account the redemption done in February 2017, with a charge to 2016. This means that in its four years of existence, Sareb has reduced its debt by a total of EUR 9,856 million, of which EUR 2,169 million correspond to repayment, with a charge to 2016.

This rate of repayment and also taking into consideration the expectations of the property market rebounding, in addition to the strategies established in its Business Plan, means that Sareb will be able to meet the final debt payment by the deadline stipulated.

SENIOR DEBT PERFORMANCE 52



*Includes 671.6 million repaid in 2017 with charge to 2016

4.6.3 Accounting regulation and fluctuations in equity

RD-LAW 4/2016 OF 2 DECEMBER

For most of 2016, the company operated under the accounting framework established by Bank of Spain Circular 5/2015, which defined the criteria for valuating the property and financial assets that make up the Sareb portfolio. At the end of the year, RD-Law 4/2016 of 2 December was also approved, which completes the previous regulation by specifying how the impairment due to losses on Sareb's portfolio should be recognised.

The Circular established Sareb's requirement to valuate all of its assets individually, which resulted in net gains and losses cumulated in its two large asset units: financial and property. The gain or loss resulted from the aggregate comparison between the price paid for the assets of each unit with their real value.

Initially, the Circular established that the losses existing in each unit of assets were provided with charge to the statement of profit or loss. On the contrary, the possible gains were not recognised when they did not occur from sales. As mentioned previously, this fact had an impact on the company's equity in 2015 and made it so in the second quarter of 2016, Sareb had to convert subordinated debt into capital to reconstitute the capital.

In late 2016, Royal Decree-Law established that the impairment for net unrealised losses should no longer be recognised on the statement of profit or loss as was

previously required, rather on the adjustment account for valuation adjustments within the company's equity. This adjustment account also will not be considered for the purposes of the causes of capital reduction and dissolution of the company included in the general corporate law.

The regulatory change required restating the 2015 accounts for information purposes in 2016, which did not change the total figure of equity, but did cause the regeneration of EUR 2,330 million in equity (reserves), whose counterparty is the aforementioned adjustment account.

In any case, it is important to point out that even if the Circular and Royal Decree-Law end up forming part of the institutions accounting framework, the impact is much broader, because it allows knowing in detail where the unrealised losses are in the portfolio that Sareb purchased from entities that received government assistance. This knowledge, necessary and very significant, allows developing more defined commercial strategies, and especially outlining a long-term plan to divest in assets that not only were acquired above their real price, but that do not have an obvious revaluation potential.

In 2016 with the new accounting framework, Sareb, in its fourth year of existence, entered into this part of the portfolio with unrealised losses, which has been reflected –as previously indicated– in reducing the business margins.

2016 PORTFOLIO VALUATION

As explained earlier, Bank of Spain Circular 5/2015 of 30 September established the criteria to be considered in Sareb's asset valuation methodology, basically through valuations performed in accordance with Ministry of Economy Order ECO/805/2003, although it also allowed using automated valuation models (AVM) in certain cases. It established the requirement to have valuers approved by the Bank of Spain, and having 50% of the portfolio complete at the end of 2015, and 100% in 2016.

It should be reiterated that within the two asset units (property and financial –which include the properties foreclosed during the company's existence), offsetting gains and losses that result from the valuation of all assets in the unit is permitted, but not between both units.

Type	Debt	Security	Regulatory value	CA	Result
With security	57,241	27,177	23,668	24,820	-1,152
Without 1st charges and participating loans	13,994	11	239	3,018	-2,779
Foreclosed / dation in payment			4,355	3,804	551
Total	**71,235**	**27,187**	**28,263**	**31,642**	**-3,380**
Other adjustments					-10
IMPAIRMENT					**-3,389**

53

The above table shows that the losses are concentrated in financial assets that do not have effective collateral or directly, without any security. In these cases, the Circular establishes that most of them, unless shown otherwise, are assumed to have no value.

In the unit of property assets, Sareb's estimates include a gain of EUR 1,491 million, nearly 18% of their carrying amount, even though they are not included in accounting, as was already indicated.

FLUCTUATIONS IN IMPAIRMENT

Even though the Circular was approved in September 2015, it was applied retroactively, allowing Sareb to rebuild which fluctuations in the impairment fund emerged from the valuation process and their impact on the statement of profit or loss since the beginning of its existence.

IMPAIRMENT CONSTITUTED					54
	2012	2013	2014	2015	2016
Charging accounts in the year prepared	0	259	719	337	377
CBE 5/2015 Restatement Charge		1,348	349	0	0
IMPAIRMENT/CBE 2015	0	1,607	1.068	337	377
CUMULATED IMPAIRMENT/CBE 2015		1,607	2,675	3,012	3,389
Net tax				-682	-100
AGAINST PROFIT OR LOSS				2,330	
AGAINST VALUE CHANGE ADJUSTMENT. EQUITY					3,289

The first line of the previous table establishes the effort in provisions that Sareb made in 2013 and 2014 in the absence of accounting regulation, and after making both enquiries to the Bank of Spain subsequent to the Circular.

After the Circular was issued and applied retroactively, impairment in the financial asset unit was estimated to be EUR 3,012 million, which was distributed in 2013, 2014 and 2015. Given that this damage was associated with a tax credit of EUR 682 million, the effect on Sareb's equity amounted to EUR 2,330 million, which is the figure that reinstated the equity after the approval of RD-Law 4/2016.

In 2016, impairment grew EUR 377 million, until reaching EUR 3,389 million. Upon being charged a tax credit of EUR 100 million (due to RD 3/2016 of 2 December that changed offsetting tax losses), it created an adjustment for a change in value of EUR 3,289 million.

LOSSES ACCUMULATED SINCE 2012

As indicated earlier, the obligatory restatement due to the change in accounting standards has also changed the company's net profit (loss) in the previous years, which does not correspond to those announced at the end of each year, given that the details of the new regulation were unknown.

According to the current accounting regulation, Sareb has recognised cumulative net losses of EUR 750 million since its inception. The consumption of equity the company has recognised in this period has been equivalent to those results. Currently, the company has a total capital and subordinated debt of EUR 4,049 million, versus the EUR 4,800 million it had when it was created.

The following table shows the fluctuation in results in the company's first years of existence, adjusted to the criteria established in RD-Law 4/2016 of 2 December. It also includes 2012, even though the company was founded 28 November of that year.

	2012	2013	2014	2015	2016	TOTAL	55
Result before taxes (in millions of euros)	-5	-47	67	-102	-663	-750	

FLUCTUATIONS IN EQUITY

In the first half of 2016, the company converted EUR 2,170 million of subordinated debt with the objective of reconstituting the equity position, after bearing the accounting impact of the Circular at the end of 2015.

As previously explained, RD-Law 4/2016 determined that impairment should be applied to the valuation adjustments, instead of recognising it with charge to the statement of profit or loss, which required making a restatement at the end of 2015.

The following table shows the company's fluctuations in equity. At the end of 2016, the company had EUR 4,050 million in capital and subordinated debt, after absorbing EUR 663 million from the losses from the year:

	2015. RESTATEMENT				2016		56
	Prepared	Reclassification		Restatement	Changes		Annual Accounts
		Impairment	Cash Tax		Conversion	Mov./Results	
EQUITY	**-3,161**	**-3,012**	**682**	**3,161**	**2,170**	**-1,770**	**-2,657**
Valuation adjustments	**-1,943**	**-3,012**	**682**	**-4,273**	**0**	**-1,004**	**-5,277**
Hedges	-1,943	0		-1,943		-45	-1,988
Financial asset unit impairment	0	-3,012	682	-2,330		-959	-3,289
Equity for capital reduction purposes	**-1,218**			**1,112**	**2,170**	**-776**	**2,620**
Capital	-300			300	4		304
Share premium	-900			900	-900		0
Reserves/Losses (years)	-2,418	2,675	-242	15	3,066	-103	2,979
Period earnings	0	337	-440	-103		-663	-663
SUBORDINATED DEBT	**3,600**			**3,600**	**-2,170**		**1,430**
EQUITY + SUBORDINATED DEBT	**2,382**			**4,712**		**-663**	**4,050**

The table also contains the valuation adjustment account, which reflects EUR 1,983 million corresponding to the valuation of the hedging derivative of interest rates, and EUR 3,289 million derivatives of applying RD-Law 4/2016, which establishes that the impairment of asset units should be charged to said item as its net tax impact.

In large figures, Sareb's equity has seen an increase since 2015 of EUR 504 million, as a sum of two contrary movements. On one side, the increase of equity as a result of converting subordinated debt, and on the other hand, the impact of impairment on the financial asset unit.

CURRENT CAPITAL STRUCTURE FOLLOWING CONVERSION

At 2016 year-end, the distribution of capital and subordinated debt was as follows:

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Holding institution	Percentage
SANTANDER	16.6%
CAIXABANK, S.A.	12.2%
BANCO SABADELL	6.6%
POPULAR	5.7%
KUTXABANK	2.5%
BANKINTER	1.4%
IBERCAJA	1.4%
UNICAJA	1.3%
CAJAMAR CAJA RURAL, S.C.C.	1.2%
MAPFRE	1.1%
MUTUA MADRILEÑA	0.7%
CAJA LABORAL POPULAR C.C.	0.6%
BANCA MARCH, S.A.	0.4%
DEUTSCHE BANK, S.A.E.	0.3%
CECA	0.3%
BANCO COOPERATIVO ESPAÑOL, S.A.	0.3%
CATALANA OCCIDENTE	0.3%
AXA SEGUROS GENERALES	0.2%
C.C. CAMINOS	0.1%
GENERALLI	0.1%
MUTUA PELAYO	0.1%
ASISA	0.1%
REALE	0.1%
ZURICH	0.1%
STA. LUCIA	0.1%
IBERDROLA INMOBILIARIA	0.2%
FROB	45.9%
TOTAL	**100%**

Sareb

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

5
OUR FUTURE

5.1 Risks

In 2016, Sareb continued to delve into its map of financial risks, mainly focussing on four areas: credit, the property market, interest rate and liquidity.

In this way, the Company, which since its first year has worked to design this map, has progressively analysed the most significant factors deriving from these risks. This has enabled it to have very detailed information today, even if until now, it has especially been concentrated on credit risk and the property market, which has facilitated making decisions.

In addition to this analysis, it has also advanced in management. In this way, Sareb profiles the global picture of the balance sheet and its financial risks, adapting to its particular features and orienting the cash flows, taking into account a peculiarity inherent to the organisation: the probability that said risks may be met by virtue of the solvency of the borrowers and values of the property collateral.

5.1.1. Credit risk

Sareb's portfolio of financial assets represents the majority of funds received. Therefore, managing its credit risk is key for guaranteeing the company's objective of efficient divestment. At the end of 2016, loans represented 69.4% of the company's portfolio of assets.

The dynamic management of this risk, which will be extended throughout the company's active existence, must preserve the value of said assets until the time of its liquidity through different profiled means. Given the high percentage of unpaid assets or NPL (Non-Performing Loans) –around 96% at the end of 2016– the profiled means are focussed on maximising recovery, taking into consideration the positions that generate cash –more than 44% of the total at the end of 2016– as the main achievement of that management.

5.1.2 Property risk

Property risk, especially in the framework of the new accounting circular, has had a notable bearing on the company indirectly through credit risk and directly on the portfolio of foreclosed property assets. Thus, monitoring and limiting property risk are fundamental in order to manage it.

5.1.3. Interest rate risk

The bonds issued to acquire all assets from the company were created as instruments for which Sareb paid a variable interest rate linked to the Euribor and to the spread on Spanish Treasury bonds with respect to the swap rates on the market. In this way, the magnitude of the interest rate was directly linked to the size of the portfolio received.

In coordination with the national and international authorities, managing the risk of the interest rate started in 2013, the floating rate profile of its borrowings was swapped for a fixed-interest structure. It was transformed into a fixed cost plus 80% of the debt and this management continues to be monitored in 2016.

On the other hand, the fall in interest rates last year, and in particular, the reduction in the spread on Spanish Treasury bonds (an element linked to defining the interest rates paid on Sareb bonds), enabled Sareb to enjoy a substantial reduction in the Company's finance charge.

5.1.4. Liquidity risk

Related to all previous aspects, liquidity is another of the fundamental pillars in Sareb's management. Therefore, its risk is continuously analysed, and contingency plans are defined to protect its status at all times, while managing the surpluses is done by following a prudent investment policy framed within strict counterparty risk limits approved by the Board of Directors.

5.2 Opportunities

To offset financial and property risks –both structural and temporary– that the company is facing, new opportunities also emerged in 2017 that helped Sareb handle the significant increasing difficulty of divesting from assets, which is the greatest challenge it faces every year.

To understand this challenge, it must be understood how the property sector behaves in Spain (and other similar areas) during times of emerging from a crisis and the start of the sector recovery, such as the present time.

CURRENT SITUATION

The enormous group of local submarkets in Spain is neither recovering equally, nor in an evenly distributed manner; rather it is recovering in a clearly asymmetrical fashion. The current situation contrasts with the worst moments of the crisis when the completed home transactions did not reach 40%, and there were enormous geographical areas of illiquid product. Now in the years of recovery, market activity is advancing in the shape of concentric circles.

This dynamic implies that, at first, the level of transactions quickly recovered in the highest quality areas of the large provincial capitals, in addition to in affordable housing areas in their nearest perimeter. This circumstance is responsible for the repressed transactions during the period of continued fall of property prices, in addition to the scarcity of product of those locations in that period of time.

This situation has made it so that in some areas, some have even spoken of a new "bubble". Nothing could be further from reality. That recovery, whose strength is clearly marked with different statistics available about the market (4.8% price increase, and 6.2% in Madrid and Barcelona during the last 12 months), has not even reached the second, third, fourth and fifth concentric circles farthest from the poles of attraction.

This still leaves most of Sareb's portfolio in geographical locations where the stock of unsold product is still very high and the rate of divestment is relatively low.

Because of that, Sareb's challenge is to provide value to their properties in these locations, keep them attractive to buyers, taking into account the incipient new construction works, and take advantage of that natural evolution –which is still slower than demand– toward the concentric circles farthest from the centre.

In addition, Sareb must count on the competency of banking institutions with housing stock in the same areas and with greater interest in quickly divesting, beyond just the price obtained for assets.

OPPORTUNITIES TO CONTINUE ADVANCING

Taking into account these circumstances, probably the greatest opportunity for the company is exploiting an increasingly established relationship with asset managers selected in late 2014 –the servicers– in an extended enterprise model. If last year was strongly marked by the progress of the technology integration model with these servicers, 2016 has focussed on culminating it and making the most out of it for the business.

With the technological integration that Sareb must carry out along with its servicers, they are intending for the IT platforms of both parties of the organisation to use almost in real time the same information about financial and property assets of the portfolio. Thus, the design process of the commercial strategy, the "creation" of transactions, its approval and subsequent formalisation will be more streamlined and efficient. In this way, the company can increase the speed of divestment and fight the growing difficulty of breaking away from the assets still remaining on the portfolio.

Second, Sareb must be capable of generating returns through investment in their own assets. Despite the scarcity of equity the company had in relation to its balance sheet, the truth is that Sareb does have a comfortable liquidity situation. The challenge is finding each and every one of the opportunities to invest part of that liquidity in its own assets to recover the value at which they were acquired. To do so, all investment in their assets that, with an assumable risk, generates significant rates of return should be studied. With a damaged portfolio with thousands of vandalised or simply impaired assets, with half-completed works and land in very early stages of urbanisation, the search for profitable investment opportunities of the cash owned should be a priority. The objective is to create a sufficient business margin to cover an increasingly important part of the company's costs.

Finally, innovation has not lost its importance for Sareb. This not only lies in searching for creating value in assets, but also in finding more attractive ways of selling and marketing for clients, improving the segmentation of its goods to better organise the timeline of its divestment and finding the aforementioned investment opportunities.

The first steps taken in 2016 were: Self-learning algorithms for valuating assets, industrialisation of processes, development of electronic platforms in a market such as the sale of non-performing debt (NPL) where they don't exist, and the incorporation of the latest techniques of data analytics and big data to provide service to the business and company strategy.

Sareb is a company that should find opportunities anywhere in order to achieve its mission: selling the assets that have become a huge burden for the Spanish financial system. Only new solutions that replace their value, transactions that are faster everyday, complicity of servicers and innovation will enable the company to maintain the necessary pace to totally divest from the portfolio before 2027.

5.3 Business plan

Sareb is a company required by its foundational documents to review and approve an updated version of its business plan every year. These plans should cover the total period of the company's useful life, that is, from the time of their approval until 2027. Even if this requirement did not exist, the company would be required to perform a complete revision of this Plan in early 2027 due to the entrance in force that year of Royal Decree-Law 4/2016 of 2 December, of urgent measures regarding financing, which alters the way of recognising asset impairment in Sareb's annual accounts, as explained in the previous sections.

The changes to the accounting regulatory framework affect the way Sareb calculates the net margin it achieves with sales, which is that which allows at least partially covering its financial and operational costs. Royal Decree-Law 4/2016 establishes that Sareb, as occurred previously, must calculate the net margin of 100% of its portfolio by comparing the price at which its assets were transferred by the transferor financial institutions. However, the most significant factor is that the changes in the accounting framework do not change the price at which Sareb sells the financial or property assets. Sareb, at all times since its creation,

has sold at prices it considers market prices. These are set above the base of appraisals independent of the property assets and loan collaterals, always adjusted according to its commercial and financial knowledge.

The accounting change also has no effect on calculating Sareb's revenue. This allows confirming that, with a revenue of EUR 3,923 million, Sareb has passed the objective set in the 2016-2017 Plan.

STRATEGY

The Company's strategy is based on the expectation of a positive cycle of the Spanish property market, which is typical of asset management companies in other areas and an essential part of its value as a restructuring tool of the financial sector.

This strategy essentially attempts to use the cushion of its capital and sale of assets that arrived to Sareb with a more reasonable price to overcome the first years of weak recovery of the market (until mid-2016, home prices had not recovered to the level at the end of 2012). The expectation is based on the favourable change in the market to recover the price and liquidity of the assets received by the company with transfer prices far from their market value. In the end, this plan is based on balancing the company's pace of divestment and capital in order to absorb losses.

In the new strategy for financial and awarded assets reflected in the current Business Plan, the original price of Sareb's assets must continue to be taken into account. It is assumed that there is a need to sell both those that arrived at reasonable prices and those that arrived at a worse price and whose expected future price range is also negative. This translates into the need, four years after the creation of Sareb, to start divesting a part of the portfolio with negative operational margins. In this way, the part of the portfolio being divested is determining both its liquidity and potential net margin for the company today, as well as its potential to gain value in the mid- and long-term.

As regards advancing in the strategy of any asset management company, the accounting change introduced by Royal Decree-Law 4/2016 bears a heavy burden, as it returns the capital lost with the impairment losses from previous years and allows a temporary margin of absorbing more prolonged losses.

TWO PILLARS OF SUPPORT

The two strategic pillars of the 2017-2027 Business Plan are based on taking advantage of the time on the market on one hand, and intensifying management of the current portfolio on the other. The first is focussed on accelerating the pace of generating revenue through a more integrated collaboration with servicers. The most intense focus is on areas where Sareb has the most stock of properties and loan collaterals, and where perhaps the sectors has not yet recovered, but should start to recover soon. In this way, sales must be promoted in regions that have been less dynamic until now and commit to the assets that, because of price range or thanks to investment in their adaptation, can generate more returns for the company.

The second of these pillars is that which marks the intensification of the strategy to generate value for the company. Sareb has received a low-quality portfolio in which it is going to be important to improve returns and recover the price at which they were transferred. In this way, the Business Plan has the objective of managing lands for advancing their urbanisation, the completion of works in progress in geographic areas where the market demand advises, and in very special cases, property development on owned land, by itself or in co-investment with partners that share the risk and provide local knowhow, and in volumes that have a palpable positive effect on the margin obtained by the company in their activity.

In addition, and in line with the updates from other years, the Business Plan contains the adaptation of some

of Sareb's hypotheses on the evolution of the property sector and interest rates changing to the reality of the market one year later. In the same way, the company's initiatives are subjected to a critical contrast that may be giving a different result than the one expected one year ago. Finally, Sareb takes advantage of the updates to insert the best information available about its assets into the plan.

In the 2017-2027 Business Plan, the main new feature was the new information obtained through delaying nearly 100% of the company's portfolio. The 2015 valuation, which was closed needing to use estimates for 45% of the portfolio has been practically finished this year. This year, the company has accumulated net gains in the property asset unit. However, in the portfolio of financial and foreclosed assets, the initial findings were not positive and did not reflect greater impairment. However, all of this updating of the documentation has served as an invaluable base to handle business in the coming years with favourable market expectations.

Sareb has received a low-quality portfolio in which it will be important to invest to improve returns and recover the price at which the assets were transferred

Sareb

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

6

OUR TEAM AND OTHER STAKEHOLDERS OF INTEREST

6.1 Fluid dialogue

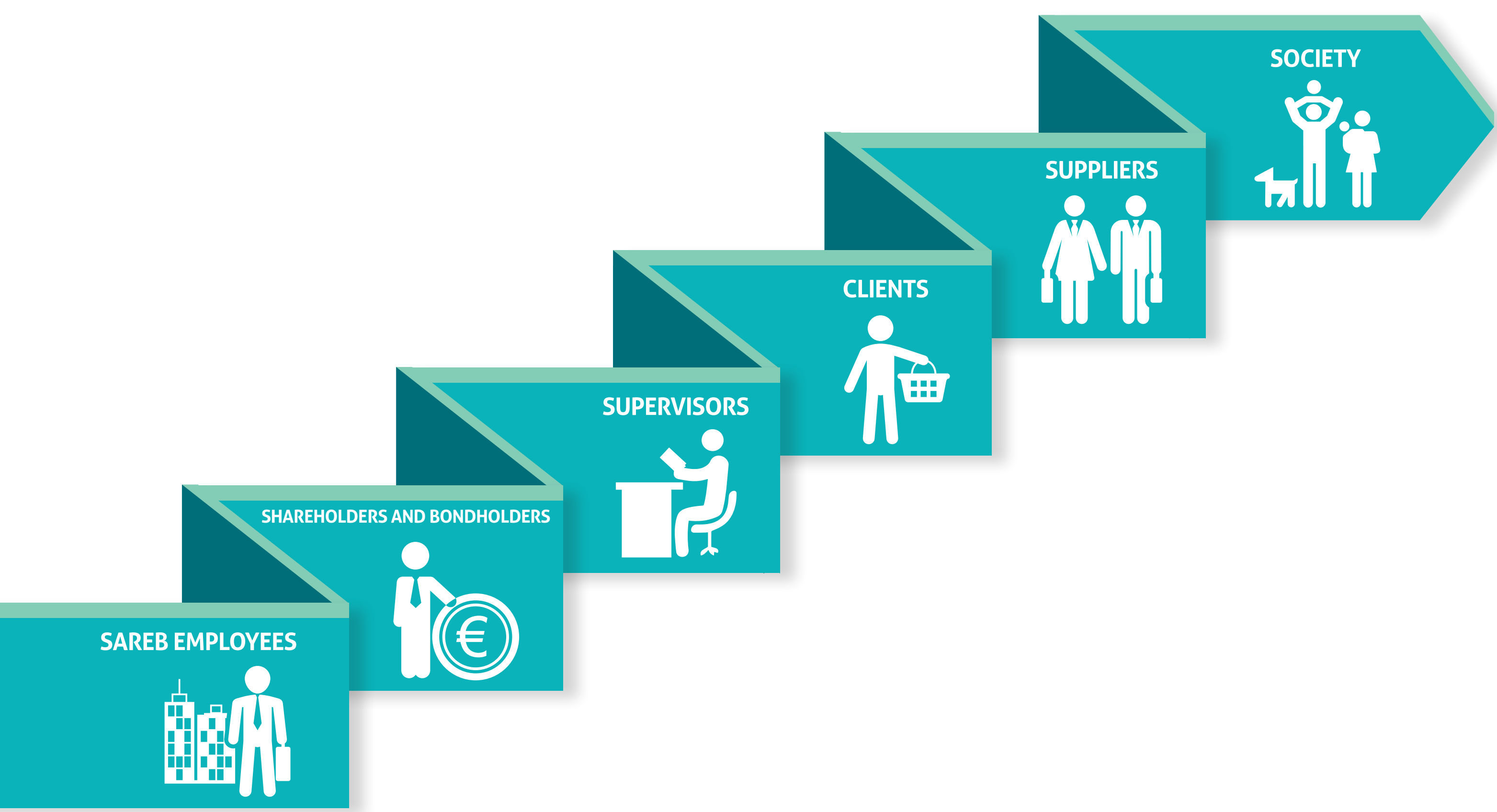
Sareb carries out its activity under a model of sustainable and responsible development, with bidirectional, complete and transparent communication adequate to the economic, social and environmental scale of its stakeholders. In addition, it actively listens to their needs and expectations, thus achieving a mutual understanding and cooperation.

The company's stakeholders include shareholders and bondholders –private and public– supervisors, clients, suppliers, employees, in addition to society as a whole.

In order to maintain dialogue with each one of them, the company has several communication channels, such as, for example, Sareb Responde, an initiative founded to establish an interaction with the company in order to answer questions and respond to meetings with representatives of the administrations –mainly autonomous communities– with which it shares a general interest.

In addition, Sareb participates in many sessions and conferences, and maintains a constant relationship with the media, and holds in-person meetings with the developer organisations to deal with the real needs of its clients.

Sareb maintains continuous communications with the main stakeholders about its daily work



6.2 Sareb employees

Sareb's management of people has the goal of attracting better employees and retaining them by developing professional growth through a strategy that goes beyond salary compensation: training, new job experiences, increased responsibilities and obtaining commitment to a project that is incomparable in Spain.

Sareb's staff also offers another differentiating element with respect to other organisations: at the end of 2016 it offered an experience per employee of 17.45 years in several sectors, especially in the financial and property sectors.

NUMBER OF EMPLOYEES AND DETAILS BY TYPE AND OWNERSHIP

At 31 December 2016 and 2015, the distribution by type, listed by categories, was as follows:

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	2016			2015		
	Women	Men	Number of employees	Women	Men	Number of employees
Executives	14	51	65	14	52	66
Managers and technicians	94	133	227	81	133	214
Administrative and Other Roles	40	24	64	46	26	72
Total	**148**	**208**	**356**	**141**	**211**	**352**

The detail of roles for 2016 and 2015 is as follows:

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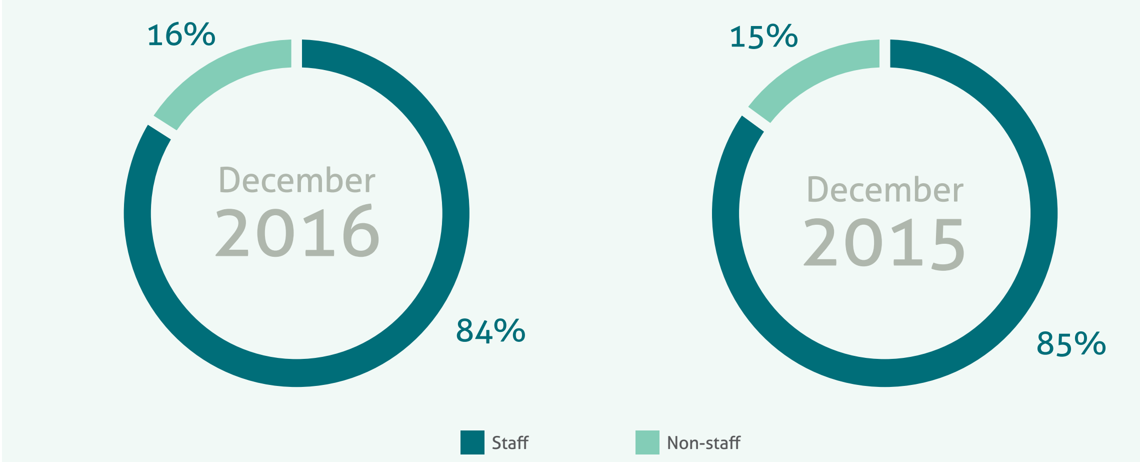


ORGANISATIONAL DEVELPMENT: TALENT MANAGEMENT AND SELECTION

The Human Resources department has carried out 79 selection processes and has made 37 new hires. This was performed in accordance with the principles of transparency, equal opportunity and anti-discrimination.

Throughout the first half of 2016, Sareb has adapted the organisational structure of the support areas for aligning with the needs derived from the business model implemented in 2015. As a basic element of this organisational development, and within the talent management policies, it has offered promotions to 36 employees. In addition, through the career opportunities process, 37 employees have had the chance to follow new career paths, strengthening their professional development.

In addition, in 2016 Sareb has continued working to retain and develop talent, and has presented the company with the Total Compensation model, which covers the following programmes:

- **DEVELOPMENT = 'YO SOY TALENTO SAREB' ("I AM SAREB TALENT") + 'SAREB Y YO' ("SAREB AND ME")**, whose objectives are the personal and professional growth of employees and the identification of areas for improvement in order to be able to adapt the 2017 training plan to each employee; Thus, it optimises employees ability to be hired, and constitutes a reference framework.

- The **2016 TRAINING PLAN**, that has included more than 11,300 training hours per year with 369 employees participating in 71 technical teaching seminars and 53 sessions about developing abilities. All of that has resulted in an average satisfaction grade of 8.8. In addition, five agreements have been signed with business schools.

- **PROFESSIONAL DEVELOPMENT MODEL** based on functions and responsibilities. This model is based on three professional groups: 'Staff', 'Control' and 'Business'. With their organisational levels, it enables development and recognition through three professional career paths: management, cross-departmental and specialisation.

- Promoting a natural **LEADERSHIP STYLE** linked to fulfilling the company's mandate, where each one of the Sareb employees is the protagonist of their professional trajectory.

SAREB AMBASSADORS

The Sareb Ambassadors project was launched from the Corporate Social Responsibility Area (CSR), which allows disclosing its values and social commitments acquired between the education community. Each one of its three phases favours the transfer of messages to secondary school and training cycle students, university students and residents in dormitories, and students of business schools. The first phase has already been implemented and the group of Sareb Ambassadors has been formed, made up of 22 volunteer employees of the company. In total, 22 sessions in 12 educational centres have been celebrated, bringing Sareb close to more than 760 students with very satisfactory results.

In addition, Sareb has continued collaborating in initiatives, such as the Start Programme, created by the Rafael del Pino Foundation, together with the UN Global Compact to bring the business world to secondary school students of Madrid. In 2016, it gave 12 sessions in 10 educational centres, reaching a total of 700 students.

6.3 Shareholders and bondholders

Sareb continuously evaluates its performance and is accountable to its shareholders and bondholders[1] through a fluid and constant dialogue that progressively gets stronger. The Company's commitment to transparency goes beyond purely fulfilling its mandate, but is a mechanism through which it is subjected to the critical judgement of the agents present in the markets in which it works and society as a whole.

The main channels of information with this collective are the Support Committees (11 meetings per year) and the shareholders' website, which is an exclusive platform for this collective on which 14 information announcements were published during the year. In addition, in-person and virtual meetings are held, and a specific mailbox is kept open for this collective.

NEW COMMUNICATION COMMITMENTS

Sareb has committed to shareholders and bondholders to encourage a more open communication policy about what is being carried out in the Support Committees, in addition to actively working to share the company's quarterly and half-year results in adequate periods of time after 2017. This policy has been applied, for example, as part of the capital conversion of part of the subordinated debt, as a result of applying the Bank of Spain Circular 5/2015. In addition, Sareb has established periodic information commitments about the financial situation, business plans and the company's main milestones.

> For Sareb, transparency is a mechanism whereby it is subjected to the critical assessment of various agents in the markets in which it operates and society as a whole

6.4 Supervisors

Due to the particular features of its business model, which make it subject to a special supervisory regime[2], Sareb maintains permanent contact with the authorities responsible for this control and faithfully follows their recommendations and requirements. To do so:

- It periodically publishes its main policies and procedures, both regarding the criteria with which it carries on its activities and operations, and the way in which it administers and exercises control over them.

- It publishes important information relating to its performance in half-yearly activity reports, annual reports and other public documentation on its most significant transactions.

[1] See section 4.6 about Financial Information for greater detail about the relationship of shareholders and bondholders.
2 Chapter 2 includes more information about Sareb's supervisory regime.

6.5 Clients

On the one hand, Sareb defines as customers parties who purchase assets (retail and wholesale customers) and, on the other, the borrower entities as a whole, which it works directly with to reduce its credit exposure and, therefore, fulfil its mandate.

Sareb's relationship with all of them is based on the premise of transparency and ensuring that all potential buyers are provided with the same information.

To do so, it has two sales channels that help the company serve the entire spectrum of investors and potential customers[3]:

- Retail: Management and sales to individuals and SMEs (properties and loans) through the platforms of the respective servicers (Altamira, Haya RE, Servihabitat and Solvia).
- Institutional[4]: This channel is intended for sales to professional and institutional investors. In 2016, Sareb actively participated in meetings and events with different investment funds and market specialists, in which it was able to explain its divestment strategies in addition to discover investors' needs first hand.

Both the internal and external visits have enabled the company to demonstrate its strategies within the portfolio available for sale on one hand, and on the other hand, to know the current market demands, and in this way, improve the strategies aimed at divestment.

With respect to the developer companies that have credits with Sareb –around 15,000– the company has made an effort to get closer to them in order to know their reality and improve suggestions in the service provided by their servicers. Thus, under the organisation of the Communication Department, in-person meetings were held in Alicante, Madrid, Malaga, Las Palmas, Madrid, Barcelona and Seville throughout 2016.

SAREB RESPONDE (900 115 500)

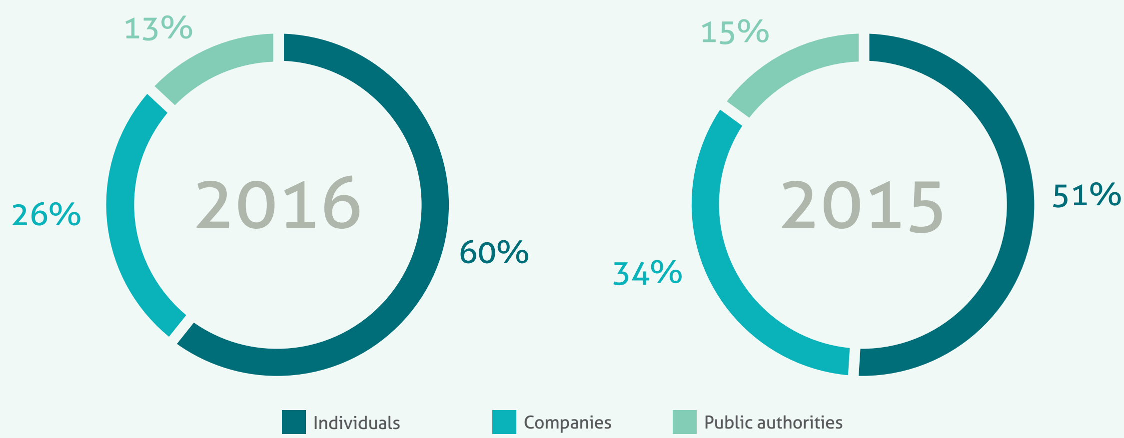
This channel, which was implemented with the objective of being a vehicle to tend to and resolve questions or complaints sent to the company, has ended up being established as a fundamental tool regarding communication with its clients. In 2016, more than 55,000 enquiries were made with an average of 4,500 managed per month. Even though telephone enquiries continue to be the most used (46% of the total), it is of note that the web channel has increased its presence threefold since 2015.

In 2016, more than 55,000 enquiries were made and the web channel received three times more enquiries than in 2015

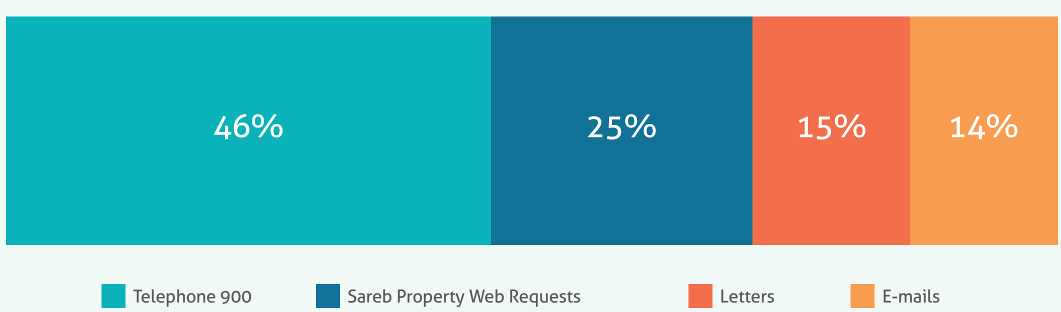
With respect to the customer profile that call the Sareb Responde service, 60% of calls relate to individuals, 26% to companies and 13% to public authorities (previous year: 51%, 34% and 5%, respectively).

3 See Chapter 4 for more information about Sareb's commercial activity.
4 See section 4.3 about loan management for more information about the institutional channel.

SAREB RESPONDE SERVICE CUSTOMER PROFILE 60



SAREB RESPONDE SERVICE INPUT CHANNEL 61



6.6 Suppliers

All acquisition of assets and services is based on optimising each purchase (quality-price relationship) and as a result of the principles of transparency, competition, supplier rotation and the prevention of supplier concentration.

Throughout 2016, new agreements were made with suppliers under the formula of competition with at least three interested parties. Among these new contracts, there is the financial and property asset filtering service, contracting more than 15 builders to carry out developments and develop lands, and approve and sign agreements with more than 15 appraisers.

In addition, Sareb has continued to work in collaboration with the servicers' purchase departments to analyse the acquisitions made for the company's assets, mainly in maintenance, surveillance and security.

As a result of the negotiations with the suppliers, important savings have been made that reach 5% of the committed expenditure, in addition to the following figures:

- More than 180 new contracts and addenda signed with suppliers.
- More than 2,000 requests.
- Work has been performed with more than 560 suppliers.

ACTIVE POLICY IN CSR

Through the Corporate Social Responsibility (CSR) policy, Sareb has assumed the commitment to develop a sustainable and responsible asset management model for its stakeholders.

> In 2016, the active policy was incorporated into the Corporate Social Responsibility (CSR) as an assessment criteria to approve suppliers.

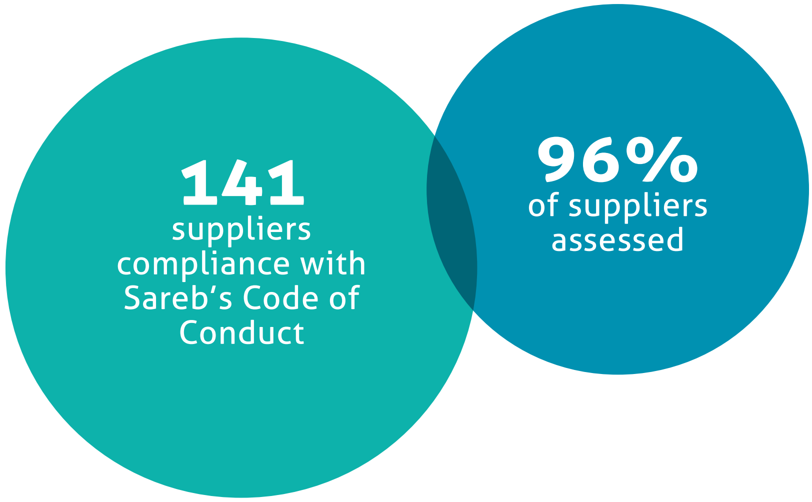
Among the new features inserted in 2016, the active policy in CSR was introduced as an assessment criteria for suppliers. This initiative evaluates aspects related to this matter for all suppliers who have participated in any of the 135 competitions launched by Sareb in the last year and that earn more than a certain amount. Among other aspects, it promotes quality relationships with their suppliers and develops approval procedures to search for continuous improvement and the benefit of both parties.

In the last year, the company has had 147 companies with which 141 have provided the necessary documentation for their approval, which means that 96% of the suppliers have been evaluated. It is of note that those 141 suppliers have complied with Sareb's Code of Conduct and more than 80 have shown willingness to collaborate in the initiatives regarding CSR that are being developed.

NEW COMMUNICATION CHANNEL WITH THE SERVICERS

It is important to highlight the intense relationship under the concept of the extended enterprise that Sareb maintains with its main suppliers –the four servicers. As was already explained, and beyond the existing solid contractual relationship, the servicers are the extension of the activities that the company carries out. Therefore, the alignment in principles, objectives and mission is essential so that the company successfully reaches its goal of divestment.

With the objective of promoting a common culture, sharing a meeting point for the sector, in collaboration with its servicers, Sareb has launched a digital informative bulletin, "Planeta Sareb" (Sareb Planet), which is published periodically, and also appears on social media.



Sareb

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

7

OUR COMMITMENT

7.1 Social housing

Sareb's commitment to Spanish society goes back to its foundation and fulfilling its divestment mission, thereby cleaning up the Spanish financial system at no additional cost to Spaniards. In parallel, Sareb has been developing voluntary lines of action that allow financing and reinforcing Sareb's social responsibility.

In this regard, one of its biggest contributions to society is Sareb's activity in social housing. It has developed different initiatives, such as providing new homes to different administrations and managing those that were delivered in previous years through a control of the agreements.

SOCIAL HOUSING ASSISTANCE PROGRAMME. In collaboration with different autonomous communities, Sareb has transferred homes under the premise of alleviating the situation of groups at risk of exclusion. With this objective, in 2016, Sareb expanded its agreements and has signed agreements with the Governments of Cantabria (40 homes), Andalusia (400), Navarra (30 homes), Extremadura (45) and Murcia (30, agreement pending signing). In addition, the company is talking with the Governments of Castilla-La Mancha and Valencia to transfer 350 more homes.

ASSISTANCE PROGRAMME FOR GROUPS IN A SOCIAL EMERGENCY SITUATION. Developed along with the city councils of large cities, the initiative contributes to alleviate the different types of extreme situations different groups are immersed in through the temporary transfer of usufruct in homes. In 2016, agreements have been signed with the city councils of Madrid (300 homes), San Sebastián de los Reyes (9), Malaga (6) and Seville (15). Sareb expects to incorporate this programme into the city councils of L'Hospitalet de Llobregat, Córdoba, Vigo, Zaragoza, Coslada, Getafe, Valdemoro and Pinto, with whom the talks are at a very advanced stage.

Of all the homes to be used for social purposes –nearly 4,000 units– Sareb has already committed a total of 2,340, benefiting more than 8,000 people.

AFFORDABLE ALTERNATIVE RENTAL HOUSING PROGRAMME. Implemented along with the social services of the autonomous communities and city councils, this programme is intended to provide

SOCIAL HOUSING

- **AGREEMENTS WITH THE ADMINISTRATION:** Sareb earmarks nearly 4,000 homes for social purposes
- **AFFORDABLE ALTERNATIVE RENTAL HOUSING PROGRAMME:** More than 600 procurement procedures have been studied
- **TEMPORARY ASSET TRANSFERS** to city councils and associations.

an alternative residential solution to vulnerable families. This programme involves the suspension of the repossession process and the activation of mediation proceedings with the occupiers of the home, permitting an analysis of the family's vulnerability, opening up the possibility of either contracting a lease reduced by up to 30% of the family's household income, or in lack thereof, through relocation to another home.

Sareb earmarks nearly 4,000 homes to social purposes

The 2017-2019 CSR Master Plan will serve as a framework for all actions regarding social responsibility that are done in this period.

TEMPORARY TRANSFERS. As in previous years, Sareb has tended to the requests of various city councils and neighbourhood associations for the temporary transfer of using different assets with the purpose of favouring the celebration of activities or community events. This line of action was consolidated after approving a Protocol of Temporary Transfer of Sareb's Land, which allows the systematisation of the transfer, granting greater legal security to them through a transfer contract model and a better inventory, and control of transfers granted. Likewise, the company has agreed to Operating Management Instructions, which starting in 2017 will allow extending the Management Protocol to different servicers.

On the other hand, the 2017-2019 Corporate Social Responsibility Master Plan was finished in 2016, and will serve as a framework for all actions regarding CSR that are carried out during that period.

COLLABORATIONS AND ALLIANCES

- In December 2016, Sareb renewed its annual commitment to the United Nations Global Compact, through which it is committed to working on behalf of the Ten Principles of the Millennium Development Goals and the 17 Sustainable Development Objectives implemented in the 2016-2030 Development Plan.

- In addition, Sareb has continued collaborating in initiatives, such as the Start Programme of the Rafael del Pino Foundation together with the Global Compact*.

- The company has also maintained contact with several NGO's and non-profit organisations in an attempt to satisfy residential demands or reach mutual agreements. Among many others, one of the most significant collaborations that Sareb has maintained is the one with the Soñar Despierto Foundation since 2016, which seeks social integration for minors and young people, and is being led by autonomous communities through social education projects.

7.2 Environment

Sareb is committed to respecting and protecting the environment, in accordance with the principles and approaches contained in its Environmental Management Policy, which was approved in January 2014. These principles are:

- **PRIORITISING QUALITY IN THE PERFORMANCE OF SERVICES AND CONSTRUCTION WORK**, eliminating costs with no value added and applying the measures necessary to prevent and correct any negative impact that the Company's activities may have on the environment.

- **FAVOURING PREVENTIVE ACTION OVER CORRECTIVE ACTION.** As regards the central offices, the following aspects are of note:

  - Implementation of the integral maintenance model to optimise the consumption of energy, materials and parts. With respect to the previous year, costs dropped by 19.72% in 2016, and the quality of service has improved by providing staff in the offices. In addition, lights are being progressively replaced for low-consumption LEDs, thereby improving energy efficiency.

  - Contracting through Ilunion, linked to ONCE and their Foundation, of the maintenance and cleaning service in the central offices to improve the integration of staff with disabilities and promote a more efficient use of the resources. Up to 25 people are integrated into this service, of which 84% have some type of disability.

  - **11.5% reduction in energy consumption with** respect to 2015.

  - Application of environmental criteria in the sustainable selection of office furniture.

  - Use of products with official eco-labelling, guaranteeing compliance with all potential environmental requirements throughout the Company's life-cycle.

  - Contracting the document destruction service stipulated in UNE-EN 15713:2010 level 5. In 2016, 2,052 kilos were recycled.

(*) See section 6.2 Sareb employees

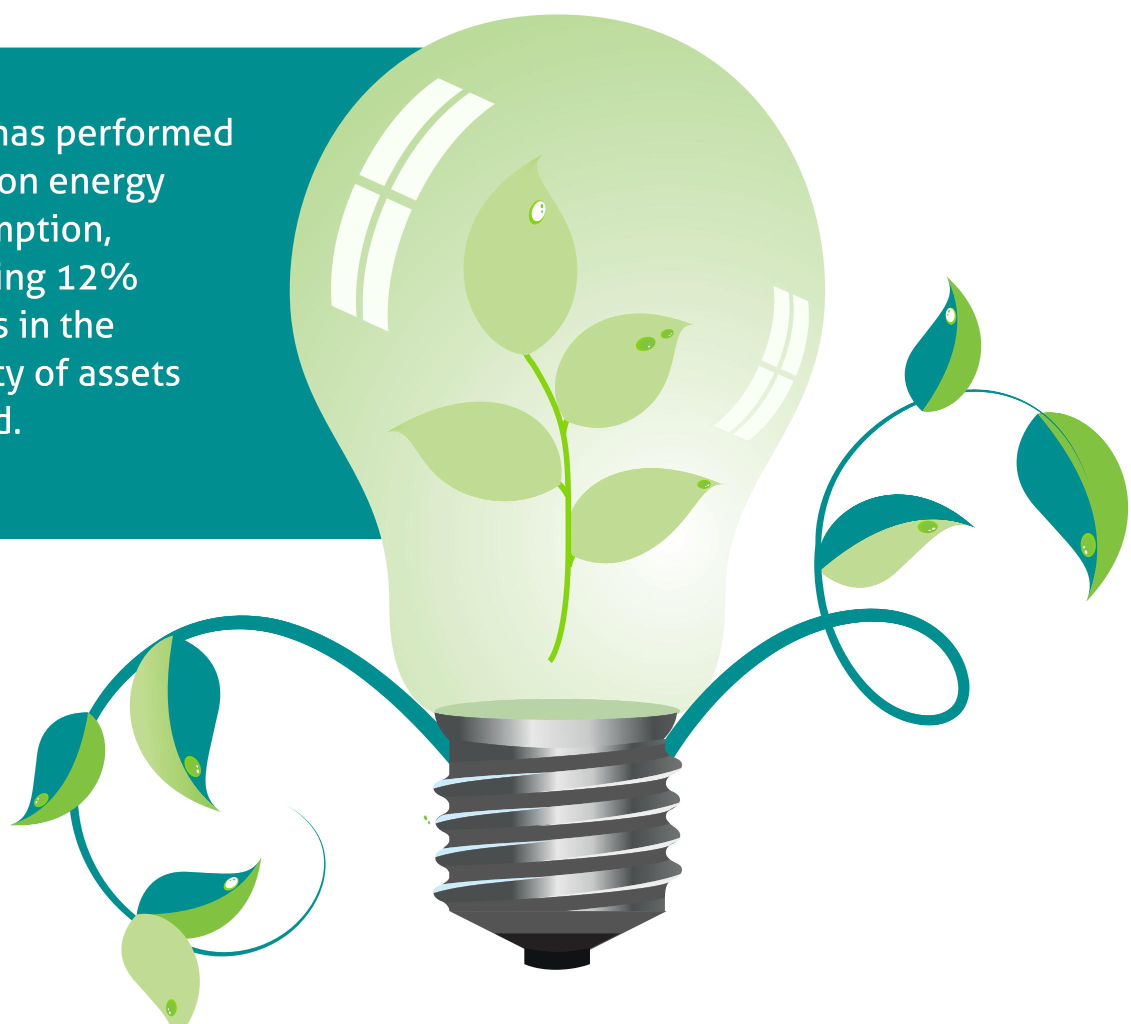
- Encouraging recycling and waste separation in the offices. During the year, 1,500 kilos of waste were generated that were deposited in a specific container to be handled.

As regards their singular assets, Sareb has performed audits about energy consumption, achieving 12% savings in the majority of assets audited.

Finally, it should be pointed out that Sareb works to improve the internal procedures for the fulfilment of environmental commitments and to prevent pollution, encouraging the pursuit of innovative and effective solutions.

Sareb has reduced energy consumption by 11.5% with respect to 2015

Sareb has performed audits on energy consumption, achieving 12% savings in the majority of assets audited.



ANNEX I: ABOUT THIS REPORT

PROFILE OF THE COMPANY'S ANNUAL REPORT
Sareb, Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A

PLACE
Spain

PERIOD COVERED
2016

FREQUENCY
Accounts

REGISTERED OFFICE
Paseo de la Castellana, 89,
Madrid 28046

CONTACT
Tel: +34 915 563 700
www. sareb.es

SELF-DIAGNOSIS OF INCORPORATING THE PRINCIPLES INTO THE INTEGRATED REPORT

CONTENT ELEMENTS OF THE INTEGRATED REPORT FRAMEWORK

Sareb's integrated report was made based on the principles established by the International Integrated Reporting Council (IIRC), following their recommendations and complying with the standard to create sustainability reports of the Global Reporting Initiative.

This report presents the relationship between the company's strategy, governance and financial performance in terms of the social, economic and environmental area in which it operates.

STRATEGIC FOCUS

Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria (Sareb) is committed to the recovery of the Spanish financial and property sectors. Thus, it has worked since 2012 to liquidate the portfolio of assets it received from those financial institutions that needed government assistance due to their high exposure to the property sector.

Through the annual publication of this report, Sareb has offered totally transparent information about its business model and business activity throughout 2016. In this way, its stakeholders can monitor the advances and results achieved during this period.

RELATED GROUPS

Sareb's stakeholders are:

- Shareholders and bondholders –private and public
- Supervisors
- Clients
- Suppliers
- Sareb employees
- Society as a whole

MATERIAL ASPECTS

To define the content of this document, Sareb has analysed both the company's strategic needs, as well as those of the most important challenges the company faces this year: the complete integration of its four servicers into the company's activity, and the regulatory framework defined by Bank of Spain Circular 5/2015, and later by Royal Decree 4/2016.

Three of the most representative aspects of the company in this period are:

BUSINESS MODEL:
Management and liquidation of the assets received, optimising their value before the end of 2027.

CAPACITY TO INNOVATE:
Sareb has committed to innovation in several plans, such as the creation of a loan sales platform that will be released in 2017.

ECONOMIC AND SOCIAL FOOTPRINT:

- **Public sector**
Sareb's main commitment is paying debt it issued to acquire its portfolio, and that is backed by the Government. Until now, it has reduced its debt by 20%. In addition, as the holder of a large volume of properties, it has contributed to public coffers with nearly EUR 600 million in taxes.

- **Property sector**
Sareb's activity is marked by innovation, professionalism and collaboration with the sector. Until now, some 2,000 small and medium companies have emerged from Sareb's orbit after settling their debt and are moving forward by themselves. In addition, it has earmarked more than EUR 230 million to the preservation and good condition of its property stock, and has invested EUR 32 million into developing land, and completing unfinished works. In order to do so, it has depended on national developers and co-investment formulas.

- **Social housing**
Sareb has collaborated since its inception with the Administration to facilitate the most vulnerable groups' access to housing. Currently, it has a social stock of 4,000 homes earmarked for affordable rent, of which more than 2,800 have already been transferred through agreements with ten autonomous communities and five city councils.

COMPARABILITY

In order to facilitate comparability and transparency, this report has been created, taking into account the global trends of the sector, the risks and opportunities they create, in addition to the future challenges and objectives of the organisation before the end of 2027.

CONTENT ELEMENT	ASPECTS INCLUDED	PAGES
ORGANISATIONAL VISION AND OPERATING CONTEXT	Mission and values of the Company/Organisational structure/ Shareholder composition/Activities/Characteristics of the market where it operates	16-19
GOVERNANCE	Corporate governance structure/Culture and ethical values of the organisation/Best practices of corporate governance implemented	18-25
OPPORTUNITIES AND RISKS	Opportunities derived from the future perspectives in the economic and regulatory areas/Evaluation of the risks associated with the future perspectives	80-83
STRATEGY AND RESOURCES	The Company's strategic plan/Resources it uses to obtain the expected results	6-7
BUSINESS MODEL	How Sareb creates value based on some resources and business processes	28-35
PERFORMANCE AND RESULTS	Key performance indicators/Performance in the different areas of management, measured through indicators/Results of the enquiries to related groups, which indicate the degree of fulfilling their needs, expectations and interests	38-77
FUTURE VISION	Opportunities, challenges and uncertainties that the Organisation may find for carrying out its strategy/Risks associated with the business and fulfilling the strategy	82-85
BASES FOR PREPARATION AND PRESENTATION	Process of analysing materiality/Scope of the information reported	103-105
GENERAL INFORMATION REPORTING PRINCIPLES	Material matters/Key quantitative indicators/Reporting period and level of aggregating information	103-105

ANNEX II - INDEX OF GRAPHICS

Chapter 6 – Our team and other stakeholders

Sareb

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

8

AUDITED ACCOUNTS

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

Financial Statements corresponding to the year ending 31 December 2016
Directors' Report

This version 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 or opinions, the original language version takes precedence over this translation.

INDEPENDENT AUDITOR'S REPORT ON ANNUAL ACCOUNTS

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

Report on the annual accounts

We have audited the accompanying annual accounts of Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A., which comprise the balance sheet as at December 31, 2016, and the income statement, statement of changes in equity, cash flow statement and related notes for the year then ended.

Directors' Responsibility for the annual accounts

The company's Directors are responsible for the preparation of these annual accounts, so that present fairly the equity, financial position and financial performance of Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A., in accordance with the financial reporting framework applicable to the entity in Spain, as identified in Note 2 to the accompanying annual accounts, and for such internal control as Directors determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these annual accounts based on our audit. We conducted our audit in accordance with legislation governing the audit practice in Spain. This legislation requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the annual accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the annual accounts. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the annual accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the annual accounts 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the presentation of the annual accounts taken as a whole.

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

PricewaterhouseCoopers Auditores, S.L., Torre PwC, Pº de la Castellana 259 B, 28046 Madrid, España
Tel.: +34 915 684 400 / +34 902 021 111, Fax: +34 915 685 400, www.pwc.es

R. M. Madrid, hoja 87.250-1, folio 75, tomo 9.267, libro 8.054, sección 3ª
Inscrita en el R.O.A.C. con el número S0242 - CIF: B-79 031290

pwc

Opinion

In our opinion, the accompanying annual accounts present fairly, in all material respects, the equity and financial position of Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A. as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with the applicable financial reporting framework, and in particular, with the accounting principles and criteria included therein.

Emphasis of matter

We draw attention to Note 2.5 to the annual accounts, which describes that the accompanying annual accounts for 2016 are the first that the Directors have prepared applying Royal Decree-law 4/2016, of December 2, of urgent financial measures, which establishes that the impairment of the assets units should be recognised in the balance sheet in "Valuation Adjustments" within Equity. Additionally, as indicated in the mentioned Note, the Royal Decree-law establishes that the impairment recognised on said heading will not be considered Equity for the purposes of mandatory share capital reduction and mandatory dissolution due to incurred losses, according to the Spanish Companies Act. In accordance with the content of section III of the mentioned Royal Decree-law, the Company has applied this modification retroactively, as it has been considered a change in accounting policy. The main impacts arising as a result of its first application are included in Note 2.5. Therefore, the corresponding figures for the preceding year differ from those approved in 2015 annual accounts that were prepared using the legislation in force in that year. This matter does not modify our opinion.

Report on other legal and regulatory requirements

The accompanying Directors' Report for 2016 contains the explanations which the Directors consider appropriate regarding the Company's situation, the development of its business and other matters and does not form an integral part of the annual accounts. We have verified that the accounting information contained in the Directors' Report is in agreement with that of the annual accounts for 2016. Our work as auditors is limited to checking the Directors' Report in accordance with the scope mentioned in this paragraph and does not include a review of information other than that obtained from the company's accounting records.

PricewaterhouseCoopers Auditores, S.L.

Original in Spanish signed by
Pedro Barrio Luis

31 March 2017

SOCIEDAD DE GESTIÓN DE ACTIVOS PROCEDENTES DE LA REESTRUCTURACIÓN BANCARIA, S.A. (SAREB)

BALANCE SHEET AS AT 31 DECEMBER 2016 AND 31 DECEMBER 2015

(Thousands of euros)

ASSET	Notes	31/12/2016	31/12/2015 Restated	LIABILITY	Notes	31/12/2016	31/12/2015 Restated
NON-CURRENT ASSET		**36,612,166**	**41,371,628**	**EQUITY**	**Note 11**	**(2,657,271)**	**(3,161,282)**
Intangible Asset	**Note 4.1**	**16,294**	**11,939**	***SHAREHOLDERS EQUITY***		**2,619,943**	**1,112,293**
Intellectual Property		52	58	**Capital**			
Computer Software		16,242	11,881	Registed capital		303,862	300,060
Property, Plant and Equipment	**Note 4.2**	**3,949**	**2,986**	**Share Premium**		-	900,000
Furniture		187	198	**Legal Reserve**		19,174	-
Technical Facilities and Other Property, Plant and Equipment		3,356	2,284	**Other Reserves**		2,959,698	14,794
Computer Equipment		406	504	**Profit (loss) for the year**		(662,791)	(102,561)
Investment Property	**Note 5**	**11,986,731**	**11,646,029**	***VALUATION ADJUSTMENTS-***	**Note 13.3**	**(5,277,214)**	**(4,273,575)**
Land		5,019,864	4,884,955	**- Hedges**		(1,987,672)	(1,943,305)
Completed Properties		6,966,867	6,761,074	**- Impairment of Financial Assets**		(3,289,542)	(2,330,270)
Non-Current Investments in Associates		**31,667**	**21,497**				
Equity Instruments	**Note 7.2.1**	9,702	1,897				
Credit Facilities to Associates	**Note 7.2.2**	21,965	19,600	**NON-CURRENT LIABILITY**		**42,267,482**	**46,045,819**
Non-Current Financial Assets	**Note 7.1**	**23,679,348**	**28,227,455**	**Long-term Provisions**	**Note 12**	**10,947**	**9,485**
Loans to Third Parties and Related Parties		20,902,659	25,555,635	**Non-Current Payables**	**Note 13**	**42,256,535**	**46,036,334**
Other Financial Assets		2,776,689	2,671,820	Debt Instruments and Other Marketable Securities		39,068,660	42,857,376
Deferred Tax Assets	**Note 15.3**	**894,177**	**1,461,722**	Derivatives		2,686,801	2,591,073
				Other Financial Liabilities		501,074	587,885
CURRENT ASSET		**7,479,907**	**6,255,712**	**CURRENT LIABILITY**		**4,481,862**	**4,742,803**
				Short-term provisions		**2,533**	**804**
Inventories	**Note 8**	**150,765**	**117,619**	**Current payables**	**Note 13**	**4,021,772**	**4,309,594**
Work in Progress		95,085	77,286	Bank Borrowings		61,430	57,823
Finished Products		21,764	12,121	Debt Instruments and Other Marketable Securities		3,959,509	4,228,773
Supplier Advances		33,916	28,212	Other Financial Liabilities		833	22,998
Trade and Other Receivables	**Note 9**	**252,032**	**219,779**	**Trade and Other Payables**	**Note 14**	**457,557**	**425,656**
Trade Receivables for Sales and Services		218,448	168,856	Suppliers		341,029	352,999
Sundry Accounts Receivable		26,437	37,517	Sundry accounts payable		-	-
Staff		7	-	Remuneration payable		11,989	6,942
Current Tax Asset	**Note 15.1**	5,899	13,406	Current Tax Liability		-	-
Other Current Tax Receivables	**Note 15.1**	1,241	-	Other Current Tax Payables	**Note 15.1**	75,258	63,693
Current Investments	**Note 7.1**	**3,584,025**	**2,681,991**	Customer Advances		29,281	2,022
Loans to companies		3,558,690	2,674,580	**Unearned income**		**-**	**6,749**
Other Financial Assets		25,335	7,411				
Current investments in associates		**-**	**30**				
Loans to companies		-	30				
Prepayment for current assets		**-**	**2,060**				
Cash and Cash Equivalents	**Note 10**	**3,493,085**	**3,234,233**				
Cash		1,726,822	1,638,254				
Cash Equivalents		1,766,263	1,595,979				
TOTAL ASSETS		**44,092,073**	**47,627,340**	**TOTAL EQUITY AND LIABILITIES**		**44,092,073**	**47,627,340**

SOCIEDAD DE GESTIÓN DE ACTIVOS PROCEDENTES DE LA REESTRUCTURACIÓN BANCARIA, S.A. (SAREB)

STATEMENT OF PROFIT AND LOSS FOR 2016 AND 2015

(thousands of euros)

	Notes	2016	2015 Restate
CONTINUING OPERATIONS			
Revenue	**Note 16.1**	**2,134,149**	**2,201,999**
Inventory Sales		23,659	14,086
Income from Investment Property Sales		986,238	769,076
Rental Income		42,135	42,011
Income from Sales of Loans and Credit Facilities		474,285	395,848
Financial Income from Loans and Credit Facilities		890,563	588,706
Margin of Loan and Credit Recoveries		(283,634)	382,776
Remuneration of Bank Asset Fund (FAB) Securities		903	9,496
Inventory Fluctuation for Finished Products and Works in Progress	**Note 16.2**	**(17,483)**	**(10,327)**
Cost of Sales	**Note 16.2**	**(1,479,361)**	**(976,282)**
Investment Property Cost		(886,246)	(606,554)
Financial Asset Sales Cost		(593,115)	(369,728)
Other Operating Income		**26,523**	**6,436**
Accessory Income and Other Management Income		26,523	6,436
Staff Costs	**Note 16.3**	**(39,401)**	**(36,974)**
Wages, Salaries and Similar Expenses		(34,606)	(31,773)
Social Charges		(4,795)	(5,201)
Other Operating Expenses		**(658,769)**	**(593,667)**
Outside Services	**Note 16.4**	(445,375)	(375,286)
Taxes	**Note 16.4**	(197,205)	(192,902)
Losses, Impairment and Fluctuations for Commercial Transactions	**Notes 9 and 12**	(14,795)	(19,181)
Other Management Income		(1,394)	(6,298)
Depreciation & Amortisation charge	**Notes 4.1, 4.2 and 4.3**	**(67,775)**	**(57,449)**
Provision Excesses	**Note 12**	**-**	**46,125**
Impairment of Financial Instruments		**(2,427)**	**(5,604)**
- Loans and Credit Facilities to Third Parties	**Note 7.1.1.**	-	-
- Equity Instruments and Loans and Credit Facilities to Associates	**Note 7.2.2.**	(2,427)	(5,604)
PROFIT FROM OPERATIONS		**(104,544)**	**574,257**
Finance Income	**Note 16.6**	**19,174**	**12,715**
Marketable Debt Securities and Other Financial Instruments			
- To Third Parties		19,174	12,715
Financial Costs	**Note 16.5**	**(577,465)**	**(724,454)**
Debts to Third Parties		(560,132)	(700,313)
Other Financial Costs		(17,333)	(24,141)
Exchange Differences	**Note 4.12**	**187**	**2,318**
FINANCIAL RESULT		**(558,104)**	**(709,421)**
RESULT BEFORE TAXES		**(662,648)**	**(135,164)**
Income Tax	**Note 15**	(143)	32,603
RESULT OF THE YEAR FROM CONTINUING OPERATIONS		**(662,791)**	**(102,561)**
RESULT OF THE YEAR		**(662,791)**	**(102,561)**

Notes 1 to 19 described in the attached report form an integral part of the 2016 statement of profits and losses.

SOCIEDAD DE GESTIÓN DE ACTIVOS PROCEDENTES DE LA REESTRUCTURACIÓN BANCARIA, S.A. (SAREB)

STATEMENT OF CHANGES IN EQUITY AND RECOGNISED PROFITS AND LOSSES STATEMENT FOR 2016 AND 2015

(Thousands of euros)

	Notes	2016	2015 Restated	Restatement effect	2015 prepared
RESULT OF THE PROFIT AND LOSS STATEMENT (I)	Note 3	**(662,791)**	**(102,561)**	**(102,893)**	**332**
Income and Expense Recognised Directly in Equity					
- Cash Flow Hedges	Note 15.2	(564,763)	(183,143)	-	(183,143)
- Due of Financial Asset Unit Impairment	Note 7.1	(376,938)	(337,172)	(337,172)	-
- Tax Effect	Note 15.2	(441,144)	485,851	440,065	45,786
TOTAL INCOME AND EXPENSES RECOGNISED DIRECTLY IN EQUITY (II)		**(1,382,845)**	**(34,464)**	**102,893**	**(137,357)**
Income and Expenses Recognised in the Profits and Losses Statement					
- Cash Flow Hedges	Note 13.3	505,607	302,059	-	302,059
- Tax Effect		(126,402)	(75,515)	-	(75,515)
TOTAL TRANSFERS TO THE PROFITS AND LOSSES STATEMENT (III)		**379,205**	**226,544**	**-**	**226,544**
TOTAL RECOGNISED INCOME AND EXPENSES (I+II+III)		**(1,666,431)**	**89,519**	**-**	**89,519**

Notes 1 to 19 of the report attached form an integral part of the 2016 Recognised Income and Expenses Statement.

SOCIEDAD DE GESTIÓN DE ACTIVOS PROCEDENTES DE LA REESTRUCTURACIÓN BANCARIA, S.A. (SAREB)

STATEMENTS OF EQUITY VARIATIONS DURING 2016 AND 2015
TOTAL STATEMENT OF EQUITY VARIATIONS
(Thousands of euros)

	Capital	Share Premium	Legal Reserve	Unavailable Reserve	Reserves by applying RD 4/2016	Negative Results from Previous Years	Offsetting the Profit for the Year	Adjustments for Variations of Value - Financial Derivatives	Adjustments for Variations of Value - FA Impairment	TOTAL
CLOSING BALANCE 2014	**300,060**	**900,000**	**-**	**-**	**-**	**(1,614,387)**	**(803,983)**	**(2,032,492)**	**-**	**(3,250,802)**
- Adjustments due to Variations in accounting policies (Note 2.5)	-	-	-	-	1,365,283	-	1,067,880	-	(2,433,163)	-
OPENING BALANCE 2015 RESTATED	**300,060**	**900,000**	**-**	**-**	**1,365,283**	**(1,614,387)**	**263,897**	**(2,032,492)**	**(2,433,163)**	**(3,250,802)**
Total Recognised Income and Expenses	-	-	-	-	-	-	(102,561)	89,187	102,893	89,519
Transactions with Shareholders										
2014 Result Dividends	-	-	-	-		(803,983)	803,983	-	-	-
Other Equity Variations (Note 2.5)	-	-	-	-	1,067,880	-	(1,067,880)	-	-	-
CLOSING BALANCE 2015 RESTATED	**300,060**	**900,000**	**-**	**-**	**2,433,163**	**(2,418,370)**	**(102,561)**	**(1,943,305)**	**(2,330,270)**	**(3,161,282)**
Total Recognised Income and Expenses	-	-	-	-	-	-	(662,791)	(44,367)	(959,272)	(1,666,430)
Transactions with Shareholders										
2015 Result distribution	-	-	33	-	-	299	(332)	-	-	-
Other equity movements (Note 2.5)	-	-	-	-	(102,893)	-	102,893	-	-	-
Reduction of Share Capital to Offset Prior Years' Losses (Note 11)	(300,060)	(900,000)	(33)	-	-	1,200,093	-	-	-	-
Expansion of Share Capital by Converting Financial Liabilities (Note 11)	2,170,440	-	-	-	-	-	-	-	-	2,170,440
Reduction of Share Capital to Offset Losses and Legal Reserve Charges (Note 11)	(1,237,151)	-	19,174	-	-	1,217,977	-	-	-	-
Reduction of Share Capital for Unavailable Reserve Charge (Note 11)	(629,428)	-	-	629,428	-	-	-	-	-	-
CLOSING BALANCE 2016 (Note 11)	**303,862**	**-**	**19,174**	**629,428**	**2,330,270**	**-**	**(662,791)**	**(1,987,672)**	**(3,289,542)**	**(2,657,272)**

Notes 1 to 19 of the report attached form an integral part of the 2016 Total Statement of Equity Variations.

SOCIEDAD DE GESTIÓN DE ACTIVOS PROCEDENTES DE LA REESTRUCTURACIÓN BANCARIA, S.A. (SAREB)

2016 AND 2015 CASH FLOW STATEMENTS
(Thousands of euros)

		2016	2015 Restated
A)	**OPERATING ACTIVITY CASH FLOWS (1+2+3+4)**	**2,298,928**	**2,346,672**
1.	**Result Before Tax**	**(662,648)**	**(135,164)**
2.	**Adjustments for the Result:**	**(247,275)**	**159,142**
(+/-)	Depreciation and amortisation charge	67,775	57,449
(+/-)	Financial Costs	577,465	724,454
(+/-)	Finance Income	(19,174)	(12,715)
(+/-)	Financial Income from Interests on Loans and Credit Facilities	(890,563)	(588,706)
(+/-)	Other Adjustments of the year	-	(46,125)
(+/-)	Loss-on & write-off of trade receivables & provision charges for commercial transactions	14,795	19,181
(+/-)	Impairment of Financial Instruments	2,427	5,604
2.a	**Tax Payments (-)**	**(1,935)**	**(3,950)**
3.	**Increase / (Reduction) for Assets and Liabilities**	**3,295,844**	**2,651,451**
	Increase / (Reduction) in Inventory (+/-)	(1,156)	(17,756)
	Increase / (Reduction) in Accounts Receivable (+/-)	(13,393)	133,772
	Increase / (Reduction) in Other Current Financial Assets (+/-)	(17,925)	22,488
	Increase / (Reduction) in Accounts Payable (+/-)	31,902	47,745
	Increase / (Reduction) in Other Current Financial Liabilities (+/-)	(22,165)	22,657
	Increase / (Reduction) in Loans and Credit Facilities to Third Parties	2,450,297	1,829,152
	Increase / (Reduction) in Investment Property	868,284	613,392
4.	**Other Operating Activity Cash Flows:**	**(85,057)**	**(324,808)**
(-)	Interest paid	(557,092)	(741,403)
(+)	Interest received	4	12,715
(+/-)	Interest received from Loans and Credit Facilities	472,031	403,880
(+/-)	Other Charges/(Payments) for Operating Activities	-	-
B)	**INVESTMENT ACTIVITY CASH FLOWS (1+2)**	**(117,491)**	**(29,310)**
1.	**Investment Payments:**	**(117,491)**	**(29,310)**
(-)	Property, plant and equipment and intangible assets	(10,258)	(9,928)
(-)	Credit Facilities and Ownership in Associated Companies	(2,365)	(3,379)
(-)	Other Financial Assets	(104,868)	(16,003)
2.	**Divestment Charges:**	**-**	**-**
(+)	Companies of the Group, Associated Companies and Business Units	-	-
(+)	Property, plant and equipment and intangible assets	-	-
C)	**FINANCING ACTIVITY CASH FLOWS (1+2+3)**	**(1,922,585)**	**(2,033,743)**
1.	**Proceeds and (Payments) relating for Equity Instruments:**	**-**	**-**
(+)	Issuance	-	-
(-)	Depreciation	-	-
(-)	Acquisition	-	-
(+)	Disposal of Treasury Shares	-	-
2.	**New Net Financing Obtained with Third Parties**	**(1,922,585)**	**(2,033,743)**
(+)	Other Non-current Financial Liabilities	(84,094)	(62,333)
(-)	Disposals/(Depreciation) of Credit Accounts	3,609	4,589
(-)	Repayment and Depreciation	(1,842,100)	(1,976,000)
3.	Net Charges for Issuing Treasury Values	-	-
D)	**EFFECT OF THE EXCHANGE RATE CHANGES**	-	-
E)	**NET INCREASE/(DECREASE) OF CASH AND CASH EQUIVALENTS (A+B+C+D)**	**258,852**	**283,618**
F)	**CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR**	**3,234,233**	**2,950,615**
G)	**CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR**	**3,493,085**	**3,234,233**
	CASH AND CASH EQUIVALENTS COMPOSITION AT THE END OF THE YEAR		
(+)	Cash and Banks	1,726,822	1,638,254
(+)	Other Financial Assets	1,766,263	1,595,979
(-)	Less: Bank Overdrafts Repayable On Demand		
	TOTAL CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	**3,493,085**	**3,234,233**

Notes 1 to 19 described in the report attached form an integral part of the 2016 Cash Flow Statement

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

Financial Statement
Corresponding to the year ending
31 December 2016

1. Company activities

Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A. (“the Company” or “Sareb”) was incorporated in Madrid for an indefinite period of time on 28 November 2012, in accordance with Law 9/2012, of 14 November, on restructuring and resolution of credit institutions, under the name of Sociedad Promotora de la Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A., as a sole-shareholder public limited liability company, with the object of performing all the preparatory activities required for the start-up of Sareb. The Company is registered at the Madrid Mercantile Registry in volume 30.521, sheet 1, section 8, page M-549.293, entry 1.

On 12 December 2012, the duration and name of the Company were changed by virtue of a public deed of corporate resolutions executed on that date before the Madrid notary José María García Collantes, under number 1624 of his protocol, establishing the limit for the duration of the Company as 28 November 2027 and adopting its current name.

At 31 December 2016, the Company's registered office and tax domicile were located at Paseo de la Castellana, 89, Madrid.

The Company is governed by its bylaws and by the laws in force applicable to it, i.e. the current Spanish Limited Liability Companies Law (except for Articles 537 and 348 bis), as stipulated by Law 9/2012, of 14 November, on restructuring and resolution of credit institutions, as well as the specific rules necessary to ensure the consistency of the accounting principles applicable to it with the mandate and general objectives of the Company established in the aforementioned Law and those set by regulations (see Note 2.1).

The Company's object is the ownership, management and direct or indirect administration, acquisition and disposal of the assets and any liabilities that may be transferred to it by the credit institutions referred to in Additional Provision Nine of Law 9/2012 (or any legislation that might replace, implement or complement it) appearing on the balance sheets of those institutions or of any entity controlled by them as defined in Article 42 of the Spanish Commercial Code (and of any other assets and liabilities it might acquire in the future as a result of the aforementioned management and administration of the former).

Without prejudice to the company object described above, pursuant to the legislation regulating it, the Company must contribute to the appropriate implementation of the credit institution restructuring or resolution processes that were in progress when it was incorporated, and facilitate achievement of the objectives envisaged in Article 3 of Royal Decree 1559/2012, in accordance with the general principles of transparency and professional management, i.e.:

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

b) To minimise public financial support.

c) To settle any debts and liabilities which it may incur in the course of its operations.

d) To minimise the possible market distortions that might arise from its activities.

e) To dispose of the assets received, optimising their value within the term for which it was incorporated.

Background to the incorporation of the Company and transfer of the assets

2012: Acquisition of assets from Group 1 institutions

At 21 December 2012, Sareb and the institutions that comprised the aforementioned Group 1 formalised the corresponding asset transfer agreements, which as stipulated, did not display full effects until 31 December 2012. These said assets were transferred to Sareb as a whole and free of encumbrances by the transferor institutions in Group 2 for a single price of EUR 36,695,308 thousand, and were acquired by Sareb through the issuance of senior bonds totalling EUR 36,694,100 thousand, which were subscribed by the transferor institutions. The payment of the difference between the transfer price and the value of the bonds issued was deferred for 36 months, and could be offset by the Company against any amounts owed to it by the transferor institutions under the terms and conditions established in the asset transfer agreements. At 31 December 2013, the aforementioned amount had been settled and there were no balances in this connection in the balance sheet attached as at that date.

The detail is presented below, by type at that date, of the assets transferred by Group 1 institutions:

	Amounts in thousands of euros
Financial Assets	28,298,902
Property Assets	8,396,406
Total	36,695,308

The detail, by risk classification, of the financial assets transferred by Group 1 institutions is as follows:

Amounts in thousands of euros	Number of assets	Total transfer price
Loans	62,435	26,493,181
Standard	28,047	8,368,902
Substandard	11,877	6,646,904
Doubtful	22,511	11,477,375
Credit facilities	5,714	1,805,721
Standard	1,810	537,427
Substandard	870	495,392
Doubtful	3,029	557,025
Other	5	215,877
Total	68,149	28,298,902

The detail of the property assets transferred by Group 1 institutions is as follows:

Amounts in thousands of euros	Number of assets	Total transfer price
Land	10,322	2,812,430
Completed properties for sale	30,158	2,426,138
Leased properties	5,822	927,620
Total investment property	46,302	6,166,188
Work in progress	3,050	470,124
Completed properties	27,682	1,760,094
Total inventories	30,732	2,230,218
Total	77,034	8,396,406

The main features of the senior bonds issued by the Company as subscribed by entities of Group 1 at 21 December 2012 in payment of the aforementioned assets are summarised as follows:

ISIN code	Description	Issue date	Maturity date (**)	Current applicable rate	Par value (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

(*) These bonds are backed by the irrevocable guarantee of the Kingdom of Spain (see Note 13.2).
(**) There is a renewal option at the Company's discretion, as described in Note 13.

These bonds were subscribed by the transferor institutions, the detail being as follows:

	Amounts in thousands of euros
Bankia, S.A./Banco Financiero 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**

2013: Acquisition of assets from Group 2 institutions

On 20 December 2012, the European Commission approved the restructuring plans for the financial institutions included in 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.) following approval thereof by the Bank of Spain.

The assets were transferred to Sareb as a whole and free of encumbrances by the transferor institutions in Group 2 for a single price of EUR 14,087,157 thousand, and were acquired by Sareb through the issuance of senior bonds totalling EUR 14,086,700 thousand, with a nominal value of EUR 100 thousand each, which were subscribed by the transferor institutions. The payment of the difference between the transfer price and the value of the bonds issued was deferred for 36 months, and could be offset by the Company against any amounts owed to it by the transferor institutions under the terms and conditions established in the asset transfer agreements. At 31 December 2013, the aforementioned amount had been settled and there were no balances in this connection in the balance sheet as at that date.

The detail, by type at that date, of the assets transferred by Group 2 institutions is as follows:

	Amounts in thousands of euros
Financial Assets	11,139,891
Property Assets	2,947,266
Total	**14,087,157**

The detail, by risk classification, of the financial assets transferred by Group 2 institutions is as follows:

Amounts in thousands of euros	Number of assets	Total transfer price
Loans	21,889	10,855,331
Standard	9,337	4,642,163
Substandard	1,800	1,872,775
Doubtful	10,752	4,340,393
Credit facilities	727	284,560
Standard	270	125,758
Substandard	137	44,161
Doubtful	230	110,643
Other	90	3,998
Total	**22,616**	**11,139,891**

The detail of the property assets transferred by Group 2 institutions at that date is as follows:

Amounts in thousands of euros	Number of assets	Total transfer price
Land	4,630	1,062,531
Halted construction work	1,445	163,505
Completed properties for sale	23,404	1,619,800
Leased properties	906	98,140
Total investment property	30,385	2,943,976
Work in progress	27	3,290
Total inventories	27	3,290
Total	**30,412**	**2,947,266**

The main features of the senior bonds subscribed on 28 February 2013 in payment of the aforementioned assets are summarised as follows:

ISIN code	Description	Issue date	Maturity date (**)	Current applicable rate	Nominal balance (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

(*) These bonds are backed by the irrevocable guarantee of the Kingdom of Spain (see Note 13.2).
(**) There is a renewal option at the Company's discretion, as described in Note 13.

These bonds were subscribed by the transferor institutions, the detail being as follows:

	Amounts in 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**

Corrections made to the asset acquisition agreements in 2016 and 2015

In 2016 and 2015, in compliance with the provisions of Royal Decree 1559/2012 and the terms and conditions of the asset transfer agreements, the loan and credit facility portfolios and the property asset portfolios acquired from Group 1 and 2 institutions were reviewed in order to identify any miscategorisations of assets, changes in scope and errors or changes in the values estimated at the transfer date.

As a result of the aforementioned analysis conducted by the Company for each year, corrections totalling EUR 69 million were made in 2016 (2015: EUR 76 million), through the return to Group 1 and 2 transferor institutions of assets amounting to EUR 64 million (2015: EUR 69 million) and adjustments to the transfer price of EUR 5 million (2015: EUR 7 million), thus reducing the amount of property assets initially transferred by EUR 33 million (2015: EUR 13 million) and that of loans and credit facilities by EUR 35 million (2015: EUR 63 million). In addition, during 2016, EUR 1 million corresponding to balances pending to be offset between the Company and the entities for differences and transfer was corrected.

As consideration, the transferor institutions delivered to Sareb a portion of the aforementioned bonds issued as payment for the transferred portfolios, for an amount equal to the returned assets, together with the cash amount of the coupons received by the institutions in relation to the bonds delivered. In addition, under the transfer agreement, the institutions incurred a compensatory interest rate of 1% per annum of the total coupon paid by the Company on the returned bonds, amounting to EUR 10 thousand in 2016 (2015: EUR 7thousand).

The summary of the corrections made in 2016 and 2015 is as follows:

2016

Amount in thousands of euros	Corrected Property Assets (Note 5) **	Corrected Financial Assets (Note 7) **	Differences between formalisation and transfer (***)	Total Correction	Exchange (*****)	Returned Bonds (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**

(*) Relates to the difference, settled in cash, between the total amount of the correction and the amount of the bonds returned.

(**) EUR 1,020 thousand of the amount of the property assets corrected related to properties sold by the Company prior to the correction, and 497 thousand of loans sold prior to the correction. The cash obtained by the Company from these sales was returned to the related institutions.

(***) Refers to changes in the transferred assets from the closure of the scope until the public deed transfer of the entities of Group 1 and Group 2.

(****) In the case of the Banco Mare Nostrum, S.A. Correction, the EUR 23,177 thousand in bonds will not be returned until the final liquidation with said entity that is expected to occur before the first 4 months of 2017. Until said liquidation occurs, the Company includes the amount owed by said entity in "Trade and Other Receivables" (see Note 9).

(*****) In addition, in 2016, Banco Caja España de Inversiones Salamanca y Soria, S.A. and Bankia, S.A. have delivered to the Company several property assets for the amount of EUR 8,485 thousand and financial assets for the amount of EUR 57 thousand to offset the corrected assets.

2015

Amount in thousands of euros	Corrected Property Assets (Note 5) **	Corrected Financial Assets (Note 7)	Total Correction	Returned Bonds (Note 13.2)	Cash Adjustment (*)
Banco Mare Nostrum, S.A.	502	-	502	(400)	102
Catalunya Caixa, S.A.	9,568	37,714	47,282	(47,100)	182
Banco Caja España de Inversiones, Salamanca y Soria, S.A.	-	455	455	(400)	55
Banco de Valencia, S.A.	239	-	239	(200)	39
Banco Gallego, S.A.	2,289	4,595	6,884	(6,700)	184
Bankia, S.A./Banco Financiero de Ahorros, S.A.	-	20,632	20,632	(20,400)	232
Total	**12,598**	**63,396**	**75,994**	**(75,200)**	**794**

(*) Relates to the difference, settled in cash, between the total amount of the correction and the amount of the bonds returned.
(**) EUR 5 thousand of the amount of the property assets corrected related to properties sold by the Company prior to the correction. The cash obtained by the Company from these sales was returned to the related institutions.

In adition, in 2016, 2015 and 2014, the Company entered into various settlement agreements with the transferor institutions (except for Banco Mare Nostrum, S.A.) whereby the parties agreed to waive the right to demand subsequent adjustments to the price and the 36-month period envisaged in the asset transfer agreement for the filing of claims. The Company is still entitled to exercise such rights and actions as might be legally or contractually attributed to it in relation to latent defects or damage and losses. This agreement does not mean that scope adjustments cannot be made with these institutions in the future in relation to assets incorrectly transferred because they did not comply with Article 48 of Royal Decree 1559/2012 or the Resolution of the FROB on transfer conditions dated 14 December 2012, as was done in 2016, 2015 and 2014.

Ibero project

In 2014 the Company launched the so-called "Ibero" project. This project consisted of replacing, by means of a tender process, the management and administration agreements formalised on the date of transfer of the assets; the aim was to:

- Bring together the management of the nine portfolios initially contributed by Group 1 and 2 institutions under new managers, in order to simplify and facilitate the management of the transferred assets.
- Seek to professionalise and improve the quality of the service at market prices to enable the Company to meet its commitment and mandate, i.e., to be able to divest the assets acquired over its lifetime and maximise the value thereof.

In November and December 2014, the formal award and formalisation of the new management and administration agreements took place. The successful bidders were as follows:

- Solvia Servicios Inmobiliarios, S.L. was awarded the property asset 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 awarded all of the portfolios previously managed by Catalunya Caixa, S.A., Banco Mare Nostrum, S.A. and Banco Caja 3, S.A.
- Haya Real Estate, S.L.U. was awarded the portfolio of loans initially transferred by Bankia, S.A. and Banco Financiero de Ahorros, S.A.
- Lastly, Servihabitat Servicios Inmobiliarios, S.L. was awarded the portfolios initially transferred by NovaGalicia Banco, S.A. (Abanca, S.A.), Liberbank, S.A. and Banco de Valencia, S.A.

The terms set for the agreements range from five to seven years from the date of entry into force thereof, and are automatically renewable for one additional year, unless either of the parties to an agreement gives six months' advance notice of their desire to terminate it. The agreements also envisage the possibility of early termination by Sareb at any time with a notice period of at least 3 months and payment of compensation to the managers calculated in accordance with the terms and conditions of the agreements.

In all cases, the agreements for the services to be provided by the new managers:

- Migration: services required to design, carry out and complete the migration of the management and administration of the assets. In 2015, the technological and administrative migration of all the portfolios of property assets was carried out in stages. At 31 December 2016, all the portfolios of financial assets were fully migrated, with the exception of the portfolios originally transferred by Bankia, S.A. that was migrated in the technological field in the first quarter of 2017.

- Administration and management of the portfolios awarded.

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

The agreements provide for consideration for the aforementioned services comprising management and administration fees calculated on the basis of the volume of assets managed by each of the managers and a sales fee calculated on the basis of the income and cash flows generated on divestment of the assets under management. Management fees of EUR 105,491 thousand and EUR 77,526 thousand, and sales fees of EUR 131,471 thousand and EUR 78,803 thousand, respectively, were incurred in 2016 and 2015 (see Note 16.4).

Also, in order to guarantee a given level of service and performance of the functions entrusted, and to align their objectives with those of the Company, in 2014 the successful bidders provided guarantees for an initial amount of EUR 588,600 thousand, which are recognised under "Non-Current Liabilities - Other Financial Liabilities" in the accompanying balance sheet (see Note 13.4). These bonds were received in full by the end of 2015.

In relation to the aforementioned performance bonds, it must be stated that the amount of these bonds was calculated based on an estimate of the assets that will be managed by each of the new managers, and may be corrected to adapt it to the actual data on two occasions, the first was established 30 March 2015, and the second at the end of each migration, as a result of any variations that might possibly be detected at each date with respect to the initial scope of assets to be managed. The Company has returned bonds in 2016 and 2015 amounting to EUR 6,091 thousand and EUR 268 thousand, respectively, as a result of changes in the scope of assets to be managed (see Note 13.4).

The return of these bonds is of a contingent nature and is tied to the new managers' adequate commercial performance. The Company considers it probable that, pursuant to current estimates, these bonds will be returned and that the return will take place as the economic rights agreed upon by the Company and the new managers accrue and are paid. The respective agreements envisage the measurement of the degree of compliance of the managers on the basis of several performance indicators applicable to the services agreed upon, and establish a scale of penalties to be applied to the billings of the economic rights assigned to the agreements based on the degree of compliance, as well as certain circumstances that constitute grounds for early termination (e.g. when non-compliance by the managers extends over a period of twelve months, with the highest level of materiality and degree of variance from the target value of those envisaged in the agreement). Based on the economic rights accrued in 2016 and 2015, the Company returned bonds provided by the new managers amounting to EUR 61,051 thousand and EUR 35,663 thousand, respectively (see Note 13.4).

Other disclosures

At 31 December 2016, the Company's financial statements were not fully consolidated in the consolidated financial statements of any shareholder since no shareholder owned more than 50% of the Company's share capital and because it was not considered that any of them controlled the Company or had the power to govern its financial and operating policies so as to obtain economic benefits from its activities, or owned the majority of its voting power or had the power to appoint or remove the majority of the members of its Board of Directors (see Note 11).

At 31 December 2016, the Company did not hold any majority ownership interests in the share capital of subsidiaries. In addition, the ownership interests in Bank Asset Funds ("FABs") (see Note 4.6.1) that did not result in the derecognition of the assets and liabilities assigned to them are not of significant interest with respect to the true and fair view of the Company's equity, financial position and results. Therefore, pursuant to the provisions of Article 9 of Royal Decree 1159/2010, of 17 September, which approved the Rules for the Preparation of Consolidated Financial Statements and amended the Spanish National Chart of Accounts approved by Royal Decree 1514/2007, of 16 November, and the Spanish National Chart of Accounts for Small and Medium-Sized Enterprises approved by Royal Decree 1515/2007, of 16 November, and Article 43 of the Spanish Commercial Code, the Company is not required to prepare consolidated financial statements.

2. Basis of presentation of the financial statements

2.1 Regulatory financial reporting framework applicable to the Company

These financial statements were formally prepared by the directors in accordance with the regulatory financial reporting framework applicable to the Company, which consists of:

a) The Spanish Commercial Code and all other Spanish corporate law, with the specific rules contained in Additional Provision Seven.10 of Law 9/2012 that where appropriate, were implemented in 2015 by a Bank of Spain Circular and modified through Article 2 of RD 4/2016 (see Note 2.1-c).

b) The Spanish National Chart of Accounts approved by Royal Decree 1514/2007 and subsequent amendments thereto, except for the specific rules included in Law 9/2012 and the modifications thereof included in Article 2 of RD 4/2016.

   Also, because of the nature of the Company's activities, the provisions of the Ministry of Economy and Finance Order of 28 December 1994 approving the adaptation of the Spanish National Chart of Accounts (1990) for real estate companies were taken into account in the preparation of these financial statements. These provisions apply in all matters which do not contradict the provisions of the Spanish Commercial Code, the Spanish Limited Liability Companies Law, Law 9/2012 and the Spanish National Chart of Accounts approved by Royal Decree 1514/2007.

   Also, the Company must comply with the general obligations regarding transparency and the preparation of financial statements established in Royal Decree 1559/2012.

c) Pursuant to Additional Provision Seven.10 of Law 9/2012, in 2015 the Bank of Spain issued its Circular 5/2015, of 30 September, which implements the specific accounting rules for Sareb ("Circular 5/2015"). Later, on 3 December 2016, Additional Provision Seven.10-c was modified by Article 2 of RD 4/2016 of 2 December, regarding urgent financial measures. These specific accounting rules are detailed in Note 2.5 to these financial statements.

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

e) All other applicable Spanish accounting legislation.

2.2 Fair Presentation

The accompanying financial statements, which were obtained from the Company's accounting records, are presented in accordance with the regulatory financial reporting framework applicable to the Company and, in particular, with the accounting principles and rules contained therein and, accordingly, present fairly the Company's equity and financial position as at 31 December 2016, and its results and cash flows for the year then ended.

Sareb's financial statements for 2015 were approved by the Annual General Meeting on 05 May 2016, and those for 2016, which were formally prepared by Sareb's Board of Directors at its meeting on 29 March 2017, will be submitted for approval by the Annual General Meeting, and it is considered that they will be approved without any changes.

2.3 Non-obligatory accounting principles applied

No non-obligatory accounting principles were applied in the preparation of the financial statements. Also, the directors formally prepared these financial statements taking into account all the obligatory accounting principles and standards with a significant effect hereon (see Note 4). All obligatory accounting principles with a significant effect on these financial statements were applied.

2.4 Key issues in relation to the measurement and estimation of uncertainty

In preparing the accompanying financial statements estimates were made by the Company's directors in order to measure certain of the assets, liabilities, income, expenses and obligations reported herein. These estimates relate basically to the following:

- The assessment of possible impairment losses on certain assets (see Notes 4.7, 5, 7 and 8).
- The useful life of intangible assets, property, plant and equipment and investment property (see Notes 4.1, 4.2, 4.3 and 5).
- The fair value of certain financial instruments (see Note 7).
- The recovery of deferred tax assets and tax credit and tax loss carryforwards due to impairment of the Financial Assets unit (see Note 15).
- The calculation of provisions (see Note 12).
- The estimate of the debt instruments and marketable securities to be redeemed at short term (see Note 13.2).
- The classification of the balances in the balance sheet as either non-current or current based on the estimated future cash flows thereof (see Notes 7 and 13).

In 2014 the Company completed a due diligence review of the assets transferred. The purpose of the review was to determine whether the price estimates and calculation mechanism (correct application of the transfer prices, confirmation of the features of the acquired assets and accuracy of the information sent by the transferor institutions) were reasonable.

Based on the results obtained from the review, the Company formalised the corrections specified in Note 1 in 2016 and 2015. Except for these corrections, based on the current information, the estimate of the possible differences that might be disclosed with respect to the transfer prices is not material for the purposes of these financial statements.

Although these estimates were made, pursuant to the applicable legislation, on the basis of the best information available at 2016 year-end and at the date of preparation of these financial statements, events that take place in the future might make it necessary to change these estimates (upwards or downwards) in coming years. Changes in accounting estimates would be applied prospectively and recognised in the statements of profit or loss for the future years affected.

Going concern principle of accounting

At 31 December 2016, the equity position of the Company was as follows:

	Thousands of Euros
Equity per the financial statements of Sareb, S.A., as at 31/12/2016	(2,657,271)
Less:	
Valuation adjustments relating to cash flow hedges	*1,987,672*
Valuation adjustments relating to financial asset impairment	*3,289,542*
Equity for the purposes of capital reductions and dissolutions at 31/12/2016	**2,619,943**

It should be noted that, in accordance with current accounting rules, changes in the value of hedging derivatives are recognised in the Company's equity until they are recognised in profit or loss in the corresponding year. The entire fair value of the interest rate risk derivative, net of the related tax effect, is recognised under "Valuation Adjustments - Hedges". However, from a corporate standpoint and pursuant to the provisions of Article 36 of the Spanish Commercial Code, these changes in the value of hedging derivatives that have not yet been taken to profit or loss do not qualify as equity for the purposes of distributions of profit, obligatory reductions of share capital or obligatory dissolution due to losses incurred.

On the other hand, as established in Article 2 of RD 4/2016, the Company has recognised the impairment losses of the asset units established in Circular 5/2015 in "Valuation Adjustments - Financial Asset Impairment", net of the related tax effect. As established in said RD, the previously mentioned adjustments will not be considered equity for the purposes of profit distribution, mandatory share capital reduction and mandatory dissolution due to incurred losses (see Notes 2.5 and 11.5).

At 31 December 2016, the Company had working capital of EUR 2,998,045 thousand as a result of classifying senior debt as long term, since, although EUR 20,040,000 thousand of senior debt contractually fall due in 2017, the Company has the option to renew the maturity date of these bonds unilaterally and, accordingly, a significant portion thereof was classified as long term on the basis of the Company's current estimates.

Also, the Company considers that the financial assets classified as doubtful will generally be recovered within a time horizon of more than twelve months and that those that are current in payment will be recovered in accordance with the original contractual payment schedule (see Note 7). Taking into account the foregoing, and considering the financial projections made by the Company, which envisage the generation of sufficient cash flows to realise its assets and settle its liabilities. On the basis of the foregoing, the Company's directors prepared these financial statements in accordance with the going concern principle of accounting.

2.5 Changes in accounting policies

As indicated in Note 2.1 and 2.4, the present financial statements are the first ones that the Company has prepared by applying the provisions set forth in Article 2 of RD 4/2016, which modifies Additional Provision Seven.10-c) of Law 9/2012, of 14 November.

Applying the aforementioned RD did not entail any change to the valuation methodology of the asset units established by Bank of Spain Circular 5/2015 and Note 4 of these financial statements; however, it does modify the form of accounting for them, by establishing the following:

- The valuation corrections of the asset units, net of the related tax effect, that are necessary to recognise based on the provisions set forth in Bank of Spain Circular 5/2015, should be recognised in the balance sheet in "Valuation Adjustments" within the Company's Equity.

- The outstanding balance of said account shall be recognised in the statement of profit or loss in those years in which the Company's result is positive. For these purposes, the Company's profit before taxes shall not include the possible accrual of interests from subordinated debt.

- The aforementioned adjustments that have not yet been recognised in the statement of profit or loss will not be considered equity for the purposes of mandatory share capital reduction and mandatory dissolution due to losses incurred, as established in the Spanish Companies Act.

Pursuant to the factual part of said Royal Decree 4/2016, as stipulated in Recognition and Measurement Standard 22 of Royal Decree 1514/2007, of 16 November, approving the Spanish National Chart of Accounts, the Company shall consider the effect of applying the rules contained in the RD 4/2016 as a change in accounting policy and shall disclose the impact thereof in the first set of financial statements prepared following the approval thereof.

The effect of this change in accounting policy on the annual accounts for 2015, which were prepared for issue on 30 March 2016, is as follows:

Balance sheet:

ASSET	31/12/2015 restated	restatement effect	31/12/2015 prepared
NON-CURRENT ASSET	**41,371,628**	**-**	**41,371,628**
Intangible Asset	**11,939**	-	**11,939**
Intellectual Property	58	-	58
Computer Software	11,881	-	11,881
Property, Plant and Equipment	**2,986**	-	**2,986**
Furniture	198	-	198
Technical Facilities and Other Property, Plant and Equipment	2,284	-	2,284
Computer Equipment	504	-	504
Investment Property	**11,646,029**	-	**11,646,029**
Land	4,884,955	-	4,884,955
Completed Properties	6,761,074	-	6,761,074
Non-Current Investments in Associates	**21,497**	-	**21,497**
Equity Instruments	1,897	-	1,897
Credit Facilities to Associates	19,600	-	19,600
Non-Current Financial Assets	**28,227,455**	**-**	**28,227,455**
Loans to Third Parties and Related Parties	25,555,635	-	25,555,635
Other Financial Assets	2,671,820		2,671,820
Deferred Tax Assets	**1,461,722**	**-**	**1,461,722**
CURRENT ASSET	**6,255,712**	**-**	**6,255,712**
Inventories	**117,619**	-	**117,619**
Work in Progress	77,286	-	77,286
Finished Products	12,121	-	12,121
Supplier Advances	28,212	-	28,212
Trade and Other Receivables	**219,779**	-	**219,779**
Trade Receivables for Sales and Services	168,856	-	168,856
Sundry Accounts Receivable	37,517	-	37,517
Staff	-	-	-
Current Tax Asset	13,406	-	13,406
Other Current Tax Receivables	-	-	-
Current Investments	**2,681,991**	-	**2,681,991**
Loans to companies	2,674,580	-	2,674,580
Other Financial Assets	7,411	-	7,411
Current investments in associates	**30**	-	30
Loans to companies	30	-	30
Prepayment for current assets	**2,060**	-	**2,060**
Cash and Cash Equivalents	**3,234,233**	-	**3,234,233**
Cash	1,638,254	-	1,638,254
Cash Equivalents	1,595,979	-	1,595,979
TOTAL ASSETS	**47,627,340**	**-**	**47,627,340**

LIABILITY	31/12/2015 restated	restatement effect	31/12/2015 prepared
EQUITY	**(3,161,282)**	**-**	**(3,161,282)**
SHAREHOLDERS EQUITY	**1,112,293**	**2,330,270**	**(1,217,977)**
Capital			
Registed capital	300,060	-	300,060
Share Premium	900,000	-	900,000
Legal Reserve	-	-	-
Other Reserves	14,794	2,433,163	(2,418,369)
Profit (loss) for the year	(102,561)	(102,893)	332
VALUATION ADJUSTMENTS-	**(4,273,575)**	**(2,330,270)**	**(1,943,305)**
- Hedges	(1,943,305)	-	(1,943,305)
- Impairment of Financial Assets	(2,330,270)	(2,330,270)	-
NON-CURRENT LIABILITY	**46,045,819**	**-**	**46,045,819**
Long-term Provisions	**9,485**	-	**9,485**
Non-Current Payables	**46,036,334**	-	**46,036,334**
Debt Instruments and Other Marketable Securities	42,857,376	-	42,857,376
Derivatives	2,591,073	-	2,591,073
Other Financial Liabilities	587,885	-	587,885
CURRENT LIABILITY	**4,742,803**	**-**	**4,742,803**
Short-term provisions	**804**	-	**804**
Current payables	**4,309,594**	-	**4,309,594**
Bank Borrowings	57,823	-	57,823
Debt Instruments and Other Marketable Securities	4,228,773	-	4,228,773
Other Financial Liabilities	22,998	-	22,998
Trade and Other Payables	**425,656**	-	**425,656**
Suppliers	352,999	-	352,999
Sundry accounts payable	-	-	-
Remuneration payable	6,942	-	6,942
Current Tax Liability	-	-	-
Other Current Tax Payables	63,693	-	63,693
Customer Advances	2,022	-	2,022
Unearned income	**6,749**	-	**6,749**
TOTAL EQUITY AND LIABILITIES	**47,627,340**	**-**	**47,627,340**

The main impacts on the restated balance sheet are as follows:

i. A decrease in "Valuation Adjustments - Impairment of Financial Assets" amounting to EUR 2,320,270 related to the recognition of EUR 3,012,418 thousand of the impairment existing at said date within the units of Financial Assets (see Note 7). In addition, EUR 682,148 thousand were recognised in "Valuation Adjustments - Impairment of Financial Assets" resulting from the tax impact associated with the aforementioned impairment. This tax effect does not represent 25% of the impairment, given that the Company did not capitalise EUR 70,956 thousand of tax credits in 2015 by understanding that recovery thereof was unlikely.

ii. An increase was made to the Company's reserves amounting to EUR 2,443,163 and a decrease of the year's profit or loss was made, amounting to EUR 102,893 thousand for the aforementioned reason.

Statement of Profit or Loss

	31/12/2015 restated	restatement effect	31/12/2015 prepared
CONTINUING OPERATIONS			
Revenue	**2,201,999**		**2,201,999**
Inventory Sales	14,086	-	14,086
Income from Investment Property Sales	769,076	-	769,076
Rental Income	42,011	-	42,011
Income from Sales of Loans and Credit Facilities	395,848	-	395,848
Financial Income from Loans and Credit Facilities	588,706		588,706
Margin of Loan and Credit Recoveries	382,776	-	382,776
Remuneration of Bank Asset Fund (FAB) Securities	9,496	-	9,496
Inventory Fluctuation for Finished Products and Works in Progress	**(10,327)**	-	**(10,327)**
Cost of Sales	**(976,282)**	**-**	**(976,282)**
Investment Property Cost	(606,554)	-	(606,554)
Financial Asset Sales Cost	(369,728)		(369,728)
Other Operating Income	**6,436**	-	**6,436**
Accessory Income and Other Management Income	6,436	-	6,436
Staff Costs	**(36,974)**	-	**(36,974)**
Wages, Salaries and Similar Expenses	(31,773)	-	(31,773)
Social Charges	(5,201)	-	(5,201)
Other Operating Expenses	**(593,667)**	-	**(593,667)**
Outside Services	(375,286)	-	(375,286)
Taxes	(192,902)	-	(192,902)
Losses, Impairment and Fluctuations for Commercial Transactions	(19,181)	-	(19,181)
Other Management Income	(6,298)	-	(6,298)
Depreciation & Amortisation charge	**(57,449)**	-	**(57,449)**
Provision Excesses	**46,125**	**-**	**46,125**
Impairment of Financial Instruments	**(5,604)**	**337,172**	**(342,776)**
- Loans and Credit Facilities to Third Parties	-	337,172	(337,172)
- Equity Instruments and Loans and Credit Facilities to Associates	(5,604)	-	(5,604)
PROFIT FROM OPERATIONS	**574,257**	**337,172**	**237,085**
Finance Income	**12,715**	-	**12,715**
Marketable Debt Securities and Other Financial Instruments			
- To Third Parties	12,715	-	12,715
Financial Costs	**(724,454)**	-	**(724,454)**
Debts to Third Parties	(700,313)	-	(700,313)
Other Financial Costs	(24,141)	-	(24,141)
Exchange Differences	**2,318**	-	**2,318**
FINANCIAL RESULT	**(709,421)**		**(709,421)**
RESULT BEFORE TAXES	**(135,164)**	**337,172**	**(472,336)**
Income Tax	32,603	(440,065)	472,668
RESULT OF THE YEAR FROM CONTINUING OPERATIONS	**(102,561)**	**(102,893)**	**332**
RESULT OF THE YEAR	**(102,561)**	**(102,893)**	**332**

The impacts of the restatement on the statement of profit or loss for 2015 are as follows:

i. A lesser charge of the year's impairment of Financial Assets amounted to EUR 337,172 thousand.

ii. A lesser recognition of tax assets charged amounted to EUR 440,065 thousand.

Both impacts have been recognised by the Company directly in the equity in “Valuation Adjustments”.

Finally, the effect on the Statement of Changes in "Equity - Recognised Income and Expense" is as follows:

	31/12/2015 restated	restatement effect	31/12/2015 prepared
RESULT OF THE PROFIT AND LOSS STATEMENT (I)	**(102,561)**	**(102,893)**	**332**
Income and Expense Recognised Directly in Equity			
- Cash Flow Hedges	(183,143)	-	(183,143)
- Due of Financial Asset Unit Impairment	(337,172)	(337,172)	-
- Tax Effect	485,851	440,065	45,786
TOTAL INCOME AND EXPENSES RECOGNISED DIRECTLY IN EQUITY (II)	**(34,464)**	**102,893**	**(137,357)**
Income and Expenses Recognised in the Profits and Losses Statement			
- Cash Flow Hedges	302,059	-	302,059
- Tax Effect	(75,515)	-	(75,515)
TOTAL TRANSFERS TO THE PROFITS AND LOSSES STATEMENT (III)	**226,544**	**-**	**226,544**
TOTAL RECOGNISED INCOME AND EXPENSES (I+II+III)	**89,519**	**-**	**89,519**

2.6 Comparative information

As required by current legislation, the information relating to 2015, which was restated as detailed in Note 2.5, as a result of applying RD 4/2016, is presented solely for comparison purposes with the information for 2016, as established in the current legislation.

2.7 Grouping of items

Certain items in the balance sheet, statement of profit or loss, statement of changes in equity and statement of cash flows are grouped together to facilitate their understanding; however, whenever the amounts involved are material, the information is broken down in the related notes to the financial statements.

2.8 Correction of errors and changes in estimates

In preparing the accompanying financial statements no significant errors were detected that would have made it necessary to restate the amounts included in the financial statements for 2015.

2.9 Environmental impact

In view of the business activity carried on by Sareb, it does not have any environmental liability, expenses, assets, provisions or contingencies that might be material with respect to its equity, financial position or results.

Therefore, the Company's financial statements for 2016 do not contain any disclosures on environmental issues.

2.10 Presentation of the financial statements

Unless stated otherwise, all the amounts in these financial statements are expressed in thousands of euros.

3. Distribution of profit/allocation of loss

The proposed distribution of the profit for 2016 that the Board of Directors will submit for approval by the shareholders at the Annual General Meeting and the allocation of the loss for 2015 that was approved by the Annual General Meeting on 05 May 2016 are as follows:

Amount in thousands of euros	2016	2015 Restated	2015 Approved
Balance of the statement of profit or loss	**(662,791)**	**(102,561)**	**332**
Distribution:			
Legal reserve	-	-	33
Voluntary reserves	(662,791)	(102,561)	-
Losses from prior years	-	-	299

4. Accounting policies

The principal accounting policies used by the Company in preparing the financial statements for 2016, in accordance with the applicable regulatory framework, were as follows:

4.1 Intangible assets

Intangible assets are recognised initially at acquisition or production cost. They are subsequently measured at cost less any accumulated amortisation and any accumulated impairment losses. These assets are amortised over their years of useful life.

Intellectual property

The amounts recognised by the Company under “Intellectual Property” relate to the capitalised expenses incurred in obtaining the corresponding patents or similar items, including intellectual property registration and formalisation costs, without prejudice to the amounts as might also be recognised as a result of the acquisition of the corresponding rights from third parties. The Company amortises on a straight-line bases over 10 years the amounts capitalised in “Intellectual Property”.

Computer software

Computer software acquired or developed by the Company is recognised at acquisition or production cost, as appropriate, and is amortised on a straight-line basis over five years. Computer software maintenance costs are recognised with a charge to the statement of profit or loss for the year in which they are incurred. “Computer Software” at 31 December 2016 and 2015 includes mainly the gross cost of the computer programs acquired by the Company, amounting to EUR 22,348 thousand and EUR 14,519 thousand, respectively.

The depreciation and amortisation charge for 2016 and 2015 amounted to EUR 3,473 thousand and EUR 2,031 thousand respectively, and this amount was recognised under “Depreciation and Amortisation Charge” in the accompanying statement of profit or loss. Accumulated amortization amounted to EUR 6,106 thousand at 31 December 2016 (31 December 2015: EUR 2,638 thousand).

In-house work on non-current assets is measured at accumulated cost (external costs plus in-house costs, determined on the basis of in-house materials consumption, and manufacturing costs allocated using the same criteria as those used to measure inventories). The Company did not capitalise any costs to intangible assets in this connection in 2016 or 2015.

Impairment of intangible assets

Whenever there are indications of impairment of intangible assets with a finite useful life (i.e. all the Company's intangible assets), the Company tests the intangible assets for impairment to determine whether the recoverable amount of the assets has been reduced to below their carrying amount.

Where 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 for the asset in prior years. A reversal of an impairment loss is recognised as income.

The Company did not recognise any impairment losses on its intangible assets in 2016 or 2015.

Also, at the end of 2016 and 2015 there were no intangible asset purchase or sale commitments of a material amount.

4.2 Property, plant and equipment

Initial recognition

Property, plant and equipment are initially recognised at acquisition or production cost, plus the amount of any additional or supplementary investments made, and are subsequently reduced by the related accumulated depreciation and by any impairment losses recognised, as indicated in this Note.

The costs of expansion, modernisation or improvements leading to increased productivity, capacity or efficiency or to a lengthening of the useful lives of the assets are capitalised.

Period upkeep and maintenance expenses are recognised as "Outside Services" in the accompanying statement of profit or loss.

In 2016 and 2015 the Company didn't capitalized any borrowing costs increasing the book value of its property, plant and equipment. In-house work on non-current assets is measured at accumulated cost (external costs plus in-house costs, determined on the basis of in-house materials consumption, and manufacturing costs allocated using the same criteria as those used to measure inventories). The Company did not capitalise any costs for property, plant and equipment in this connection in 2016 or 2015.

Amortisation

Property, plant and equipment are amortised by the straight-line method, based on the years of estimated useful life of the assets. The annual amortisation rates applied to the respective updated cost values, where appropriate, and the years of estimated useful life are as follows:

Line item	Annual Rate	Years of Estimated Useful Life
Linear Amortisation System:		
Other facilities	10	10
Furniture	10	10
Information-processing Equipment	20	5
Other Property, Plant and Equipment	12.5	8

The depreciation expense during 31 December 2016 and 2015 amounted to EUR 281 thousand and 263 thousand, respectively, and are recognised as "Depreciation and amortization charge" in the accompanying statements of profit or loss. The accumulated depreciation at 31 December 2016 and 2015 amounted to EUR 847 thousand and 566 thousand, respectively.

Items of property, plant and equipment in the course of construction do not begin to be depreciated until they come into operation, when they are transferred to the corresponding property, plant and equipment account on the basis of their nature.

Impairment of property, plant and equipment

Whenever there are indications of impairment of tangible assets (i.e. all the Company's property, plant and equipment), the Company tests the tangible assets for impairment to determine whether the recoverable amount of the assets has been reduced to below their carrying amount.

Where 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 for the asset in prior years. A reversal of an impairment loss is recognised as income.

The Company did not capitalise any costs to property, plant and equipment in this connection in 2016 or 2015.

Also, at the end of 2016 and 2015 there were no property, plant and equipment purchase or sale commitments of a material amount.

4.3 Investment property

"Investment Property" in the balance sheet reflects the values of the land, buildings and other structures held either to earn rentals or for capital appreciation.

Initial recognition

Investment property is initially recognised at acquisition or production cost, plus the amount of any additional or supplementary investments made, and is subsequently reduced by the related accumulated depreciation and by any impairment losses recognised, as indicated in this Note.

Pursuant to Additional Provision Seven.10-a) of Law 9/2012, the acquisition cost of the assets received from Group 1 and Group 2 transferor institutions was determined by applying the transfer prices that were set for each type of asset by Bank of Spain resolution in accordance with the criteria established in Royal Decree 1559/2012.

Pursuant to Rule Three of Bank of Spain Circular 5/2015, the value at initial recognition of property assets foreclosed or acquired in payment of debts is the carrying amount of the financial assets derecognised at the date of foreclosure or dation in payment. Court and registration costs and taxes paid are added to the value at initial recognition provided that the resulting amount does not exceed the estimated fair value of the asset.

The costs of expansion, modernisation or improvements leading to increased productivity, capacity or efficiency or to a lengthening of the useful lives of the assets are capitalised.

Period upkeep and maintenance expenses are recognised as "Outside Services" in the accompanying statement of profit or loss.

In-house work on non-current assets is measured at accumulated cost (external costs plus in-house costs, determined on the basis of in-house materials consumption, and manufacturing costs allocated using the same criteria as those used to measure inventories). The Company did not capitalise any costs to investment property in this connection in 2016 or 2015.

In 2016 and 2015 no borrowing costs or finance charges were capitalised to investment property.

Subsequent measurement and assessment of impairment

Investment property is assessed for impairment as indicated in Note 4.7.

Amortisation

Investment property is depreciated by the straight-line method, based on the years of estimated useful life of the assets. The annual depreciation rates applied to the respective cost values, where appropriate, and the years of estimated useful life are as follows:

	Annual Rate	Years of Estimated Useful Life
Linear Amortisation System:		
Buildings	2	50
Other facilities	10	10
Furniture	10	10
Information-processing Equipment	20	5
Other Property, Plant and Equipment	12.5	8

Amortisation expenses for investment properties in 2016 and 2015 amounted to EUR 64,021 and 55,155 thousand, (see Note 5), and are recognised as "Depreciation and amortization charge" in the accompanying statements of profit or loss.

Items of property, plant and equipment in the course of construction do not begin to be depreciated until they come into operation, when they are transferred to the corresponding property, plant and equipment account on the basis of their nature. No items were transferred from "Property, Plant and Equipment" in 2016 or 2015.

4.4 Asset exchange transactions and foreclosures

"Asset exchange" means the acquisition of property, plant and equipment or intangible assets in exchange for the delivery of other non-monetary assets or of a combination of monetary and non-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 statement of profit or loss.

Assets received in an exchange that lacks commercial substance are recognised 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.

Specifically, assets foreclosed in payment of debts are classified as investment property or as inventories, based on their nature and their intended purpose, and are recognised as described in Notes 4.3. and 4.11., respectively.

4.5 Leases

The Company considers as operating leases those leases originating from an agreement whereby the lessor conveys to the lessee, in return for a single payment or a series of payments, the right to use an asset for an agreed period of time, provided that the lease is not required to be classified as a finance lease in accordance with current legislation.

The Company recognises the lease income and expenses from operating leases in which it acts as the lessor on an accrual basis in the statement of profit or loss. Also, the acquisition cost of the leased asset is presented in the balance sheet according to the nature of the asset, increased by the costs directly attributable to the lease, which are recognised as an expense over the lease term, applying the same method as that used to recognise lease income.

The Company treats any payment made on entering into or acquiring a leasehold that is accounted for as an operating lease as prepaid lease payments that are amortised over the lease term in accordance with the pattern of benefits provided.

The Company did not have any finance leases in 2016 or 2015.

4.6 Investments in associates and Financial assets - Categories of financial assets

4.6.1 Investments in associates

Associates are companies over which the Company is in a position to exercise significant influence. Significant influence is defined as when the Company has an ownership interest in another company and has the power to participate in the financial and operating policy decisions of the investee, but not control or joint control of those policies. Significant influence normally arises when an entity holds (directly or indirectly) 20% or more of the voting power of the investee.

Investments in associates are recognised under “Non-Current Investments in Associates - Equity Instruments” in the balance sheet and are measured at acquisition cost, net of any impairment losses on the investments (see Note 4.7.3).

The remuneration earned on these investments, provided it does not arise unequivocally from profits generated prior to the date of acquisition, is recognised under “Revenue” in the statement of profit or loss (see Note 16.1).

Bank Asset Funds (FABs)

Article 20 of Royal Decree 1559/2012, of 15 November, empowers the Company to set up separate divisions or compartments of assets in the form of the so-called “Bank Asset Funds” (“FABs”).

The business object of the FABs, which are fund-like entities without legal personality, is to liquidate the portfolio of assets and liabilities contributed by Sareb, within the time frame for which the FABs have been created.

When accounting for its investments in FABs, the Company distinguishes between:

- FABs in whose creation substantially all the risks and rewards inherent to the transferred assets and liabilities were not transferred to third-party investors. As a general rule, these funds are those in which the Company retains control and more than 50% of the Fund's total liabilities and equity. In the case of these funds, the Company does not derecognise the transferred assets and liabilities (i.e. it does not recognise any income from their sale or any related costs) and measures them using the same criteria as those which were applicable before the transfer. However, it recognises a liability for an amount equal to the consideration received, which it measures at amortised cost, and it recognises, for their net amount where appropriate, both the income from the transferred assets not derecognised and the costs of the new financial liability at the time of their effective transfer to third parties. At 31 December 2016, the only FAB constituted that was not derecognised was FAB 2013 Bull. These FAB’s have their own accounting and tax legislation.

- FABs in whose creation substantially all the risks and rewards inherent to the transferred assets and liabilities were transferred to third-party investors. As a general rule, these funds are those in which the Company does not retain more than 50% of the Fund's total liabilities and equity. In the case of these funds, since control of the transferred assets has generally been transferred to the investor, the Company recognises the cost of the securities equivalent to share capital subscribed by it under "Non-Current Investments in Associates - Equity Instruments". These equity instruments are measured as stipulated in Note 4.7.3 (Impairment of equity instruments issued by FABs). In addition, any financing granted by the Company to the FAB is recognised under "Non-Current Investments in Associates - Loans to Companies". At 31 December 2016, the FABs derecognised for accounting purposes by the Company were FAB 2013 Teide and FAB May.

A summary of the main transactions performed with FABs in 2016 and 2015 is as follows:

2016:

On 30 June 2016, FAB Crossover I and FAB Corona were liquidated after realising tits assets and liquidating all of its liabilities. These liquidations did not have any impact on the Company's financial statements.

2015:

FAB Crossover I

In October 2015 FAB Crossover I sold en bloc all the land lots in its portfolio to a Spanish investor for EUR 58,500 thousand, of which EUR 33,762 thousand were collected in cash and EUR 24,738 thousand were deferred and are scheduled to mature in 2016. On 11 October and 15 December 2016, the Company collected the amounts deferred, amounting to EUR 4,000 thousand and 20,738 thousand, respectively. As a result of this transaction, the Company received remuneration in 2015 from FAB Crossover amounting to EUR 6,525 thousand, which were recognised under "Remuneration of Bank Asset Fund (FAB) Securities" in the accompanying statement of profit or loss.

Subsequently, on 28 October 2015, the Company repurchased from the majority investor/shareholder 80% of the securities of FAB Crossover I for a price of EUR 19,030 thousand, of which EUR 5,165 thousand were paid in cash, EUR 10,337 thousand were offset against the collection right relating to the deferred payment on the sale in 2014 of 80% of FAB Crossover I's securities, EUR 28 thousand were offset against the interest accrued on that collection right (recognised under "Trade and Other Receivables - Sundry Accounts Receivable") and EUR 3,500 thousand were deferred, and paid by the Company on 22 December 2016.

Following the purchase of 80% of its securities, the Company obtained full control of FAB Crossover I and, accordingly, it included the FAB's assets and liabilities in its balance sheet and eliminated the cost of the investment against the FAB's shareholders' equity. The effect of this integration was not significant in 2016 and 2015.

4.6.2 Loans and receivables

This category of financial instruments includes the debt instruments arising from the rendering of the Company's services and those which, not arising from these activities, represent collection rights of fixed or determinable amount and are not traded in an active market.

Loans and receivables are recognised under "Non-Current Investments in Associates - Loans to Companies", "Non-Current Investments - Loans to Third Parties and Related Parties", "Current Investments - Loans to Companies", "Non-Current/Current Investments - Other Financial Assets" and under "Trade and Other Receivables" and "Cash and Cash Equivalents" on the asset side of the balance sheet as at 31 December 2016.

The Company transfers to doubtful assets any loans and credit facilities that have interest and/or principal payments more than 90 days past due.

Initial recognition

As a general rule, loans and receivables are recognised initially at their fair value, i.e. the transfer/acquisition price, which is equal to the fair value of the consideration given, plus any directly attributable transaction costs. In 2013 the Company capitalised EUR 17,561 thousand relating to the necessary costs incurred by it to obtain control of these assets. At 31 December 2016 and 2015, the expenses capitalised in this connection amounted to EUR 13,397 thousand and 14,571 thousand, respectively (see Note 7.1.1.).

Pursuant to Additional Provision Seven.10-a) of Law 9/2012, the acquisition cost of the assets received from Group 1 and Group 2 transferor institutions was determined by applying the transfer prices that were set for each type of asset by Bank of Spain resolution in accordance with the criteria established in Royal Decree 1559/2012.

Subsequent measurement

The assets included in this category are measured at amortised cost, net of any possible impairment losses. The accrued interest on these assets is recognised in the statement of profit or loss using the effective interest method. In accordance with the ruling issued by the Bank of Spain following the request filed in this connection and with the previous pronouncements of the Spanish Accounting and Audit Institute (ICAC), when estimating future cash flows for the purpose of determining the effective interest rate, the value of any collateral securing the transactions is taken into account.

Without prejudice to the foregoing, certain items established in the applicable regulations, maturing in less than twelve months, are recognised initially at their nominal amount when the effect of not discounting their cash flows is not material, and they are measured subsequently at that same amount.

Any impairment losses on these assets are recognised as explained in Note 4.7.2.

At 31 December 2016 and 2015, Sareb did not have any of the financial assets envisaged in the applicable regulations, other than those indicated in this Note.

4.7 Impairment of financial assets, investment property and other receivables

As indicated in Note 2.1, in 2015 the Bank of Spain, with a view to the implementation of Additional Provision Seven.10 of Law 9/2012, published accounting Circular 5/2015, which implements the specific accounting rules for the Company.

The publication of the aforementioned Circular 5/2015 regulates the criteria that must be used as the basis for the methodology which the Company is required to use to estimate the value of the assets transferred by the Group 1 and 2 institutions. Pursuant to the Circular, this value must be calculated in accordance with the methodology used to determine the prices at which the assets were transferred to the Company, taking into consideration any changes in the market prices and the time horizons envisaged in the Company's business plan.

In compliance with the Circular, the Company developed and approved the methodology to estimate impairment losses based on the criteria established in the Circular.

The impairment losses arising from measurement of the assets must be recognised by asset unit. The Circular establishes offsetting gains against losses for assets in the same “asset unit”. The asset units defined in the Circular are as follows:

a) Properties foreclosed or acquired as payment of debts, irrespective of their origin, provided they were recognised in the separate or consolidated balance sheets of the transferor institutions at the transfer date.

b) The following collection rights:

   i. Loans or credit facilities to finance land for property development in Spain, or to finance construction or property developments in Spain, either in progress or completed, irrespective of their age or accounting classification.

   ii. Participating loans granted to companies in the property sector or to companies related to them, irrespective of the age or accounting classification of the loans.

iii. Other loans or credit facilities granted to holders of loans or credit facilities included in section i) above, when the FROB considers the transfer to be advisable in order to enable Sareb to adequately manage the transferred assets.

c) The properties and collection rights that meet the requirements described in sections a) and b) above originating from companies in the property sector, or from companies related to them, over which the credit institution exercises control, as defined in Article 42 of the Spanish Commercial Code.

d) The equity instruments of companies in the property sector or of companies related to them which, directly or indirectly, enable the credit institution or any other entity in its group to exercise joint control or significant influence over those companies, when the FROB considers the transfer to be advisable because these companies hold a highly significant volume of the assets referred to in section a), or serve as an effective channel through which the entity carries on construction or property development business activities in Spain.

e) Consumer or SME loans or credit facilities, loans or credit facilities secured by home mortgages and any other assets not included in the aforementioned sections, provided that these assets are significantly impaired or that the continued recognition thereof in the entity's balance sheet would be detrimental to its viability. Verification of the existence of these circumstances shall require a prior report from the Bank of Spain.

However, from the five asset units defined Ley Circular, only the first two are applicable to Sareb: the asset unit relating to the foreclosed properties originally transferred to Sareb and the asset unit comprising the original collection rights.

It should be noted that the Circular establishes that the assets foreclosed or received as payment of debts after the transfer dates shall remain in the asset unit in which they were initially included.

At year-end or whenever the Company publishes information on its financial situation, it must assess the need to recognise impairment losses for each of the asset units. To this end, the Company shall assess, on the basis of the best information available at any given time, whether the carrying amount of the asset unit is higher than the value of the asset unit as a whole estimated in accordance with the methodology developed by the Company based on the criteria established in Rule Four of Circular 5/2015. In that case, an impairment of the carrying amount of its tax effect shall be recognised in "Valuation Adjustments" in the Company's equity, as stipulated in Article 2 of RD 4/2016 (see Notes 2.1 and 2.5).

The impairment loss recognised on each asset unit may be reversed when there is evidence that there has been a recovery in the value of the assets in the asset unit, in accordance with the methodology developed by the Company and regulated by Circular 5/2015, up to the limit of the carrying amount that would have been determined for the asset unit had no impairment loss been recognised.

For each asset unit, the amount of the losses on impaired assets may be offset against any gains on unimpaired assets included in the same asset unit, estimated in accordance with the criteria established in Rule Four of Circular 5/2015.

An asset shall remain in its corresponding asset unit provided that it meets the requirements contained in Article 36.1-a) of the Spanish Commercial Code and, therefore, that there is sufficient objective evidence confirming that it is likely that the asset's carrying amount will be recovered.

In 2015, and as stipulated in the aforementioned Transitional Provision, it was realised as follows:

- For the property assets unit, a group of properties representing at least 50% of the carrying amount of this unit.

- For the financial assets unit, at least 50% of the carrying amount of this unit, excluding unsecured transactions.

Also, the group of assets measured at the end of 2015 in accordance with the criteria established in the Circular is sufficiently representative of the total population of assets in terms of the type and location thereof.

Also pursuant to Transitional Provision Two of the Circular, the Company's directors estimated the value of the other property assets (whether owned by the Company or held as collateral for financial assets of which the Company is the creditor), which could not be measured in accordance with the methodology established in Rule 4 of the Circular, on the basis of the best available valuations of the assets (obtained mainly from the due diligence review, from other up-to-date valuations, even if they were not eligible for the purposes of the Circular, and from the original valuations). Sareb applied to these valuations certain correcting coefficients prepared by it, considering the change in prices according to public information and, specifically, the experience obtained in measuring the group of property assets mentioned above.

These correcting coefficients take into consideration the type of asset, the geographical location, the year of measurement and the original transferor credit institution. The preparation of these coefficients was evaluated by an independent external expert.

Pursuant to Transitional Provision Two of the aforementioned Bank of Spain Circular 5/2015, in 2016, the Company measured its entire portfolio of financial and property assets. However, considering the high volume of assets and collaterals subject to the valuation process and the complexity of this process, an appraisal in accordance with Rule 4 of the Circular was not obtained for a percentage of the portfolio.

In relation to 6% of the portfolio (3.5% with respect to the carrying amount of the assets recognised in "Financial Assets - Loans to Third Parties and Related Parties", "Investment Property" and "Inventories"), for which there are no appraisals in accordance with Rule 4 of the Circular. As in 2015, the latest appraisals available were updated with correcting coefficients calculated based on information obtained from the update realised on 94% of the portfolio, which did comply with the eligibility criteria described in the aforementioned Rule 4. For calculating this estimate, the type of asset, location and time of the appraisals available were taken into account. In the opinion of the Administrators, the criteria followed is the best estimate of the asset values of this portfolio, and will not significantly differ from the values that would result from an updated appraisal eligible in accordance with Rule 4 of the Circular.

In addition, it should be pointed out that for the case of those appraisals that have conditions set by the appraiser, the Company has applied some correcting coefficients as a function of their type, either due to the impossibility to access the property, due to urban checks, or registration checks. These correcting coefficients go from 7% to 30%, and were prepared internally based on the Company's best knowledge and professional judgement.

Pursuant to the provisions of Rule Four, assets shall be derecognised at their carrying amount, without taking into consideration the impairment losses estimated by asset unit.

The criteria applied by the Company to determine the existence of impairment losses in each of the various asset units identified and the method used to calculate such impairment losses and recognise them are as follows:

4.7.1. Impairment of the property assets unit

This asset unit includes the balances recognised under "Investment Property" and "Inventories" except for EUR 3,885 million and 2,562 million in 2016 and 2015, respectively, relating to property assets received by the Company as payment of debts after the transfer date of the financial assets, which were measured as part of the asset unit detailed in Note 4.7.2.

In order to determine the value of its property assets the Company takes into consideration the characteristics that a knowledgeable buyer would use to decide whether to acquire the assets, such as geographical location, the availability of infrastructure, their legal situation, the terms and conditions for the sale or use thereof, the supply and demand of similar assets, their most likely use, and matters relating to urban planning, demographic changes and utility prices. In order to take into account the asset's legal situation and the urban planning considerations, the Company valued the land using the urban development classification levels defined in Article 4 of Ministry of Economy Order ECO/805/2003, of 27 March, on rules for the valuation of properties and specific rights for certain financial purposes.

Value estimation of investment property held to earn rentals

The Company estimated the value of the investment property held to earn rentals on the basis of the discounted future cash flows thereof, taking into consideration the occupancy rate at the measurement date, the probable future occupancy of the property and current market rents.

Value estimation based on individual appraisals

The Company estimated the value of its property assets on an individual basis in accordance with the valuation reports of independent experts with proven experience in the area and the type of asset appraised. Specifically, the assets were valued by appraisal companies registered in the Bank of Spain's Official Register of Appraisal Companies, as provided for in Ministry of Economy Order ECO/805/2003, of 27 March, on rules for the valuation of properties. Pursuant to Rule 4 of Bank of Spain Circular 5/2015, for the purpose of performing the aforementioned appraisals the following methods were taken into consideration by the independent experts based on the type of asset in question:

- Dynamic residual method for land.

- Discounted future cash flow method for assets held to earn rentals, taking into consideration the expected occupancy rates and current market rents.

At least every three years the Company shall review the mortgage appraisals performed on its property assets and replace the independent expert. If market conditions and circumstances indicate the need to perform more frequent appraisals, the Company shall shorten the period between them.

Value estimation of completed homes, annexes and commercial premises

As permitted by Rule 4 of Bank of Spain Circular 5/2015, the Company opted to estimate the value of completed homes and annexes thereto (such as garages and storage rooms) using automated valuation methods, which were performed by independent experts (appraisal companies registered in the Bank of Spain's Official Register of Appraisal Companies). These statistical methods or automated valuation models were used to calculate the value of commercial premises in areas in which there is an established market of comparable properties, i.e. a market where operators prepared to negotiate a purchase, sale or rental agreement can be found at almost any time.

The valuations performed using statistical or automated methods are recalculated every year and take into account the statistics provided by the Spanish National Statistics Institute on the trend in new and second-hand house prices.

Value estimation of other assets using internal estimates or methodologies

The Company used its best estimate to determine the discounted present value of property assets different in nature to those described in the foregoing sections and with an aggregate carrying amount per lot of less than EUR 1 million. It determines the discounted present value of these assets at least once a year. These estimates were made using valuation models whose methodology was validated by independent external experts, and were conducted only for assets for which the required sufficiently tested data were available. Otherwise, these assets would be valued using appraisals compliant with Ministry of Economy Order ECO/805/2003.

In addition to the valuations performed in accordance with the foregoing methods, the methodology developed by Sareb, which is based on the criteria established in Circular 5/2015 and is applicable to both property and financial assets, includes a series of assumptions the most noteworthy of which are as follows:

- Adjustments to reflect the trend in market prices and the time horizons in the Company's business plan. To make these adjustments, the directors used their best estimate based on the type and location of the various property assets, as well as the sales estimates for the various years included in the business plan. To this end, as established in Circular 5/2015, the Company considered the average estimated change in market prices, ranging from 3.8% to 5% (1.5% and 5% in 2015), together with an average time horizon, depending on the various types of asset, ranging from 5.5 to 8 years (seven to ten years in 2015).

- Estimated maintenance and marketing costs, which are deducted from the estimated valuations. These costs are estimated considering the average estimated length of time for which the asset will be held under the business plan (indicated in the preceding paragraph). For this purpose, based on the various types of assets, the average costs associated with the aforementioned assets range from 1.1% to 8% (0.9% to 6.7% in 2015), depending on the nature of the asset and the costs.

- Discount rate. The valuation obtained after making the foregoing adjustments is discounted to present value using a discount rate estimated on the basis of the Company's cost of funding and the risk inherent to the assets. Average rates ranging from 1.7% to 3% (2% to 3% in 2015) were used, which include on an aggregate basis the Company's estimated finance costs per the business plan. Also, the measurement model used for financial assets incorporates a risk metric additional to the finance costs included in the business plan and to the real estate risk included in the methodology of the Ministry of Economy Order, which ranges from 8% to 30%.

- In addition, pursuant to the Circular, any valuation which is 15% higher than the mortgage value or the value obtained using statistical sampling methods or automated valuation models must be supported by two or more market transactions involving similar assets. However, the Company did not make any adjustment exceeding 15% of the mortgage value or of the values obtained using statistical sampling methods or automated valuation models.

At 31 December 2016 and 2015, the Company did not have any net losses on this asset unit.

The Company performed a sensitivity analysis on certain key assumptions of the property asset valuation model. The results obtained are summarised below:

Figures in millions of euros	+ 100 p.b / + 1 year	- 100 p.b./ -1 year
Appraisal values	89	(89)
Discount rate	542	(511)
Time horizon of the business plan	22	37
Total	**653**	**(563)**

These sensitivities in 2015 caused some effects that varied between EUR 793 and 32 thousand, in either direction.

4.7.2. Impairment of loans and credit facilities, receivables and property assets received in payment of debts

Trade receivables

At least at each reporting date, the Company tests its trade receivables for impairment in order to adjust them to their recoverable value. Objective evidence of impairment is considered to exist when the recoverable amount of the financial asset is lower than its carrying amount. When this occurs, the impairment loss is recognised in the statement of profit or loss. At 31 December 2016 and 2015, the Company had recognised accumulated impairment losses on its trade receivables amounting to EUR 41,212 thousand and 31,938 thousand, respectively (see Note 9).

Loans and credit facilities and other property assets received in payment of debts

The value of the financial assets in the form of debt instruments transferred to the Company is estimated on an individual basis according to the ability of the principal debtors to pay their debts and taking into consideration, where applicable, the existence of any guarantors or sureties with a proven ability to pay.

The ability of the debtors to pay their debts is estimated on an individual basis, and must be supported by documentary evidence and proven by the fulfilment of the contractual obligations without significant delays in payment. Unsecured loans are assessed collectively, considering that this reflects the expected loss on the portfolio in question, with the exception of unsecured financial assets with missed or delayed contractual payments more than 18 months past due, which are considered to have a zero value unless there is evidence to the contrary. This criterion is applied to the residual value of assets with non-first ranking security, after deducting all debtor liability covered by higher-ranking security, including late payment interest. The discounted present value of the debt is used only when the Company is the sole first-ranking creditor and when this value is less than the mortgage liability and the value of the security can cover both the higher and lower-ranking claims, either partially or in full.

For financial assets (or property assets received by the Company as payment of debts) with respect to which the amounts owed are expected to be recovered through the execution of the guarantee, where this guarantee represents a first-ranking security interest in property assets, or a lower-ranking security interest if the requirements detailed in the foregoing paragraph are met, the property value of the security is taken into consideration when measuring the financial asset. This measurement is performed as explained in Note 4.7.1. on property assets. The estimate of costs includes both the maintenance and marketing costs incurred until the subsequent sale of the collateral, and the costs required to execute the guarantee (procedural, legal and tax costs).

In the case of loans and receivables with collateral other than properties, such as debt or equity instruments pledged as security, the Company calculates the market value of that instrument at the measurement date if it is a financial instrument traded on an active market or, where applicable, uses generally accepted valuation techniques.

A series of assumptions based on the Company's business plan, which are detailed in Note 4.7.1., were used to estimate the value of these assets.

As a result of the impairment test performed by the Company, it still has impairment losses, which are recognised in “Valuation Adjustments - Impairment of Financial Assets” (see Notes 2.1 and 2.5), in 2016 and 2015, impairment losses of EUR 3,389,356 thousand and 3,012,418 thousand, respectively, were recognised on debt instruments classified as loans and receivables and on assets received in payment of debts (see Note 7.1.1.) These impairment losses were recognised under “Non-Current Investments - Loans to Third Parties and Related Parties”.

As it did for the property assets unit, the Company performed a sensitivity analysis on certain key assumptions of the valuation model, and obtained the following results:

Figures in millions of euros	**+ 100 p.b / + 1 year**	**- 100 p.b./ -1 year**
Appraisal values	231	(233)
Discount rate	1,405	(1,353)
Time horizon of the business plan	(155)	241
Total	**1,481**	**(1,345)**

These sensitivities in 2015 caused some effects that varied between EUR 1,729 thousand and 196 thousand, in either direction.

4.7.3 Investments in associates

The Company estimates and recognises impairment losses on its investments in associates whenever there is objective evidence, as defined in the applicable regulations, that the carrying amount of an investment in an associate may not be recoverable.

In assessing whether there is any evidence of impairment of these investments, the Company considers, among other factors: falls in their underlying carrying amount adjusted by any unrecognised unrealised gains of the companies, changes in their market price (in the case of listed companies), 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 amount of the investments and their recoverable amount. Recoverable amount is the higher of fair value less costs to sell and the present value of the future cash flows from the investment.

Where it is not possible to estimate the recoverable amount of an investment as described in the preceding paragraph and in the case of scantly material investments, the impairment of the investment is estimated by taking into account the equity of the investee adjusted by any unrealised gains existing at the measurement date.

In accordance with ruling 2 of Spanish Accounting and Audit Institute Gazette (BOICAC) 79, impairment losses and, where appropriate, the reversal of impairment losses are recognised as an expense and as income, respectively, under “Impairment of Financial Instruments - Equity Instruments and Loans and Loans to companies” as part of the profit from operations in the statement of profit or loss. The limit of any reversal of a previously recognised impairment loss is the carrying amount of the investment that would have been recognised at the date of reversal had no impairment loss been recognised.

In 2016 and 2015, the impairment losses recognised by the Company amounted to EUR 2,427 thousand and 3,824 thousand, respectively (see Note 7.2).

4.8 Financial liability classification categories

The Company classifies as financial liabilities the trade payables that have arisen from the purchase of goods or services in the normal course of the Company's business, the financing received (see Note 1) and the nontrade payables which, not having commercial substance, cannot be classed as derivative instruments.

Accounts payable are initially recognised at the fair value of the items received, adjusted by the directly attributable transaction costs. These liabilities are subsequently measured at amortised cost.

Without prejudice to the foregoing, certain items established in the applicable regulations, maturing in less than twelve months, are recognised initially at their nominal amount when the effect of not discounting their cash flows is not material, and they are measured subsequently at that same amount.

Liability derivative financial instruments are measured at fair value using the same methods as those described in Note 4.9 for held-for-trading financial assets.

The interest accrued on these liabilities, which is calculated using the effective interest method, is recognised under "Finance Costs" in the statement of profit or loss.

4.9 Hedging derivatives

The Company uses financial derivatives in hedges of its asset and liability positions, as part of its strategy to reduce its exposure to interest rate risk.

When the Company designates a transaction as a hedge, it does so from the date of inception of the transactions or instruments included in the hedge, and the hedging relationship is documented appropriately. The documentation of the hedging relationship includes identification of the hedged item(s) and the hedging instrument(s), 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 to be hedged.

Sareb only applies hedge accounting for hedges that are considered highly effective over their entire lives. A hedge is considered to be highly effective if, during its expected life, the changes in the fair value or cash flows of the hedged item(s) that are attributable to the hedged risk are offset substantially in full by changes in the fair value or cash flows, as the case may be, of the hedging instrument(s).

To measure the effectiveness of hedges designated as such, the Company analyses whether, at inception and throughout the term of the hedge, it can be expected, prospectively, that the changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk will be offset substantially in full by changes in the fair value or cash flows, as appropriate, of the hedging instrument(s) and, retrospectively, that the actual results of the hedge will have been within a range of 80% to 125% of the results of the hedged item.

In determining the aforementioned fair value, the Company takes into account the Company's own credit risk, if the value is negative, or the counterparty credit risk, if it is positive.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised or no longer meets the criteria for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to profit or loss.

Cash flow hedges

In 2016, the derivatives covering the bonds issued at one year and part of the bonds issued at two years have maintained effectiveness within the thresholds required by the International Accounting Standards, but due to the decreasing evolution of the interest types, which reference the risks covered and the existence of a "floor", for which the interest rate cannot be, in any case, less than 0%, they have lost part of their effectiveness. As a result of this, the Company recognised an amount of EUR 36,572 thousand for the valuation of said hedging instruments in "Financial Costs" of the accompanying statement of profit or loss (see Note 16.5).

The rest of the hedges maintained by the Company at 31 December 2016, Sareb met the definition of "cash flow hedges", i.e. they are hedges of the exposure to variability in the cash flows associated with the interest rate risk of a highly probable forecast transaction and of the variable-rate financing received, respectively, which affect the Company's profit or loss. The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised temporarily in equity under "Valuation Adjustments - Hedges", net of the related tax effect, and is transferred to profit or loss in the same period or periods during which the hedged forecast cash flows affect profit or loss.

Note 13.3 provides certain information on the cash flow hedges arranged by the Company.

4.10 Derecognition of financial instruments

A financial asset is derecognised when one of the following circumstances arises:

1. The contractual rights to the cash flows from the financial asset expire; or
2. The contractual rights to receive the cash flows of the financial asset and substantially all the risks and rewards of ownership of the financial asset are transferred, or, even if the Company neither transfers nor retains substantially all the risks and rewards of ownership, control of the financial asset is transferred.

A financial liability is derecognised when the obligations giving rise to it cease to exist or when they are repurchased by the Company, with the intention either to re-sell them or to cancel them.

4.11 Inventories

Inventories relate basically to property developments in progress and the value of the associated land, earmarked for sale in the ordinary course of the Company's business. Sareb recognises under "Inventories" all the assets with respect to which it intends to perform any kind of action or carry out any construction and/or development work for their subsequent sale through its promotion activity.

The costs incurred in uncompleted property developments are considered to be work in progress. These costs include building lot, urban development and construction costs, the capitalisation of borrowing costs incurred during the construction period and other allocable direct or indirect costs. The Company does not capitalise any marketing costs, which it charges directly to profit or loss.

All property assets for which the Company's governing bodies have approved an investment and development plan for subsequent retail sale are transferred from "Property Investments" to "Inventories".

The cost relating to property developments whose construction was completed in the year is transferred from "Work in Progress" to "Completed Buildings".

The criteria used for analysing inventory write-downs are similar to those applied for assessing impairment of investment property (see Note 4.7.1.).

4.12 Foreign currency transactions

The Company's functional currency is the euro. Therefore, transactions in currencies other than the euro are deemed to be "foreign currency transactions" and are recognised by applying the exchange rates prevailing at the date of the transaction.

At year-end the Company did not have any material balances and had not performed any material transactions in foreign currency. The amount of income recognised during the year from 2016 amounted to EUR 187 thousand (EUR 2,318 thousand of income in 2015).

4.13 Income and expenses

Revenue and expenses are recognised on an accrual basis, i.e. when the actual flow of the related goods and services occurs, regardless of when the resulting monetary or financial flow arises. Revenue is measured at the fair value of the consideration received, net of discounts and taxes.

Presentation in the statement of profit or loss

The Company, in accordance with Additional Provision Seven.10 of Law 9/2012, of 14 December, as amended by Additional Provision Nine of Law 26/2013, of 27 December, and pursuant to Bank of Spain Circular 5/2015, recognised the income from the management and orderly liquidation of all the transferred assets as part of its "Revenue" in the statement of profit or loss (see Notes 2.1 and 16.1).

Interest income

Without detriment to the criteria provided for in Recognition and Measurement Standard 9 of the Spanish National Chart of Accounts, according to which financial assets must be measured subsequently at amortised cost and "accrued interest shall be recognised in the statement of profit or loss using the effective interest method", the general use of the accrual principle and of the amortised cost method may have specific practical applications depending on the type of assets involved, the conditions of their acquisition or even the sector in which the method is applied, insofar as this may contribute to the fair presentation of the financial statements.

Considering the characteristics of the assets received and the high level of uncertainty regarding the recovery of their value through ordinary channels, as already described in Note 4.6.2, the accrual model applied by Sareb envisages the accrual of interest only on transactions in which the interest is expected to be effectively collected and this is supported by the recoverable amount of the collateral securing these transactions. This recoverable amount is estimated on the basis of the criteria detailed in Note 4.7.2.

As part of the effective interest rate, the Company recognises under "Revenue - Recoveries of Gains on Loans and Credit Facilities" the difference between the amount recovered and the acquisition cost of the loans and credit facilities that have been fully or partially repaid.

Income from sales of loans and credit facilities

The income from sales of loans is recognised under "Revenue - Income from Sales of Loans and Credit Facilities". A sale is deemed to have taken place when all the risks and rewards associated with the transferred financial asset have been transferred to the buyer, which is normally when the transaction is executed in a deed and the sale price is collected.

Income from sales of property (investment property and inventories)

Income from sales of property (both investment property and inventories) is recognised when the significant risks and rewards of ownership of the property sold have been transferred to the buyer, and the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the property sold. This generally coincides with the execution of the deed for the property being sold. The proceeds from property sales are recognised under "Revenue" in the accompanying statement of profit or loss.

The Company recognises in the accompanying statement of profit or loss, as a period provision for the completion of construction work, the amounts of the expenses yet to be incurred in order to liquidate the property developments.

The amount advanced in cash or in notes receivable relating to property development reservations and sale agreements, when the developments have not been handed over to customers and, therefore, the sale has not been recognised, is accounted for under "Customer Advances" on the liability side of the accompanying balance sheet, and is classified as a current item irrespective of the date on which the sale of the developments is expected to be recognised.

The Company recognises sales of land and building lots when the risks and rewards of ownership have been transferred, which is normally when the sale agreement is executed in a deed.

Rental income

Rental income is recognised on an accrual basis and incentives and the initial lease costs are allocated to income on a straight-line basis.

4.14 Income tax

Tax expense (tax income) comprises current tax expense (current tax income) and deferred tax expense (deferred tax income). Income tax is calculated on the basis of accounting profit or loss determined by application of generally accepted accounting principles, which does not necessarily coincide with the taxable profit or tax loss.

The current income tax expense is the amount payable by the Company as a result of income tax settlements for a given year. Tax credits and other tax benefits, excluding tax withholdings and pre-payments, and tax loss carryforwards from prior years effectively offset in the current year reduce the current income tax expense.

The deferred tax expense or income relates to the recognition and derecognition of deferred tax assets and liabilities. These include temporary differences measured at the amount expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities and their tax bases, and tax loss and tax credit carryforwards. These amounts are measured at the tax rates that are expected to apply in the period when the asset is realised or the liability is settled.

Deferred tax assets are recognised to the extent that it is considered probable that the Company will have taxable profits in the future against which the deferred tax assets can be utilised. In this case, the deferred tax assets are measured at the tax rate that is expected to apply in the period when the tax asset is recovered.

Deferred tax assets and liabilities arising from transactions charged or credited directly to equity are also recognised in equity.

The deferred tax assets recognised are reassessed at the end of each reporting period and the appropriate adjustments are made to the extent that there are doubts as to their future recoverability. Also, unrecognised deferred tax assets are reassessed at the end of each reporting period and are recognised to the extent that it has become probable that they will be recovered through future taxable profits.

4.15 Provisions and contingencies

When preparing the financial statements the Company's directors made a distinction between:

a) Provisions: credit balances covering present obligations arising from past events with respect to which it is probable that an outflow of resources embodying economic benefits that is uncertain as to its amount and/or timing will be required to settle the obligations; and

b) Contingent liabilities: possible obligations that arise from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more future events not wholly within the Company's control.

The financial statements include all the provisions with respect to which it is considered that it is more likely than not that the obligation will have to be settled. Contingent liabilities are not recognised in the financial statements, but rather are disclosed, unless the possibility of an outflow in settlement is considered to be remote.

Provisions are measured at the present value of the best possible estimate of the amount required to settle or transfer the obligation, taking into account the information available on the event and its consequences. Where discounting is used, adjustments made to provisions are recognised as interest cost on an accrual basis.

The compensation to be received from a third party on settlement of the obligation is recognised as an asset, provided that there are no doubts that the reimbursement will take place, unless there is a legal relationship whereby a portion of the risk has been externalised as a result of which the Company is not liable; in this situation, the compensation will be taken into account for the purpose of estimating the amount of the related provision that should be recognised.

At 31 December 2016 and 2015, the Company had recognised the provisions described in Note 12.

4.16 Related party transactions

A related party is defined as any person or entity that has control or significant influence over an entity or is a member of the entity's key management personnel. According to the directors, no entity has control or joint control over the Company and there is no relationship with the members of key management personnel, other than the employment relationship with them.

Significant influence is defined as the power to participate in the financial and operating policy decisions of the Company, but is not control over those polices. In this regard, significant influence is presumed to exist when an ownership interest of more than 20% is held and, therefore, the FROB exercises significant influence.

As a general rule, related party transactions are recognised using the general recognition and measurement bases contained in the Spanish National Chart of Accounts, i.e. the items involved in the transaction are recognised at their fair value on initial recognition and, subsequently, are measured in accordance with the corresponding accounting standards.

Note 17 provides information on the related party transactions performed in 2016 and 2015 and on the balances held with related parties at 31 December 2016 and 2015.

4.17 Termination benefits

Under current legislation, the Company is required to pay termination benefits to employees terminated under certain conditions. Therefore, termination benefits that can be reasonably quantified are recognised as an expense in the year in which the decision to terminate the employment relationship is taken. At 31 December 2016, the Company had not recognised any liability in this connection. However, in 2016 it recognised termination benefits amounting to EUR 515 thousand under "Staff Costs - Wages, Salaries and Similar Expenses" in the accompanying statement of profit or loss (2015: EUR 391 thousand).

4.18 Statements of cash flows

The following terms are used in the statements of cash flows (prepared using the indirect method) with the meanings specified:

1. Cash flows: inflows and outflows of cash and cash equivalents, which are short-term, highly liquid investments that are subject to an insignificant risk of changes in value.

2. Operating activities: the principal revenue-producing activities of the Company and other activities that are not investing or financing activities. The Company classifies these activities as described in Note 4.13.

3. Investing activities: the acquisition and disposal of long-term 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 the equity and borrowings of the Company that are not operating activities, and other activities that are not investing activities.

5. Investment property

The detail of "Investment property" at 31 December 2016 and 2015 is as follows:

	Thousands of euros	
	31/12/2016	31/12/2015
Land and building lots	5,019,864	4,884,955
Completed buildings		
Residential property - principal residence	5,148,449	4,897,877
Offices, premises and multi-purpose industrial buildings	1,255,626	1,165,796
Other properties	508,092	624,130
Residential property - other than usual residence	54,700	73,271
Total completed buildings	6,966,867	6,761,074
Of which: Leased buildings (Note 6)	854,864	700,253
of which: Land	4,089,235	3,795,119
Total investment property	**11,986,731**	**11,646,029**

The changes in "Investment Property" in 2016 and 2015 were as follows:

2016

	Thousands of euros		
	Completed buildings	Land and building lots	Total
Cost:			
Balance at 1 January 2016	**6,898,945**	**4,884,955**	**11,783,900**
Additions due to foreclosure and dation in payment	834,429	489,238	1,323,667
Other additions	7,006	10,665	17,671
Sales and disposals	(558,859)	(327,096)	(885,955)
Transfers to inventories (Note 8)	(24,785)	(7,205)	(31,990)
Reductions due to corrections (Note 1)	(1,642)	(30,693)	(32,335)
Balance at 31 December 2016	**7,155,094**	**5,019,864**	**12,174,958**
Accumulated depreciation			
Balance at 1 January 2016	**(137,871)**	**-**	**(137,871)**
Charge to income for the year	(64,021)	-	(64,021)
Sales, disposals 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**

2015

	Thousands of euros		
	Completed buildings	Land and building lots	Total
Cost:			
Balance at 01 January 2015	**6,181,364**	**4,888,231**	**11,069,595**
Additions due to foreclosure and dation in payment	930,651	399,029	1,329,680
Other additions	885	19,413	20,298
Sales and disposals	(326,343)	(307,347)	(633,690)
Transfers from inventories (Note 8)	113,830	(103,220)	10,610
Reductions due to corrections (Note 1)	(1,442)	(11,151)	(12,593)
Balance at 31 December 2015	**6,898,945**	**4,884,955**	**11,783,900**
Accumulated depreciation			
Balance at 01 January 2015	**(89,905)**	**-**	**(89,905)**
Charge to income for the year	(55,155)	-	(55,155)
Sales, disposals and other changes	7,189	-	7,189
Balance at 31 December 2015	**(137,871)**	**-**	**(137,871)**
Net balances at 31 December 2015	**6,761,074**	**4,884,955**	**11,646,029**

The most significant changes in "Inventories" in 2016 and 2015 were as follows:

Other additions

In 2016 and 2015, the Company capitalised EUR 9,186 thousand and 20,298 thousand, respectively, of improvements and developments made to its investment property as an increase in the cost of its investment property. These improvements relate mainly to the development work carried out on land and building lots.

In addition, that line item recognises EUR 8,485 thousand relating to the Company's acquisition of certain property assets through the asset exchange transaction with Bankia S.A. (see Note 1).

Transfers between items

In 2016, the Company reclassified from "Inventories" to "Investment Property" EUR 31,990 thousand relating to various properties for which the Company decided to start construction and develop residential properties. In 2015 the Company reclassified from "Inventories" to "Investment Property" EUR 10,610 thousand relating to various plots of land and property developments in progress, on which no construction work is intended to be performed in the short term (see Note 8).

Mortgage foreclosures and dations in payment

2016:

On 31 May 2016, the Company formalised the dation in payment of the land and finished products that the borrower "Inmobiliaria Osuna, S.L." had mortgaged as security for various bilateral loans held by the Company. The acquisition cost of the land and finished products acquired amounted to EUR 27,075 thousand, which was the carrying amount of the loans and credit facilities repaid in full as part of the dation in payment.

On 22 June 2016, the dation in payment was formalised of part of the finished products that the borrower "Levalta S.L." had mortgaged as security for various bilateral loans held by the Company. The acquisition cost of the land and finished products acquired amounted to EUR 20,774 thousand.

On 4 August 2016, the dation in payment was formalised of the finished products that the borrower "Imberti Viviendas, S.A." had mortgaged as security for various bilateral loans held by the Company. The acquisition cost of the land and finished products acquired amounted to EUR 22,076 thousand.

2015:

On 29 October 2015, the dation in payment was formalised of the land and finished products that the borrower Vehículo de Tenencia y Gestión 9, S.L. had mortgaged as security for various bilateral loans held by the Company. The acquisition cost of the land and finished products acquired amounted to EUR 42,875 thousand.

The total amount of the properties acquired through dation in payment and/or mortgage foreclosure was EUR 1,323,667 thousand in 2016 (2015: EUR 1,329,680 thousand). These foreclosures and dations in payment did not have a significant effect on the accompanying statements of profit or loss for 2016 and 2015.

Sales and disposals

2016:

The main sales in 2016 were as follows:

On 31 August 2016 the sale of 4 parcels located in the "El Cañaveral" sector in Vicálvaro (Madrid) was recognised for an overall price of EUR 7,722 thousand, which were fully collected when the public deed was executed.

On 28 October 2016, a single building was sold located on Calle Protectora in Palma de Mallorca (Balearic Islands) for a price of EUR 5,000 thousand, which were fully collected at the end of 2016.

On 29 November 2016, the Company recognised the sale of a building lot on Paseo de los Melancólicos (Madrid) for a price of EUR 20,000 thousand, whereby EUR 9,000 thousand were deferred until 30 September 2017. The sale deed provides that, in the event of default on the part of the buyer, the Company will recover the transferred assets plus an indemnity.

On 2 December 2016, the sale deed was realised for an office building at Calle Gobelas No. 29 (Aravaca-Madrid) for a price of EUR 9,200 thousand, which were fully collected at the end of 2016.

2015:

The main sales in 2015 were as follows:

On 15 June 2015, the sale of an office building located in the Salamanca district (Madrid) was executed in a public deed. The selling price amounted to EUR 52,000 thousand, which had been collected in full at the end of 2015.

On 22 December 2015, the Company sold a residential-use building lot located in the municipality of Fuengirola (Málaga). The selling price amounted to EUR 14,000 thousand, of which EUR 7,700 thousand were collected at 31 December 2015 and EUR 6,300 thousand were deferred and later collected in 2016. The sale deed provides that, in the event of default on the part of the buyer, the Company will recover ownership of the land plus an indemnity.

On 30 December 2015, the Company sold a residential complex located in La Alcaidesa (San Roque - Cádiz), which had 252 housing units and annexes. The sale price stipulated amounted to EUR 30,150 thousand.

Lastly, on 30 December 2015 the Company sold a building lot for tertiary-sector use located in the district of Arganzuela (Madrid). The selling price amounted to EUR 19,000 thousand, of which EUR 10,450 thousand were collected in cash while the remainder, EUR 8,550 thousand, was deferred until 30 December 2016 and is guaranteed by a first-demand bank guarantee.

Total sales of investment property formalised in 2016 and 2015 gave rise to the recognition of income from sales of investment property amounting to EUR 986,238 thousand and EUR 769,076 thousand, respectively (see Note 16.1). The net cost of the investment property sold amounted to EUR 886,246 thousand and EUR 606,554 thousand, respectively (see Note 16.2). These figures include EUR 20,362 thousand and EUR 21,471 thousand of income from the FABs not derecognised at Sareb and costs of sales of EUR 19,113 thousand and EUR 18,571 thousand (see Note 4.6.1).

Sale commitments:

At 31 December 2016 and 2015, the Company had the following sale commitments on investment property:

- Eloise portfolio: In December 2016, the Company sold the Eloise portfolio, within which a package of property assets were sold for a price of EUR 19,809 thousand. This portfolio included a series of investment properties for which there is a firm sales commitment that should be formalised in the first quarter of 2017. The sales price assigned to said investment properties amounted to EUR 17,864 thousand, which are recognised in "Trade and Other Payables - Customer Advances" from the accompanying balance sheets (see Note 14).

- FAB Bull: In 2013 the Company transferred to FAB 2013 Bull, for EUR 100,000 thousand, an investment property portfolio with a net cost of EUR 97,896 thousand at 31 December 2013. The Company did not recognise the related sale as it considered that the risks and rewards inherent to the aforementioned assets were not transferred. At 31 December 2016 and 2015, the outstanding property assets owned by FAB Bull amounted to EUR 17,777 thousand and 34,358 thousand euros, respectively.

At 31 December 2016 and 2015, there were no sale commitments for material amounts other than those described above.

Other disclosures

At 2016 and 2015 year-end:

- All the Company's investment property was free of liens and encumbrances.

- The Company did not have any fully depreciated investment property on its balance sheet.

- There were no significant dismantling or removal costs capitalised as an increase in the cost of its investment property.

- The assets foreclosed by Sareb that form part of the Financial Asset Unit did not give rise to any gain or loss on their recognition as property assets in the balance sheet.

- In this regard, the application of the valuation rules established in Bank of Spain Circular 5/2015 for the Property Asset Unit, consisting of those assets that were transferred by the transferor institutions on Sareb's incorporation, which are classified under "Investment Property" and "Inventories" (see Note 8), gave rise to a gain of EUR 1,491 million and 1,249 million at the end of 2016 and 2015, respectively, with respect to the carrying amount of these assets.

- The valuation of the assets foreclosed or received in payment of debt subsequent to the transfer date, performed in accordance with the criteria of Bank of Spain Circular 5/2015, contributed a gain in 2016 and 2015 of EUR 551 million and 595 million, respectively, to the Financial Asset Unit (see Note 7.1) which decreased the write-down requirements of this Unit's loan transactions.

- The Company had not recognised any impairment losses on its investment property portfolio.

The Company takes out all the insurance policies considered necessary to cover the possible risks to which its investment property is subject. The insurance coverage arranged by the Company in connection with its investment property exceeds the carrying amount thereof and is updated annually.

6. Operating leases

At the end of 2016 and 2015 the Company acted as lessor in certain operating leases the minimum lease payments on which, based on the leases currently in force, without taking into account the charging of common expenses, future increases in the CPI or future contractual lease payment revisions, were as follows:

Minimum payments	Thousands of euros	
	2016	2015
Less than one year	36,025	34,556
Between one and five years	62,838	66,139
More than five years	82,558	168,102
Total	**181,421**	**268,797**

Also, the operating lease and sublease payments for 2016 and 2015 were recognised under "Revenue", the detail being as follows:

	Thousands of euros	
	2016	2015
Minimum lease payments (Note 16.1)	42,135	42,011
Charging general expenses	2,412	1,959
Total	**44,547**	**43,970**

The detail of the most significant leases is as follows:

Location	Contract date	Type of property	Annual gross amounts (thousands of euros)	Maturity date
c/ Ajalvir (Torrejón de Ardoz)	01/03/2012	Shopping Centre	910	21/05/2023
c/ Cronos (Madrid)	26/06/2006	Office building	729	30/06/2017
Sant Celoni (Barcelona)	01/11/2016	Commercial premises	643	03/12/2034
c/ Manfredonia (Zaragoza)	01/03/2009	Industrial warehouse	393	27/04/2024
c/ Adolfo Suarez (Benidorm)	01/12/2013	Tourist complex	200	30/09/2023

The net cost of the properties leased out by the Company amounted to EUR 854,864 thousand at 31 December 2016 (31 December 2015: EUR 700,253 thousand) (see Note 5).

The amount of contingent rent, i.e. variable rent payments, relating to the aforementioned leases and recognised under "Revenue" in 2016 and 2015 was not significant.

Lastly, the leases in which the Company acts as the lessee refer mainly to the lease of the offices where the Company's head office is located and the lease of various computer equipment. The Company's lease payment obligations in this connection were not material at the end of 2016 and 2015.

7. Non-current and current investments

The carrying amount of each of the categories of financial assets held by the Company at 31 December 2016 and 2015 is as follows:

7.1 Detail of non-current and current investments

The detail, classified as required by applicable legislation, of the financial assets owned by Sareb at 31 December 2016 and 2015 is as follows:

2016

Types / Categories	Thousands of euros				
	Non-Current Financial Instruments		Current Financial Instruments		Total
	Equity instruments	Credit facilities, derivatives and others	Debt values	Credit facilities, derivatives and others	
Other financial assets	-	2,776,689	-	25,335	2,802,024
Loans and Receivables - Loans to Third Parties	-	20,902,659	-	3,558,690	24,461,349
Assets Available For Sale	-	-	-	-	-
Total	**-**	**23,679,348**	**-**	**3,584,025**	**27,263,373**

2015

Types / Categories	Thousands of euros				
	Non-Current Financial Instruments		Current Financial Instruments		Total
	Equity instruments	Credit facilities, derivatives and others	Debt values	Credit facilities, derivatives and others	
Other financial assets	-	2,671,820	-	7,411	2,679,231
Loans and Receivables - Loans to Third Parties	-	25,555,635	-	2,674,580	28,230,215
Assets Available For Sale	-	-	-	-	-
Total	**-**	**28,227,455**	**-**	**2,681,991**	**30,909,446**

7.1.1 Non-current and current loans to third parties

The detail, by counterparty and type of instrument, of “Non-Current Financial Instruments - Loans to Third Parties” and “Current Financial Instruments - Loans to Third Parties” at 31 December 2016 and 2015 is as follows:

	Amounts in thousands of euros	
	31/12/2016	31/12/2015
Public Administrations	4,523	3,760
Other resident sectors	1,673,384	2,302,560
Trade credit	-	-
Debtors with securities	1,473,549	2,086,561
with mortgage guarantees	1,473,529	2,079,295
with other securities	20	7,266
Other term loans	141,175	130,451
Overdrafts and others	58,660	85,548
Non-resident private sector	35	70
Loans and credit facilities of doubtful collection	25,604,185	28,518,248
Valuation adjustments	(2,820,778)	(2,594,423)
Valuation corrections due to asset impairment	(3,389,356)	(3,012,418)
Other valuation adjustments -*accrued interest pending collection*	555,181	403,424
Others - Capitalised expenses - (Note 4.6.2)	13,397	14,571
Total	**24,461,349**	**28,230,215**

In 2016 and 2015 the Company did not grant any new loans or credit facilities to third parties for significant amounts, except for the draw-downs made by borrowers against undrawn balances.

Corrections formalised

As indicated in Note 1, in 2016 the Company formalised corrections of financial assets amounting to EUR 34,718 thousand (2015: EUR 63,396 thousand) as a result of the review of the portfolio of loans and credit facilities transferred by the Group 1 and 2 institutions.

Finance income

At 31 December 2016, 89.4% of the portfolio of loans and credit facilities was benchmarked to Euribor plus a market spread (31 December 2015: 90.7% of the total amount of loans and credit facilities). Conversely, 10.6% was benchmarked to fixed interest rates (31 December 2015: 9.3%) (see Note 7.3.3).

In 2016, the Company recognised interest from its portfolio of loans and credit facilities amounting to EUR 890,563 thousand under "Revenue" in the accompanying statement of profit or loss (2015: EUR 588,706 thousand) (see Notes 4.13 and 16.1).

Sales of loans and credit facilities

In 2016, the Company made wholesale sales of loans for EUR 474,285 thousand recognising a negative gross margin of EUR 118,830 thousand (2015: EUR 395,848 thousand of income, and a positive margin of EUR 26,120 thousand) (see Note 16.1)

The details of the most significant portfolio sale transactions in 2016 and 2015 are as follows:

2016

At 19 February 2016 the Company sold 16 loans backed by mortgage guarantees. The price set for this portfolio amounted to EUR 45,500 thousand, which were collected in full and recognised under "Revenue" in the accompanying statement of profit or loss.

At 14 September 2016, the Company sold 241 loans backed by first-ranking mortgage guarantees. The selling price of the portfolio amounted to EUR 70,500 thousand, which were collected in full. The proceeds from the sale are recognised under "Revenue" in the accompanying statement of profit or loss.

"Antares" transaction: on 23 December 2016, the sale of a portfolio of 123 loans with mortgage guarantees on various properties was completed for a global amount of EUR 49,367 thousand, which is recognised under "Revenue". At 31 December 2016, the price had been collected in full.

“Sevilla” transaction: on 29 December 2016, the Company formalised the transfer of 41 loans with first-ranking mortgage guarantees. The price set for this portfolio amounted to EUR 33,278 thousand, which were collected in full and recognised under “Revenue” in the accompanying statement of profit or loss.

“Eloise” transaction: on 29 December 2016, the sale of a portfolio of loans with mortgage guarantees on various properties was completed for a global amount of EUR 240,601 thousand, which is recognised under “Revenue”. At 31 December 2016, the price had been collected in full. This portfolio included a package of “Investment Property”, for which part of the recognition has been deferred until the first quarter of 2017 (see Note 5).

2015

On 17 March and 30 June 2015, the Company formalised the transfer of various loans with first-ranking mortgage guarantees and a participation in a syndicated loan. The price set for this portfolio amounted to EUR 69,326 thousand, which were collected in full and recognised under “Revenue” in the accompanying statement of profit or loss.

In July 2015 the Company sold seven loans backed by mortgage guarantees. The selling price of the portfolio amounted to EUR 53,900 thousand, which were collected in full. The proceeds from the sale are recognised under “Revenue” in the accompanying statement of profit or loss.

“Alquimaison” transaction: on 29 September 2015, the sale of a portfolio of 317 loans with mortgage guarantees on various properties was completed for a global amount of EUR 37,500 thousand, which was recognised under “Revenue”. At 31 December 2015, the price had been collected in full.

“Macarena and Pegasus” transaction: on 30 December 2015, the sale of a group of loans and credit facilities with various residential buildings and other property assets as collateral was completed. The price of this portfolio amounted to EUR 220,337 thousand, which were recognised under “Revenue” in the accompanying statement of profit or loss. At 31 December 2015, this amount had been collected in full.

Recoveries of loans and credit facilities

The Company recognised in that line item the difference between the recovered amounts of loans fully and/or partially repaid and their carrying amount (see Notes 4.13 and 16.1). The order of priority followed by the Company implies that the amounts collected apply in the first place to cancelling the interests and subsequently, capital. This has made the recoveries of loans and credit facilities in 2016 negative, amounting to EUR 283,634 thousand. In 2015, said line item amounted to EUR 382,776 thousand.

Impairment losses due to credit risk

The changes in the impairment losses recognised by the Company in 2016 and 2015 were as follows:

2016

	Amounts in thousands of euros			
	Initial balance	Charge	Application	Final balance
Provision for depreciation of loans and credit facilities	(3,012,418)	(376,938)	-	(3,389,356)
Total	**(3,012,418)**	**(376,938)**	**-**	**(3,389,356)**

2015

	Amounts in thousands of euros			
	Initial balance	Charge	Application	Final balance
Provision for depreciation of loans and credit facilities	(2,675,246)	(337,172)	-	(3,012,418)
Total	**(2,675,246)**	**(337,172)**	**-**	**(3,012,418)**

In application of the valuation rules established by Bank of Spain Circular 5/2015 for the Financial Asset Unit, in 2016 the Company recognised EUR 376,938 thousand (2015: EUR 337,172 thousand) of impairment losses on its portfolio of loans and credit facilities due to credit risk (see Note 4.7.2).

As detailed in Notes 2.1 and 2.5, in 2016, RD 4/2016 was approved, based on which the Company has recognised the aforementioned impairment, net of the related tax effect, in “Valuation Adjustment - Impairment of financial assets” (see Note 11.4).

The detail of the allowance for impairment of loans and credit facilities for 2016 and 2015 is as follows:

Type of transaction	31/12/2016		31/12/2015	
	Carrying amount (millions of euros)	**Loss/(gain) (millions of euros)**	**Carrying amount (millions of euros)**	**Loss/(gain) (millions of euros)**
With security	24,832	1,160	28,032	648
Personal or without first liens	3,018	2,780	3,210	2,959
Foreclosed Sareb	4,115	(551)	2,562	(595)
Total	**31,965**	**3,389**	**33,804**	**3,012**

Note 7.3.1 contains the required information on the nature and the level of credit risk of the portfolio of loans and receivables at 31 December 2016 and 2015 (see Note 4.7.2).

Other disclosures

At 31 December 2016 and 2015:

- The nominal value of the drawable amounts of the loan and credit facility transactions was EUR 1,517,598 thousand and EUR 1,895,556 thousand, respectively.

- There were no significant commitments to sell any financial assets recognised under “Loans and Credit Facilities to Third Parties”.

- There were no lawsuits or attachments significantly affecting the amount of the Company's non-current and current investments.

The Company's directors consider, taking into account also the content of Note 4.7, that the carrying amount of the aggregate balances included under this heading in the balance sheet approximates their fair value.

Following the Company's analyses and the updating of its estimates, the financial assets classified as doubtful were classified as non-current investments since it was considered that their recovery will take place over a time horizon of more than twelve months (see Note 2.4).

7.1.2 Non-current and current investments- Other financial assets

The detail of "Non-Current Investments - Other Financial Assets" and "Current Investments - Other Financial Assets" in the balance sheets as at 31 December 2016 and 2015 is as follows:

	31/12/2016		31/12/2015	
Amounts in thousands of euros	**Non-current**	**Current**	**Non-current**	**Current**
Cash collateral for undersigned derivatives (Note 13.3)	2,766,800	-	2,659,900	-
Security deposits on leases (Note 6)	5,342	-	4,743	-
Deposits and payments into court	4,169	-	6,422	-
Other financial assets	378	25,335	755	7,411
Total	**2,776,689**	**25,335**	**2,671,820**	**7,411**

Security deposits on leases

Non-current guarantees and deposits relate mainly to amounts delivered by lessees as security deposits which the Company deposits with the housing institute or property association in each autonomous community.

Cash collateral given in derivative transactions

At 31 December 2016, the Company had given cash collateral amounting to EUR 2,766,800 thousand (31 December 2015: EUR 2,659,900 thousand) to counterparties with which it has entered into financial derivative contracts (see Note 13.3). The collateral bears interest at a rate tied to Eonia and 3-month Euribor plus a market spread. The finance income accrued in 2016 and 2015 was not material.

The Company's directors consider that the carrying amount of the balances included under this heading in the balance sheet approximates their fair value.

Deposits and payments into court

At 31 December 2016 and 2015, the Company had made deposits and payments into court amounting to EUR 4,169 thousand and 6,422 thousand, respectively, mainly as a result of the mortgage foreclosure processes in which it is involved.

7.2 Detail of investments in associates

The detail of "Non-Current Investments in Associates" at 31 December 2016 and 2015 is as follows:

2016

Amounts in thousands of euros	31/12/2015	Additions	Amorti-sations	31/12/2016
Investments in associates	1,897	10,232	-	12,129
Impairment of investments in associates	-	(2,427)	-	(2,427)
Total equity instruments	**1,897**	**7,805**	**-**	**9,702**
Loans to associates	28,339	2,382	(17)	30,704
Impairment of loans to associates	(8,739)	-	-	(8,739)
Total loans to associates	**19,600**	**2,382**	**(17)**	**21,965**
Total	**21,497**	**10,187**	**(17)**	**31,667**

2015

Amounts in thousands of euros	31/12/2014	Additions	Amorti-sations	Decreases due to integration	31/12/2015
Investments in associates	8,614	1,897	-	(8,614)	1,897
Impairment of equity instruments	-	(2,678)	-	2,678	-
Total equity instruments	**8,614**	**(781)**	-	**(5,936)**	**1,897**
Loans to associates	29,314	2,205	(2,845)	(335)	28,339
Impairment of loans to associates	(7,593)	(1,146)	-	-	(8,739)
Total loans to associates	**21,721**	**1,059**	**(2,845)**	**(335)**	**19,600**
Total	**30,335**	**278**	**(2,845)**	**(6,271)**	**21,497**

7.2.1. Investments in associates

Associates

2016

At 8 February 2016, the Company executed all of the pledged assets of Quabit Inmobiliaria S.A., holder of the loan on behalf of the borrower Martibalsa, S.L., for a carrying amount of EUR 10,232 thousand. At 2016 year-end, 4,064,515 shares were valued based on their market price at that time, recognising an accumulated impairment loss of EUR 2,427 thousand in "Impairment of Equity Instruments, Loans and Loans to companies", on the accompanying statement of profit and loss.

The Company's ownership held in Quabit Inmobiliaria, S.A. (whose corporate address is C/ Roger de Lauria 19 – Valencia, and their business object is property development) amounted to 7.66%. The equity and loss of operations in the last unaudited year of said Company amounted to EUR 113,341 thousand and 19,674 thousand, respectively.

Furthermore, the Company's ownership of Hercesa Internacional, S.L. at 31 December 2016 amounted to 6.94% of the Company's capital (whose corporate address is Plaza de Europa, Guadalajara and business object is property development). The equity and loss of operations in the last unaudited year of said Company amounted to EUR 100,773 thousand and 3,767 thousand, respectively.

2015

On 14 December 2015, the Company converted into capital the debt of the borrower Hercesa Internacional, S.L. through the settlement of the loans granted to this company, the gross carrying amount of which was EUR 3,448 thousand. The Company recognised an allowance of EUR 1,551 thousand on these loans in 2014. As a result of this transaction, the Company now owns 78,074 Class B shares of Hercesa Internacional, S.L. representing 6.94% of its share capital.

Bank asset funds - assets derecognised at Sareb

2016

In 2016, there were no significant changes related to the assets derecognised at Sareb.

2015

As indicated in Note 4.6.1., on 28 October 2015 the Company repurchased from the majority investor/shareholder 80% of the securities of FAB Crossover I for EUR 19,030 thousand. This purchase gave the Company full control over this fund and, accordingly, the FAB's assets and liabilities were included in the Company's balance sheet and the cost of the investment was eliminated against equity.

Prior to the purchase of securities described above, the Company had received income of EUR 6,525 thousand on the securities, which was recognised under "Revenue" in the accompanying statement of profit or loss. The returns obtained from FAB 2013 Teide and FAB May (see Note 16.1) were also recognised under "Revenue".

The most important information on the funds whose assets were derecognised by the Company is as follows:

2016

Company	Ownership	Address	Main Activity	Thousands of euros			
				Values (*)	Reserves and Other Equity Items	Gross Margin (*)	Profit / (loss) after taxes
1. Not listed.-							
FAB 2013 Teide	15%	Pza. Pablo Ruiz Picasso 1, Madrid	Sale and management of property	87,815	-	11,615	-
FAB May	5%	Pª Castellana 143	Sale and management of property	57,614	-	642	-

(*) Data taken from the latest available financial statements as at 31 December 2016, prepared in accordance with the standards applicable to each entity. At the date when the accompanying financial statements were authorised for issue, this fund's financial statements had not been audited.

2015

Company	Ownership	Address	Main Activity	Thousands of euros			
				Values	Reserves and Other Equity Items (*)	Gross Margin	Profit / (loss) after taxes (*)
1. Not listed.-							
FAB 2013 Teide	15%	Pza. Pablo Ruiz Picasso 1, Madrid	Sale and management of property	87,815	-	4,132	-
FAB May	5%	Pª Castellana 143	Sale and management of property	57,614	-	576	-

(**) In 2015 FAB 2013 Teide and FAB May, at the behest of the CNMV, adopted a change in accounting policy consisting of loss for the year through an offsetting item, the balancing entry for which is a correcting account that reduces the amount of the debt securities issued. This change in accounting policy did not have any impact on the Company's financial statements.

Bank asset funds - assets not derecognised at Sareb

In 2016 and 2015 no significant changes took place and no new funds were formed with assets not derecognised at Sareb, except the aforementioned repurchase of securities of FAB Crossover I. The most significant information on these funds is as follows:

2016

Company	Ownership	Address	Main Activity	Thousands of euros			
				Values (*)	Reserves and Other Equity Items	Gross Margin (*)	Profit / (loss) after taxes
1. Not listed.-							
FAB 2013 Bull	49%	Pza. Pablo Ruiz Picasso 1, Madrid	Sale and management of property	50,364	-	3,319	-
Corona bank asset funds at Sareb (**)	-	-	-	-	-	-	-
FAB Crossover I (**)	-	-	-	-	-	-	-

(*) Data taken from the latest available financial statements as at 31 December 2016, prepared in accordance with the standards applicable to each entity. At the date when the accompanying financial statements were authorised for issue, this fund's financial statements had not been audited.

(**) These funds were liquidated on 30 June 2016 (see Note 4.6.1).

2015

Company	Ownership	Address	Main Activity	Thousands of euros			
				Values	Reserves and Other Equity Items (*)	Gross Margin	Profit / (loss) after taxes (*)
1. Not listed.-							
FAB 2013 Bull	49%	Pza. Pablo Ruiz Picasso 1, Madrid	Sale and management of property	50,364	-	5,716	-
Corona Bank Asset funds at Sareb	100%	Pº Castellana 143	Sale and management of rental assets	-	-	(667)	-
FAB Crossover I	100%	Pª Castellana 143	Sale and management of property	43,071	24,508	15,267	14,128

(**) In 2015 FAB 2013 Bull and FAB Corona, at the behest of the CNMV, adopted a change in accounting policy consisting of loss for the year through an offsetting item, the balancing entry for which is a correcting account that reduces the amount of the debt securities issued. This change in accounting policy did not have any impact on the Company's financial statements.

7.2.2. Loans to associates

The changes in loans to associates in 2016 and 2015 were as follows:

2016

	31/12/2015	Draw-downs	Depreciation	31/12/2016
FAB 2013 Teide	**16,665**	**2,358**	**-**	**19,023**
Debt securities	13,172	-	-	13,172
Impairment of 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
VAT financing	-	-	-	-
Credit facility	54	24	(17)	61
Total	**19,600**	**2,382**	**(17)**	**21,965**

At 31 December 2016 and 2015, the Company granted a credit facility to FAB 2013 Teide, for a maximum limit of EUR 14,635 thousand. The maturity for this credit policy is set for 20 December 2018.

2015

	31/12/2014	Draw-downs	Depreciation	Decrease due to integration	31/12/2015
FAB 2013 Teide	**16,347**	**522**	**(204)**	**-**	**16,665**
Debt securities	13,172	-	-	-	13,172
Impairment of debt securities	(7,593)	(1,146)	-	-	(8,739)
Credit facility	10,768	1,668	(204)	-	12,232
FAB Crossover I	**1,854**	**486**	**(2,005)**	**(335)**	**-**
VAT financing	1,809	-	(1,809)	-	-
Credit facility	45	486	(196)	(335)	-
FAB May	**3,520**	**51**	**(636)**	**-**	**2,935**
Debt securities	2,881	-	-	-	2,881
VAT financing	605	-	(605)	-	-
Credit facility	34	51	(31)	-	54
Total	**21,721**	**1,059**	**(2,845)**	**(335)**	**19,600**

In 2016 and 2015, no significant changes took place in “Loans to Associates”.

In 2016, the Company did not obtain and return the debt securities of FAB Teide subscribed. In 2015, these returns amounted to EUR 1,377 thousand. The total returns obtained on securities of the FABs amounted to EUR 903 thousand in 2016 (2015: EUR 9,496 thousand) (see Note 16.1).

7.3 Information on the nature and level of risk of financial assets

Risk management is the basic principle for the achievement of the objectives set for the Company, which consist of contributing to the clean-up of the financial system, minimising public financial support, settling the debts and liabilities incurred in the course of its operations, minimising the possible market distortions that could result from its actions and disposing of the assets received whilst optimising their value, within the term for which it has been incorporated, at all times preserving the soundness of the Company's financial and equity position.

The Board of Directors is the governing body responsible for determining and approving general internal control procedures as well as policies regarding the assumption, management, control and mitigation of the risks to which the Company is exposed. Also, exercising the powers delegated by the Board of Directors, the Risk and Business Group, which replaces the former Investment and Divestment Group, and the Network and Direct Management areas perform risk management functions.

The Audit Committee, with the support of the Internal Audit area and the Internal Control and Compliance department, is responsible for supervising the efficiency of the operating processes and the internal control systems, and for checking compliance with the applicable regulations.

The Company manages risk on the basis of the principles of independence, senior management commitment, delegation of functions and proactive management of loans and investment property. Its aim is to minimise defaults and the impairment of investments by monitoring and controlling positions and through technical specialisation, establishing appropriate risk management and measurement tools and methodologies and applying them on a consistent basis.

As a result of the balance sheet structure with which the Company was incorporated, the major risks to which it is subject are as follows:

- Credit and concentration risk, related to the financial asset units acquired by the Company, and certain investments made in the ordinary course of its activities.

- The liquidity risk of financial instruments, arising from the unavailability, at reasonable prices, of the necessary funds to enable the Company to meet its commitments on a timely basis and to maintain in its lending activity.

- Interest rate risk, which is associated with the probability of losses arising as a result of an adverse trend in market interest rates.

- Operational risk, which is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

In view of the types of assets and liabilities held by the Company, foreign currency risk, which relates to potential losses arising from adverse fluctuations in the prices of assets and liabilities denominated in foreign currencies, is not significant.

7.3.1 Credit risk

Credit risk is defined as the possibility of loss stemming from the total or partial failure of customers or counterparties to meet their contractual payment obligations, or due to deterioration in their credit rating. At 31 December 2016, 95.1% of the loan portfolio as a whole had payments in arrears (31 December 2015: 93.9%). This risk is managed by the Risk and Business Group following the policies, methods and procedures approved by the Company's Board of Directors.

The Company's policy, in accordance with its company object, focuses on managing the portfolios acquired in order to maximize their recoverability through collection or sale. Accordingly, specific procedures are established for credit risk management according to the different characteristics of the financial asset units, as defined in Note 1 above, and of the transactions included in each of these categories, on the basis of:

- Identification, analysis and monitoring of specific risks over the life of the transaction until termination.
- Measurement and evaluation of these specific risks based on established methodologies, which are consistent with those used for calculating the transfer prices of the financial asset units.
- Recovery management of risk transactions.

Customer risk concentration regarding property rentals and sales is not significant and, for credit risk purposes, there are no significant payment deferrals. Also, it is Company policy, in the event of payment deferrals, to require customers to provide the collateral necessary to ensure recoverability of the deferred amounts, either as guarantees or as conditions precedent or subsequent in the public deeds of transfer.

The Company's exposure to credit risk at 31 December 2016 and 2015 affects mainly the transactions recognised in the "Loans and Receivables" category of financial assets (see Note 7.1). The carrying amount of these assets, including contingent amounts drawable against the loans and credit facilities held at those dates, represents the maximum exposure to credit risk at those dates. In this respect, at 31 December 2016 and 2015, "Non-Current Investments - Loans to Third Parties and Related Parties" and "Current Investments - Loans to Companies" represented 89.6% and 91.3%, respectively, of the Company's total financial assets.

Set forth below is salient information concerning the credit risk profile of the loans included under these headings.

Loans to third parties by borrower sector

The detail, by borrower sector, of "Non-Current Investments - Loans to Third Parties" and "Current Investments - Loans to Third Parties" at 31 December 2016 and 2015 is as follows:

Amounts in thousands of euros	Total		Of which: property guarantee (gross impairment)		Of which: remaining securities (gross impairment)	
	31/12/2016	31/12/2015	31/12/2016	31/12/2015	31/12/2016	31/12/2015
Public Administrations	4,523	11,631	-	-	-	-
Financial institutions	-	6,718	-	1,784	-	-
Non-financial companies and individual business owners	27,745,773	31,182,164	25,985,587	28,980,866	59,602	190,777
Construction and property development	26,346,156	30,831,708	24,972,373	28,701,575	42,858	185,645
Public works construction	2,461	1,183	1,947	460	-	-
Other purposes	1,397,157	349,273	1,011,267	278,831	16,743	5,132
Large companies	26,728	35,429	3,641	1,725	45	5,020
SME's and individual business owners	1,370,429	313,844	1,007,626	277,106	16,699	112
Other homes	87,011	27,549	82,829	18,525	-	553
Capitalised expenses (Note 4.6.2)	13,397	14,571	-	-	-	-
Valuation corrections due to asset impairment	(3,389,356)	(3,012,418)	-	-	-	-
Total	**24,461,349**	**28,230,215**	**26,068,416**	**29,001,175**	**59,602**	**191,330**

Recovery measures - debt refinancing and restructuring:

As part of the recovery management carried out by the Company, a number of measures have been implemented to provide borrowers with the conditions required to meet their established contractual obligations, on the basis that the continuation of their activities is the main guarantee of their honouring those obligations.

These measures include, inter alia, the foreclosure of property guarantees or dation in payment (see Note 5), settlement of guarantees and debt refinancing and restructuring transactions.

The recovery activities, especially in the case of debt refinancing and restructuring transactions, have been carried out on the basis of objective criteria that took into account both circumstances common to certain portfolios of loans and credit facilities and the specific circumstances of the borrowers, such as their economic and financial position and the viability of their business activities. The debt refinancing and restructuring tools implemented include changes in the conditions originally agreed with debtors in respect of terms to maturity, interest rates, guarantees provided and, in certain circumstances, forgiveness or partial reduction of the amounts owed.

Refinancing or restructuring transactions include changing the conditions originally agreed upon with debtors with regard to expiration dates, interest rates, guarantees provided, and in certain circumstances, writing off or partially removing owed amounts. The refinancing or restructuring operations include that the operation is made current, in terms of the total or partial payments of the corresponding debts.

In no case has the refinancing of transactions given rise to an equity impact for the Company with respect to the status of the refinanced or restructured transaction, or to a deferral of the recognition of possible impairment losses on such transactions based on the circumstances thereof. Therefore, all transactions that, by applying the provisions set forth in the legislative framework related to the Company, should be impaired have been considered as such for the purposes of preparing these financial statements.

The number and amount of refinanced transactions in 2016 and 2015 were as follows:

2016:

	Number of transactions	Amount (thousands of euros)
Refinanced/restructured transactions	508	1,000,246
Renegotiated/renewed transactions	-	-
Total	508	1,000,246

2015:

	Number of transactions	Amount (thousands of euros)
Refinanced/restructured transactions	364	607,347
Renegotiated/renewed transactions	19	26,307
Total	383	633,654

Geographical distribution of loans and credit facilities

The geographical distribution of "Non-Current Investments - Loans to Third Parties", "Current Investments - Loans to Third Parties" and "Cash and Cash Equivalents" at 31 December 2016 and 2015 is as follows:

Amounts in thousands of euros	31/12/2016	31/12/2015
Andalusia	2,712,781	3,104,030
Aragon	1,332,416	1,662,568
Asturias	471,092	506,646
Balearic Islands	595,230	749,867
Canary Islands	602,879	664,925
Cantabria	494,319	545,500
Castilla - La Mancha	766,140	802,949
Castilla y León	1,668,537	1,646,526
Catalonia	5,346,517	5,909,695
Extremadura	269,817	313,563
Galicia	1,541,867	1,723,442
Madrid	8,269,719	8,699,857
Murcia	1,311,547	1,584,373
Navarra	38,693	48,425
Valencia	5,084,825	5,593,172
Basque Country	406,864	410,420
Rioja	393,784	475,283
Ceuta and Melilla	23,366	21,054
Other non-residential sectors	-	-
- Others - Capitalised expenses (Note 4.6.2)	13,397	14,571
- Corrections of financial asset impairments	(3,389,356)	(3,012,418)
Total	**27,954,434**	**31,464,448**
Of which: Cash and cash equivalents	3,493,085	3,234,233
Of which: Non-current and current loans to third parties	24,461,349	28,230,215

7.3.2 Liquidity risk

Liquidity risk is defined as the risk that Sareb might not have sufficient funds to meet its debt repayments at their maturity dates.

The Company determines cash requirements periodically and specifically through the preparation of a cash budget with a twelve-month time horizon, which is updated on a recurring basis with the aim of identifying any short-term cash requirements or cash surpluses. Additionally, for liquidity risk management purposes, generic medium- and long-term funding requirements are identified, as well as how to address them in a manner consistent with business projections.

In any event, liquidity risk is also mitigated by the Company having the power to renew on maturity the bonds issued as consideration for the assets received from the transferor institutions (see Note 13.2).

Over the first few years of the Company's life, criteria of prudence have prevailed in liquidity management, which it is intended to endow with greater versatility. For this purpose, a system of liquidity auctions has been established among entities to which counterparty risk limits have been assigned. The auctions are carried out in accordance with Sareb's principles of transparency, competition and maximisation of profitability.

Also, the Board of Directors has approved a liquidity risk management policy for the Company that envisages the measurement and periodic monitoring of a series of short- and long-term liquidity indicators and the activation, where appropriate, of contingent measures aimed at maintaining the Company's liquidity position.

Detail of financial assets by maturity date

As discussed in Note 2.4, the Company considers that its financial assets will be recovered in accordance with the contractual payment schedule, except for those experiencing difficulties - doubtful financial assets - (see Note 1), which will be recovered over a period of more than twelve months, according to the Company's updated estimates.

Due to the unilateral option for the renewal of the maturity of the senior debt (see Notes 2.4 and 13.2), the Company classifies the probable maturities of this debt in accordance with updated forecasts. The detail of the maturities of the Company's financial assets and liabilities at 31 December 2016 is as follows:

	Thousands of euros						
	Up to 1 year	Between 1 and 2 years	Between 2 and 3 years	Between 3 and 4 years	Between 4 and 5 years	More than 5 years	Total
Asset:							
Cash and cash equivalents	**3,493,085**	**-**	**-**	**-**	**-**	**-**	**3,493,085**
Financial assets	**3,584,025**	**3,319,983**	**3,228,643**	**2,854,789**	**2,690,164**	**11,585,769**	**27,263,373**
- Loans and Credit Facilities 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
Investments in associates	**-**	**-**	**-**	**19,023**	**-**	**12,644**	**31,667**
- Equity instruments	-	-	-	-	-	9,702	9,702
- 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***	**11,598,413**	**30,788,125**
Liability:							
Non-current and current payables	**4,021,822**	**3,937,496**	**3,704,508**	**3,962,992**	**4,501,492**	**26,149,997**	**46,278,307**
- Debt instruments 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
- Bank borrowings	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 cash position amounted to EUR 3,493,085 thousand at 31 December 2016. This liquidity, together with the cash generated from full or partial repayments and sales of loans and credit facilities, from sales of property assets and from rentals of the Company's assets, enables the Company's directors to be confident that sufficient resources will be available to meet cash needs resulting mainly from the maturity of senior bonds and accrued finance costs. In this respect, it must be stated that Sareb has the unilateral right to redeem the senior bonds on maturity by delivering new senior bonds with similar features, which reduces the liquidity risk to a highly significant extent. In addition, if certain circumstances arise, Sareb also has the option to lengthen the terms of the marketable securities issues.

7.3.3. Interest rate risk

Structural interest rate risk is defined as the Company’s exposure to changes in market interest rates resulting from the different maturity and repricing dates of the asset and liability items on its balance sheet. The purpose of the management of on-balance-sheet interest rate risk is to maintain the Company's exposure to fluctuations in market interest rates at levels that are in line with its strategy and compatible with its Business Plan.

Regarding assets, tools have been developed internally that allow loan principal and interest flows to be simulated in accordance with contractual terms and conditions based on the information provided by the managers. These tools enable interest rate fluctuation scenarios to be included and the impact on future interest flows to be evaluated, taking into account the probability of the borrower being solvent.

Similarly, the modelling of liabilities makes it possible to simulate the cash flows of issued debt considering market conditions or simulated scenarios and to value such debt. To mitigate the Company's heavy exposure to interest rate fluctuations, resulting from the high level of sensitivity of the Company's liabilities and the considerable insensitivity of its assets to such fluctuations, in 2013 the Company decided to hedge, with derivative instruments, around 85% of the expected outstanding balance of the senior debt over a time horizon of nine years (at 31 December 2016: seven years) with the aim of reducing the risk that increases in interest rates could have a significant adverse effect on the statement of profit or loss in the future. This decision was taken bearing in mind that the rates in force at the date the hedge was entered into were compatible with the Company's Business Plan.

Benchmark interest rates

Regarding the contractual interest rates to which the acquired portfolio of loans and credit facilities is linked, 89.4% (31 December 2015: 90.7%) of the aforementioned loans and credit facilities are benchmarked to variable interest rates and 10.6% (31 December 2015: 9.3%) are benchmarked to fixed interest rates. However, since a significant portion of the portfolio of loans received are non-performing, the actual sensitivity thereof to fluctuations in interest rates is very low.

The variable interest rates applied to the above balances are benchmarked to Euribor for various maturities, plus the related spread. However, the Company accrues interest income as described in Note 4.13.

Interest rate hedging derivatives

As indicated in Note 13.3, the Company has arranged interest rate derivatives with various financial institutions enabling it to fix the interest rate of approximately 85% of the estimated senior bonds for the next seven years, thus eliminating any uncertainty in the coming years, regarding the statement of profit or loss and future cash flows, that would result from fluctuations in benchmark interest rates.

The Company’s directors consider that, in view of the low sensitivity of its portfolio of financial assets to fluctuations in interest rates and the management of the interest rate risk of its financial liabilities, at 31 December 2016 interest rate risk exposure was not significant for the purposes of the Company’s financial position.

8. Inventories

The detail of "Inventories" at 31 December 2016 and 2015 is as follows:

	Thousands of euros	
	31/12/2016	31/12/2015
Completed buildings	**21,764**	**12,121**
Residential property	21,764	12,121
Offices, premises and multi-purpose industrial buildings	-	-
Other properties	-	-
Other than usual residence of the borrower	-	-
Buildings under construction	**95,085**	**77,286**
Residential property	95,085	77,286
Offices, premises and multi-purpose industrial buildings	-	-
Other properties	-	-
Other than usual residence of the borrower	-	-
Advances to suppliers	**33,916**	**28,212**
Total	**150,765**	**117,619**

The changes in "Inventories" in 2016 and 2015 were as follows:

	Thousands of euros			
	Completed buildings	Buildings under construction	Advances to suppliers	Total
Balance at 31 December 2014	**12,338**	**94,507**	**3,628**	**110,473**
Additions	20	3,267	28,212	31,499
Removals	(10,115)	-	(3,628)	(13,743)
Transfers to Completed Buildings	9,878	(9,878)	-	-
Transfers to Investment Property (Note 5)	-	(10,610)	-	(10,610)
Balances at 31 December 2015	**12,121**	**77,286**	**28,212**	**117,619**
Additions	-	13,042	33,916	46,958
Removals	(17,590)	-	(28,212)	(45,802)
Transfers to Completed Buildings	27,233	(27,233)	-	-
Transfers to Investment Property (Note 5)	-	31,990	-	31,990
Balance at 31 December 2016	**21,764**	**95,085**	**33,916**	**150,765**

The most significant changes in "Inventories" in 2016 and 2015 were as follows:

Additions

In 2016 the Company incurred expenses amounting to EUR 13,042 thousand (2015: EUR 3,267 thousand) relating to the execution of construction work and the development of its construction in progress. These amounts were capitalised as additions to the value of inventories at 31 December 2016 and 2015.

Transfers between items

In 2016 and 2015 the Company conducted a detailed analysis of its work in progress with the aim of maximising its value. This analysis sought mainly to distinguish the work in progress from which it expects to obtain a higher level of return through the execution of construction work, the development and completion of properties, and their sale through the retail channel. As a result of this analysis, the Company made transfers in 2016 of EUR 31,990 thousand from “Inventories” to "Investment Property”. In 2015 EUR 10,610 thousand were reclassified from “Investment Property” to “Inventories” as a result of construction work that the Company stopped and put up for sale in their current state.

Corrections

In 2016 and 2015 no corrections were made that affected “Inventories”.

Other disclosures

At 31 December 2016 and 2015, all the Company's inventories were free of liens and encumbrances.

Furthermore, in 2016 and 2015, no borrowing costs were capitalised as an increase in the cost of inventories.

As a standard procedure, substantially all of the pre-sales are subject to late delivery indemnity clauses as they are formalised in agreements with similar characteristics. The aforementioned late delivery indemnity clauses comprise mainly the legal interest on the amounts delivered between the forecast contractual delivery date and the effective delivery date. The Company does not expect these clauses to have any impact mainly because the forecast delivery date in the agreements includes a safety margin of a specific number of months with respect to the forecast delivery date. Accordingly, and in view of the few transactions of this type in 2016 and 2015, the Company did not recognise any impact in this connection in the 2016 and 2015 financial statements. In addition, pre-sales generally include compensation payable to the Company in the event of cancellation by the customer. However, no amount is recognised in this connection until the contract is formally terminated for reasons not attributable to the Company.

The Company’s policy regarding guarantees covering advances received from customers is that all advances received from customers must be guaranteed. At 31 December 2016, the advances delivered by customers as down payments totalled EUR 925 thousand (31 December 2015: EUR 433 thousand).

The Company's directors consider that the carrying amount of the balances included under “Inventories” in the balance sheet at least approximates their fair value (see Note 5).

9. Trade and other receivables

The detail of “Trade and Other Receivables” at 31 December 2016 and 2015 is as follows:

	31/12/2016	31/12/2015
Trade Receivables for Sales	218,448	168,856
Sundry Accounts Receivable	26,437	37,517
Doubtful trade receivables	41,212	31,938
Allowance for doubtful debts	(41,212)	(31,938)
Staff costs	7	-
Current tax assets (Note 15.1)	5,899	13,406
Other accounts receivable from public authorities (Note 15.1)	1,241	-
Total	**252,032**	**219,779**

At 31 December 2016, the amount pending liquidation resulting from the corrections formalised in 2016 with Banco Mare Nostrum, S.A. amounting to EUR 23,177 thousand was principally recognised in “Sundry Accounts Receivable” (see Note 1). In addition, at 31 December 2015, “Sundry Accounts Receivable” recognised the deferred collection from FAB Crossover I arising from the sale of land owned by this fund (see Note 4.6.1), which was fully collected in 2016.

The Company's policy is to require guarantees for deferred collections, either first-demand bank guarantees or guarantees provided by guarantors of proven solvency.

In 2016 and 2015, the Company collected the amounts deferred in connection with the sale of securities of FAB Crossover I and FAB May, totalling EUR 16,420 thousand and 10,337 thousand, respectively (see Note 4.6.1).

The amount recognised by the Company under "Trade Receivables for Sales" includes the uncollected amount arising mainly from sales of property assets and rental income earned by the Company in 2016 and 2015.

The Company's directors consider that the carrying amount of the trade and other receivables approximates their fair value.

10. Cash and cash equivalents

"Cash and Cash Equivalents" includes the Company's cash and short-term bank deposits with an original maturity of three months or less.

The detail of "Cash and Cash Equivalents" at 31 December 2016 and 2015 is as follows:

	31/12/2016	31/12/2015
Other cash equivalents	1,766,263	1,595,979
Banks	1,726,822	1,638,254
Total	**3,493,085**	**3,234,233**

The amount recognised under "Other Cash Equivalents" at 31 December 2016 relates to several fixed-term deposits held by the Company at various banks amounting to EUR 1,766,263 thousand (31 December 2015: EUR 1,595,979 thousand). Although the initial maturity of these fixed-term deposits was set at more than three months, the Company decided to classify them under "Other Cash Equivalents" since it may opt to redeem them early without having to pay a penalty fee.

In 2016 the Company recognised EUR 4 thousand (2015: EUR 11,868 thousand) of interest on these investments and on the money deposited in current accounts (see Note 16.6).

At 31 December 2016 and 2015, there were no restrictions for using cash and other cash equivalents, except for the balance of a current account, where 8% of the cash was deposited by the Company since its incorporation. This current account, whose balance at 31 December 2016 and 2015 amounted to EUR 521,000 thousand and 359,000 thousand, respectively, will be released in 2017 as detailed in the Company's contracts to issue senior financing (see Note 13).

11. Equity

11.1 Share capital

At 31 December 2016 and 2015, the Company's share capital was represented by 2,170,440,000 and 300,060,000 fully subscribed and paid bearer shares of EUR 0.14 and 1, respectively, par value each. All these shares carry identical voting and dividend rights.

On 5 May 2016, given the situation of equity imbalance and as stipulated in Article 363.1.e) of the Spanish Limited Liability Companies Law, the Company's Annual General Meeting and Board of Directors approved the following:

a) Reducing the share capital and share premium at that date (EUR 300,060 and 900,000, respectively) to offset the losses of previous years.

b) Waiving of the Company's shareholders' pre-emption rights.

c) Increasing the share capital by capitalising the subordinated debt (as provided for in Article 343 of the Spanish Limited Liability Companies Law, a resolution to reduce share capital to zero may only be adopted if it is simultaneously resolved to increase capital with pre-emption rights. Therefore, it is necessary to submit for approval by the General Meeting either a capital increase with acknowledgement of the shareholders' pre-emption rights or the express waiver of these rights by all the Company's shareholders. Accordingly, the Board of Directors shall prepare two alternative resolution proposals in this connection). As detailed in Notes 1 and 13.2, the Company simultaneously issued the acquisition of the assets, EUR 3,600 million of convertible subordinated debt, which was mainly subscribed by the Company’s same original shareholders. The deed of this issuance states that it is contingently convertible into capital if the Company has insufficient equity as a result of: i) the existence of accumulated losses equal to or greater than its share capital plus reserves; or ii) the Company being in a situation of mandatory dissolution as a result of losses reducing its equity to below one-half of share capital. The deed states that, in the event of conversion, the capital to be converted shall be the amount necessary, which following conversion, the Company's share capital represents 2% of the value of its assets. As a result, the Annual General Meeting set the conversion of capital necessary to the amount of EUR 2,170,440 thousand by issuing 2,170,440,000 new shares of a nominal value of one euro, whereby all of the new shares enjoy the same political and economic rights, and are the same in class and series.

d) Reducing the capital to offset losses from previous years for an amount of EUR 1,217,977 thousand and establishing a legal reserve (see Note 11.2) for an amount of EUR 19,174 thousand. This reduction of capital was realised through a nominal reduction of the shares existing at 0.57 euros per share. Thus, after this conversion, the nominal value of the shares was set at 0.43 euros per share.

e) Reducing Company’s capital again to provide a restricted reserve for a total of EUR 629,428 thousand. As with the previous reduction of share capital, it was realised through a reduction of EUR 0.29 of nominal value for each of the shares issued. After this capital reduction, the nominal value of the assets was set at EUR 0.14.

The aforementioned transactions did not entail an inflow of cash for the Company.

At 31 December 2016, as a result of the agreements adopted by the Annual General Meeting and the Board of Directors, on 5 May 2016, changes of the % of ownership were made with respect to those maintained at 31 December 2015. The shareholders holding an ownership interest of more than 2.5% of the Company's share capital were as follows:

2016:

	% ownership	Share capital	Share premium
Fund for Orderly Bank Restructuring (FROB)	45.90%	139,472	-
Banco Santander, S.A.	16.62%	50,491	-
Caixabank, S.A.	12.00%	36,455	-
Banco de Sabadell, S.A.	6.61%	20,097	-
Banco Popular Español, S.A.	5.68%	17,269	-
Kutxabank, S.A.	2.53%	7,698	-
Other shareholders	10.66%	32,380	-
Total	**100%**	**303,862**	**-**

2015:

	% ownership	Share capital	Share premium
Fund for Orderly Bank Restructuring (FROB)	45.01%	135,060	405,000
Banco Santander, S.A.	17.28%	51,850	155,550
Caixabank, S.A.	12.69%	38,075	114,202
Banco de Sabadell, S.A.	6.93%	20,800	62,400
Banco Popular Español, S.A.	5.97%	17,925	53,775
Kutxabank, S.A.	2.62%	7,875	23,625
Other shareholders	9.50%	28,475	85,448
Total	**100%**	**300,060**	**900,000**

The Company is not aware of any other ownership interests of 3% or more of the Company's share capital or voting power, or of any interests which, although lower than the established percentage, allow significant influence to be exercised over the Company.

11.2 Legal reserve

Use of the legal reserve is restricted by several legal provisions. According to Article 274 of the Spanish Limited Liability Companies Law, 10% of net profit for each year must be transferred to the legal reserve until the balance of this reserve reaches at least one fifth of the share capital. The legal reserve can be used for offsetting losses or increasing capital, provided that the remaining reserve balance does not fall below 10% of the increased share capital amount, and for distribution to the shareholders in the event of liquidation.

At 31 December 2016, the legal reserve amounted to EUR 19,174 thousand. At 31 December 2015, there was no legal reserve established.

As stipulated in Article 326 of the Spanish Limited Liability Companies Law, once the share capital is reduced, it will be necessary for the legal reserve to reach ten percent of the new capital.

11.3 Other reserves

The detail of "Other Reserves" at 31 December 2016 and 2015 is as follows:

Amounts in thousands of euros	31/12/2016	31/12/2015 Restated
Losses from prior years	-	(2,418,369)
Voluntary reserves by applying RD 4/2016 (see Notes 2.1 and 2.5)	2,330,270	2,433,163
Restricted reserve	629,428	-
Total	**2,959,698**	**14,794**

11.4 Valuation adjustments

"Valuation Adjustments" in the accompanying balance sheet includes the amount of changes in the value of financial derivatives designated as cash flow hedging instruments (see Note 13.3), and the net of the related tax effect resulting from the impairment in the unit of Financial Assets in applying the provisions of RD 4/2016 (see Notes 2.1, 2.5 and 7.1.1.).

The changes in "Valuation Adjustments" in 2016 and 2015 were as follows:

2016

	Amounts in thousands of euros				
	Initial balance	Reductions for decreased tax credits	Reduction for impairment of the FA unit	Additions / Reductions	Final balance
Valuation of derivatives	(1,943,305)	-	-	(44,337)	(1,987,672)
Impairment of the financial assets unit	(2,330,270)	(582,334)	(376,938)	-	(3,289,542)
Balance	**(4,273,575)**	**(582,334)**	**(376,938)**	**(44,337)**	**(5,277,214)**

2015 Restated

	Amounts in thousands of euros		
	Initial balance	Additions / Reductions	Final balance
Valuation of derivatives	(2,032,492)	89,187	(1,943,305)
Impairment of the financial assets unit	(2,433,163)	102,893	(2,330,270)
Balance	**(4,465,655)**	**192,080**	**(4,273,575)**

The valuation adjustments in equity are as follows:

	Amounts in thousands of euros	
	31/12/2016	31/12/2015 Restated
Derivatives of types of interest (Note (13.3)	(2,686,801)	(2,591,073)
Inefficiency of derivatives	36,572	-
Tax effect	662,557	647,768
Valuation Adjustments - Hedges (net taxes)	***(1,987,672)***	***(1,943,305)***
Impairment of the financial assets unit (see Note 7.1.1)	(3,389,356)	(3,012,418)
Tax effect	682,148	682,148
Deactivation of tax credits from prior years	(582,334)	-
Valuation adjustments - Impairment of financial asset units (net taxes)	***(3,289,542)***	***(2,330,270)***
Total valuation adjustments	**(5,277,214)**	**(4,273,575)**

As indicated in Note 15.3, the Company derecognised those tax credits from the balance sheets that will not be recoverable during the life of the Company according to its best estimates.

11.5 Equity position of the Company

The equity calculable for the purposes of the aforementioned Articles 317 and 363.1 e) of the redacted text of the Spanish Limited Liability Companies Law is that which is detailed below, whereby the Company is not involved in any of the cases on 31 December 2016:

	Thousands of Euros
Equity per the financial statements of Sareb, S.A. as at 31/12/2016	(2,657,271)
Less:	
Valuation adjustments relating to cash flow hedges	*1,987,672*
Valuation adjustments relating to financial asset impairment	*3,289,542*
Equity for the purposes of capital reductions and dissolutions at 31/12/2016	**2,619,943**

It should be noted that, in accordance with current accounting rules, changes in the value of hedging derivatives are recognised in the Company's equity until they are recognised in profit or loss in the corresponding year. The entire fair value of the interest rate risk derivative, net of the related tax effect, is recognised under “Valuation Adjustments - Hedges”. However, from a corporate standpoint and pursuant to the provisions of Article 36 of the Spanish Commercial Code, these changes in the value of hedging derivatives that have not yet been taken to profit or loss do not qualify as equity for the purposes of distributions of profit, obligatory reductions of share capital or obligatory dissolution due to losses incurred.

On the other hand, as established in Article 2 of RD 4/2016, the Company has recognised the impairment losses of the asset units established in Circular 5/2015 in “Valuation Adjustments - Financial Asset Impairment”, net of the related tax effect. As stipulated in said RD, the aforementioned adjustments shall not be considered as equity for the purposes of profit distribution, mandatory share capital reduction and mandatory dissolution as a result of losses.

12. Provisions and contingencies

“Long-Term Provisions” in the balance sheets as at 31 December 2016 and 2015 includes the long-term provisions recognised by Sareb in order to cover certain contingent and other liabilities acquired by Sareb as part of its normal course of business, which are reasonably covered. The changes in 2016 and 2015 in “Long-Term Provisions” in the balance sheets were as follows:

	Thousands of Euros	
	2016	2015
Balance at the start of the year	9,485	49,886
Charges	2,561	5,724
(Reversal)	(1,099)	(46,125)
Transfers and other movements	-	-
Year-end balance	**10,947**	**9,485**

The Company is the defendant in certain proceedings in relation to the liability inherent to the business activities carried on by it. The provisions recognised in relation to litigation in 2016 represent immaterial amounts when considered individually, and there are no other particularly noteworthy lawsuits. In this regard, Sareb recognises provisions for likely litigation risks based on the opinion of its legal advisers.

13. Detail of financial liabilities

The detail, as required by applicable legislation, of the financial liabilities assumed by Sareb at 31 December 2016 and 2015 is as follows:

2016

Categories \ Types	Thousands of euros						
	Non-Current Financial Instruments			Current Financial Instruments			Total
	Bank borrowings	Debt Instruments and Other Marketable Securities	Derivatives and Others	Bank borrowings	Debt Instruments and Other Marketable Securities	Derivatives and Others	
Accounts Payable	-	39,068,660	501,074	61,430	3,959,509	833	43,591,506
Hedging Derivatives	-	-	2,686,801	-	-	-	2,686,801
Total	**-**	**39,068,660**	**3,187,875**	**61,430**	**3,959,509**	**833**	**46,278,307**

2015

Categories \ Types	Thousands of euros						
	Non-Current Financial Instruments			Current Financial Instruments			Total
	Bank borrowings	Debt Instruments and Other Marketable Securities	Derivatives and Others	Bank borrowings	Debt Instruments and Other Marketable Securities	Derivatives and Others	
Accounts Payable	-	42,857,376	587,885	57,823	4,228,773	22,998	47,754,855
Hedging Derivatives	-	-	2,591,073	-	-	-	2,591,073
Total	**-**	**42,857,376**	**3,178,958**	**57,823**	**4,228,773**	**22,998**	**50,345,928**

13.1 Bank borrowings

At 31 December 2016 and 2015, the Company had been granted credit facilities by several Group 1 and Group 2 institutions, against which EUR 47,220 thousand had been drawn down in both years.

In addition, at 31 December 2016, the Company had recognised EUR 14,210 thousand (31 December 2015: EUR 9,400 thousand) under "Bank Borrowings" in relation to accrued interest payable on the hedging derivatives entered into in 2013 (see Note 13.3).

13.2. Non-current and current debt instruments and other marketable securities

The detail of "Non-Current Payables - Debt Instruments and Other Marketable Securities" and "Current Payables - Debt Instruments and Other Marketable Securities" at 31 December 2016 and 2015 is as follows:

	31/12/2016		31/12/2015	
Amounts in thousands of euros	Non-current	Current	Non-current	Current
Marketable securities - senior debt	37,639,100	3,958,000	41,427,900	2,048,500
Marketable securities - subordinated debt	1,429,560	-	1,429,476	2,170,524
Accrued interests pending collection	-	1,509	-	9,749
Total	**39,068,660**	**3,959,509**	**42,857,376**	**4,228,773**

Marketable securities - senior debt

The detail of “Marketable Securities - Senior Debt” in the foregoing table at 31 December 2016 and 2015 is as follows:

31 December 2016

Name	Issue date	Contract maturity date	Current applicable rate	Amounts in 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**

31 December 2015

Name	Issue date	Contract maturity date	Current applicable rate	Amounts in thousands of euros
Sareb/VAR BO 20151231 2015-3	31/12/2015	31/12/2016	Eur 3m + 0.199%	10,262,600
Sareb/VAR BO 20141231 2014-3	31/12/2014	31/12/2016	Eur 3m + 0.428%	13,918,000
Sareb/VAR BO 20150228 2015-1	28/02/2015	26/02/2016	Eur 3m + 0.103%	4,084,500
Sareb/VAR BO 20150228 2013-3	28/02/2013	26/02/2016	Eur 3m + 2.464%	2,537,900
Total short-term contractual maturities				30,803,000
Sareb/VAR BO 20151231 2015-4	31/12/2015	31/12/2018	Eur 3m + 0.388%	6,569,700
Sareb/VAR BO 20150228 2015-2	28/02/2015	28/02/2017	Eur 3m + 0.263%	6,103,700
Total long-term contractual maturities				12,673,400
Total				**43,476,400**

At 31 December 2016 and 2015, all the marketable debt securities were represented by book entries. Also, they are secured by an unconditional and irrevocable guarantee of the Spanish Treasury, with a waiver of the right of excussion.

Sareb maintains the option to renew the maturity of issuances of the aforementioned senior debt unilaterally, even if at the time of the transaction, there are no significant differences between its fair value and nominal value.

This unilateral option enables the Company, also on the basis of its business forecasts and the experience acquired since its incorporation, to consider that approximately EUR 16,082,000 thousand of the short-term contractual maturities shown above will occur in the long term.

The interest rates on these bonds are tied to 3-month Euribor plus a spread. This spread remains unchanged throughout the term of the issue.

2016

Redemption of bonds in 2016

The summary of the redemptions of senior debt carried out by the Company in 2016 is as follows:

Name	Redemption in cash	Redemption due to corrections (Note 1)	Redemption through a 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**

Correction of asset purchase deed

As indicated in Note 1, in 2016 the Company redeemed the following bonds as a result of the corrections formalised in the year:

Amounts in 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**

2015

Redemption of bonds in 2015

The summary of the redemptions of senior debt carried out by the Company in 2015 is as follows:

Name	Redemption in cash	Redemption due to corrections (Note 1)	Redemption through a new issue	Total
Sareb/VAR BO 20141231 2014-2	-	16,200	10,262,600	10,278,800
Sareb/VAR BO 20141231 2014-3	1,476,000	33,500	-	1,509,500
Sareb/VAR BO 20130228 2012-3	34,200	13,500	6,569,700	6,617,400
Sareb/VAR BO 20150228 2015-1	-	200	4,084,500	4,084,700
Sareb/VAR BO 20150228 2015-2	-	400	-	400
Sareb/VAR BO 20150228 2013-3	465,800	200	-	466,000
Sareb/VAR BO 20150228 2013-2	-	-	6,103,700	6,103,700
Sareb/VAR BO 20151231 2015-3	-	6,100	-	6,100
Sareb/VAR BO 20151231 2015-4	-	5,100	-	5,100
Total	**1,976,000**	**75,200**	**27,020,500**	**29,071,700**

On 17 February 2015, the Company carried out an additional redemption, amounting to EUR 34,200 thousand, of the bonds issued for the acquisition of the assets transferred by the Group 1 institutions.

The detail of this redemption is as follows:

	Outstanding balance prior to redemption	Redemption in cash	Balance after redemption	Maturity
Sareb/VAR BO 20151231 2012-3	6,622,500	34,200	6,588,300	31/12/2015
Total	**6,622,500**	**34,200**	**6,588,300**	

Correction of asset purchase deed

As indicated in Note 1, in 2015 the Company redeemed the following bonds as a result of the corrections formalised in the year:

Amounts in thousands of euros	Bankia S.A.	Catalunya Caixa, S.A.	CEISS, S.A.	Banco Gallego, S.A.	Banco de Valencia, S.A.	Banco Mare Nostrum, S.A.	Total
Sareb/VAR BO 20141231 2014-2	-	14,100	-	2,000	100	-	16,200
Sareb/VAR BO 20141231 2014-3	9,200	21,200	-	3,000	100	-	33,500
Sareb/VAR BO 20131231 2012-3	-	11,800	-	1,700	-	-	13,500
Sareb/VAR BO 20140228 2015-1	-	-	100	-	-	100	200
Sareb/VAR BO 20150228 2015-2	-	-	200	-	-	200	400
Sareb/VAR BO 20160228 2013-3	-	-	100	-	-	100	200
Sareb/VAR BO 20151231 2015-3	6,100	-	-	-	-	-	6,100
Sareb/VAR BO 20151231 2015-4	5,100	-	-	-	-	-	5,100
Total	**20,400**	**47,100**	**400**	**6,700**	**200**	**400**	**75,200**

Other disclosures

The interest accrued in 2016 in relation to these marketable securities, amounting to EUR 54,526 thousand (2015: EUR 398,255 thousand) was recognised under "Finance Costs - On Debts to Third Parties" in the accompanying statement of profit or loss (see Note 16.5). At December 31 2016 and 2015, the accrued interest pending collection amounted to EUR 1,509 and 9,749 thousand, and were recognised in "Current Payables - Debt Instruments and Other Marketable Securities" on the accompanying balance sheet. At the date of preparation of these financial statements, this interest had been paid in full.

At 31 December 2016 and 2015, the senior marketable securities issued by the Company had been listed and admitted to trading.

The directors consider that the carrying amount of the marketable securities approximates their fair value.

Marketable securities - subordinated debt

The detail of "Marketable Securities - Subordinated Debt" in the foregoing table at 31 December 2016 and 2015 is as follows:

31 December 2016

	Issue date	Maturity date	Current applicable rate	Amounts in thousands of euros
Sareb/8.00 OBSUBDCONV 20271127 2013	26/02/2013	27/11/2027	8.00%	1,429,560
Total				1,429,560

31 December 2015

	Issue date	Maturity date	Current applicable rate	Amounts in thousands of euros
Sareb/8.00 OBSUBDCONV 20271127 2013	26/02/2013	27/11/2027	8.00%	3,600,000
Total				3,600,000

The main terms and conditions of the contingent convertible unsecured subordinated debentures are detailed below:

- All the securities belong to a single series and have the same terms and conditions. Therefore, they confer identical rights on the holders. They are freely transferable, are represented by book entries and are registered in the book-entry registries by Iberclear and its authorised participating entities.

- These bonds bear a fixed rate of interest that accrues annually, provided that profits are obtained and that there are sufficient distributable reserves. Accordingly, in 2016 and 2015 the Company did not incur or pay any coupon in this connection in view of the difficulty in estimating distributable future cash flows.

- Full redemption: obligatory on 27 November 2027.

- Partial redemption: at the Company's discretion, this is possible from the fifth year from the issue onwards, depending on the existing solvency and gearing ratios.

- Conversion: the subordinated debt will be convertible into capital if the Company has insufficient equity as a result of: i) the existence of accumulated losses equal to or greater than its share capital plus reserves; or ii) the Company being in a situation of mandatory dissolution as a result of losses reducing its equity to below one-half of share capital. If a conversion occurs, the new shares will have the same par value, class and series, and their amount will be such that the Company's share capital will represent 2% of the value of its assets following the conversion. In 2016, after approval from the Annual General Meeting on 5 May 2016, the Board of Directors approved the conversion of EUR 2,170,440 thousand in the Company's share capital, by issuing 2,170,440 thousand shares of 1 euro of par value each (see Note 11). After this conversion, the subordinated debt balance increased to EUR 1,429,560 thousand.

- Seniority: the convertible subordinated debentures are ranked in order of priority as follows:

    - Junior to all the Company's general (senior) creditors;

    - "Pari passu" with any of the Company's non-convertible or convertible subordinated debt already issued or that may be issued in the future, or any debt already incurred or that may be incurred in the future under any other security.

    - Senior to the Company's preference or ordinary shares.

13.3 Derivatives

At 31 December 2016 and 2015, Sareb's main source of funding comprised the floating-rate debt instruments and marketable securities issued in 2013 and 2012, or renewed where appropriate on maturity, in order to acquire the property and loan assets described in Note 1. In view of the large size of the transaction, and in order to reduce the high exposure and consequent risk for the Company in the event of a possible interest rate increase, on 2 August 2013, the Company entered into an interest rate swap enabling it to hedge this risk for an initial notional amount of EUR 42,221 million, which will gradually decrease as the hedged senior bonds mature in future years. The hedge sets the annual interest on the debt at fixed rates ranging from 0.491% to 3.145%. This transaction was not speculative in nature but rather it is classified as a cash flow hedge. It in fact gave rise to the conversion of a portion of the Company's debt over the term of the hedge into fixed rate debt, as opposed to the floating rate profile of the bonds issued.

The cash flow hedge was entered into at a time and in a market context in which interest rates were compatible with those envisaged in the Company's Business Plan. Therefore, the Company used this transaction to cover a substantial portion of this plan, thus reducing the risk that a rise in interest rates might jeopardise the Company's Plan and viability. In contrast, as a consequence of this transaction, the Company forwent any possible gains, in respect of the portion of its debt hedged and the hedge term, from a decline in benchmark interest rates.

The monetary policy easing measures adopted by the European Central Bank since the end of 2013 have contributed to a gradual decline in interest rates that are currently at all-time lows. This trend was transferred to the value of the hedging derivative entered into by the Company.

The market value of the swaps is obtained as the sum of the present value of the all cash flows according to the contractual conditions and the interest rates listed on the market. The interest rates used for estimating the future variable interests is obtained from instruments listed on financial markets and are benchmarked to the EURIBOR 3M rate. The discounted interest rates used to update the flows are obtained from instruments listed on financial markets and are benchmarked to the EONIA rate.

The balance of “Non-Current Payables - Derivatives” on the liability side of the balance sheets as at 31 December 2016 and 2015 relates in full to the fair value of this interest rate risk hedging derivative entered into with various banks. At 31 December 2016, the fair value of this derivative, obtained by applying generally accepted valuation techniques based on the use of observable market inputs, amounted to EUR 2,686,801 thousand (31 December 2015: EUR 2,591,073 thousand) (see Note 11.4).

The detail of the notional amount and the fair value of these transactions, in relation to the periods within which the related cash flows are expected to occur and the years in which they are expected to affect the statement of profit or loss, is as follows (in thousands of euros):

SWAPS INTEREST RATES	Fixed Rate Range	Maturity	2017	2018	2019	2020	2021	More than 5 years	Total
Notional value	0.49%-3.15%	2017-2023	25,453,000	22,181,000	18,986,000	15,936,000	13,257,000	10,695,000	106,508,000
Fair value			**(524,191)**	**(554,196)**	**(507,689)**	**(440,994)**	**(362,410)**	**(297,322)**	**(2,686,801)**

The Company estimates that the effect on the market value of these derivatives of an increase of one basis point in benchmark interest rates would give rise to a positive impact of EUR 10,100 thousand on its equity. The estimated impact of a decrease of one basis point in benchmark interest rates would be a negative impact of a similar amount.

In accordance with current accounting rules, changes in the value of hedging derivatives are recognised in the Company's equity until they are recognised in profit or loss in the corresponding subsequent years. As detailed in Note 4 in 2016, the derivatives that cover the bonds issued at one year and part of the bonds issued at two years have maintained effectiveness within the thresholds required by Recognition and Measurement Standard 9. 6, but due to the decreasing trend of the interest rates to which the hedged items are benchmarked, and the existence of a floor, for which the interest rate may not be, in any case, less than 0%, it has lost part of its effectiveness. As a result of this, the Company recognised an amount of EUR 36,572 thousand for the valuation of said hedging instruments in “Financial Costs” of the accompanying statement of profit or loss (see Note 16.5).

The rest of the value of the derivatives, net of the related tax effect, was recognised under “Valuation Adjustments” for the amount of EUR 1,987,672 thousand and 1,943,305 thousand, respectively, at 31 December 2016 and 2015. As a result, the Company had an equity deficit. However, from a business perspective, and pursuant to Article 36 of the Spanish Commercial Code, for the purposes of profit distribution, mandatory share capital reduction and mandatory dissolution as a result of losses, these changes in value of the hedging derivative that have not yet been recognised in the statement of profit or loss are not classified as equity.

In addition, at 31 December 2016 and 2015, EUR 469,034 thousand and 302,058 thousand, respectively, had been transferred from equity to “Finance Costs - On Debts to Third Parties” in the statement of profit or loss (see Note 16.5).

The credit risk associated with the derivative transactions is minimised by collateral swap agreements and other types of guarantees that depend on the nature and type of counterparty, in accordance with the standards of the International Swaps and Derivatives Association (ISDA).

At 31 December 2016 and 2015, for the purpose of ensuring compliance with the clauses in the aforementioned derivative contracts, Sareb had provided cash collateral amounting to EUR 2,549,300 thousand and EUR 2,442,400 thousand, respectively, to the counterparties of the derivatives entered into which had a negative value for the Company at those dates. This collateral is recognised under "Non-Current Investments - Other Financial Assets" in the balance sheet. Sareb had also set up deposits at the counterparties for a total amount of EUR 217,500 thousand in both years (see Note 7.1.2).

13.4 Other non-current financial liabilities

The detail of "Other Non-Current Financial Liabilities" in the balance sheets as at 31 December 2016 and 2015 is as follows:

	Amounts in thousands of euros	
	31/12/2016	31/12/2015
Fair value of the Íbero guarantees	480,955	543,981
Effect of the financial update of the Íbero guarantees	4,572	8,688
Nominal total of the Íbero guarantees	*485,527*	*552,669*
FAB 2013 Bull advance (See Note 5).	6,515	25,685
Guarantees from lessees and others	9,032	9,531
Total	**501,074**	**587,885**

Pursuant to Recognition and Measurement Standard 9.5.6 of the Spanish National Chart of Accounts, the Company estimated the fair value of the performance bonds detailed in Note 1 in relation to the Íbero Project. The weighted average cost of the Company's debt (see Note 13.1) was taken into consideration in order to calculate the discounted present value.

Based on the latest estimates contained in the FAB 2013 Bull business plan, given its the configuration and payment structure, there are EUR 19,170 thousand of the advance received by the investor that will not be returned during its life. In light of the foregoing, the Company recognised an income under "Financial income" of the accompanying statement of profit or loss (see Note 16.6).

The Company's Directors estimate that the fair value of "Other non-current financial liabilities" does not differ from the carrying amount.

14. Trade and other payables

The detail of "Trade and Other Payables" in the balance sheets as at 31 December 2016 and 2015 is as follows:

	Amounts in thousands of euros	
	31/12/2016	31/12/2015
Suppliers	43,817	97,016
Payable to Suppliers - Unreceived Invoices	297,212	255,983
Staff costs	11,989	6,942
Liabilities - Current Tax (Note 15.1)	-	-
Other Payables (Note 15.1)	75,258	63,693
Customer Advances	29,281	2,022
Total	**457,557**	**425,656**

"Trade and Other Payables" includes mainly the amounts outstanding for trade purchases and related costs, and the advances received from customers prior to recognition of the sale of the properties or land.

At 31 December 2016, “Payable to Suppliers - Unreceived Invoices” included EUR 74,417 thousand and EUR 80,761 thousand (31 December 2015: EUR 84,703 thousand and EUR 67,251 thousand) of expenses incurred in relation to management fees and sales commissions, respectively, and EUR 142,034 thousand (31 December 2015: EUR 104,029 thousand) of general and maintenance expenses relating to the assets managed by the Company, for which it had not received the related invoices.

“Customer Advances” principally includes EUR 17,864 thousand related to the future transfer of certain properties included in the “Eloise” portfolio (see Note 5).

The directors consider that the carrying amount of trade payables approximates their fair value.

Disclosures on the periods of payment to suppliers. Additional Provision Three. “Disclosure obligation” provided for in Law 15/2010, of 5 July

In accordance with Final Provision Two of Law 31/2014, of 3 December, amending Additional Provision Three of Law 15/2010, of 5 July, which amended Law 3/2004, of 29 December, on combating late payment in commercial transactions, and in respect of the disclosures to be included in notes to financial statements on periods of payment to suppliers in commercial transactions, calculated in accordance with the Spanish Accounting and Audit Institute Resolution of 29 January 2016, the detail of the Company's average period of payment to suppliers in 2016 and 2015 is as follows:

	2016	**2015**
Average period of payment to suppliers	30	50
Ratio of collected transactions	31	48
Ratio of operations pending collection	20	111
	Amounts in thousands of euros	
Total collections realised	502,318	557,518
Total pending collections	43,271	97,013

15. Tax matters

15.1 Current tax receivables and payables

The detail of the current tax receivables and tax payables at 31 December 2016 and 2015 is as follows:

31 December 2016

	Amounts in thousands of euros			
	Asset		Liability	
	Non-current	Current	Non-current	Current
Deferred VAT to Tax Authority	-	29	-	624
Borrower for VAT/IGIC from the Tax Authority	-	1,212	-	-
Deferred tax assets	894,177	-	-	-
Provision of taxes	-	-	-	24,917
VAT Creditor to the Tax Authority	-	-	-	46,800
IRPF Creditor to the Tax Authority	-	-	-	2,443
IGIC Creditor to the Tax Authority	-	-	-	-
Social Security Creditor Bodies	-	-	-	474
Income tax	-	5,899	-	-
Creditor/borrower of other tax expenses to the Tax Authority	-	-	-	-
Total	**894,177**	**7,140**	**-**	**75,258**

31 December 2015

	Amounts in thousands of euros			
	Asset		Liability	
	Non-current	Current	Non-current	Current
Creditor for deferred VAT to the Tax Authority	-	-	-	-
Borrower for VAT to the Tax Authority	-	-	-	-
Deferred tax assets and tax credit and tax loss carryforwards	1,461,722	-	-	-
Provision of taxes	-	-	-	23,600
VAT Creditor to the Tax Authority	-	-	-	36,016
IRPF Creditor to the Tax Authority	-	-	-	3,671
IGIC Creditor to the Tax Authority	-	-	-	17
Social Security Creditor Bodies	-	-	-	389
Income tax	-	13,406	-	-
Creditor/borrower of other tax expenses to the Tax Authority	-	-	-	-
Total	**1,461,722**	**13,406**	**-**	**63,693**

15.2 Reconciliation of the accounting loss to the tax loss

The reconciliation of the accounting loss for the year to the tax loss for income tax purposes is as follows:

2016

	Thousands of euros				
	Statement of profit or loss		Income and Expense Recognised Directly in Equity		Total
Net income and expense balance from the period. Profit / (loss)		(662,791)		(1,003,640)	(1,666,431)
	Increases	Decreases	Increases	Decreases	
Income tax	143	-	567,545	-	567,688
Permanent differences	15,619	(38,354)	-	-	(22,735)
Temporary differences	-	-	-	-	-
- Starting in the period	2,426	-	436,095	-	438,521
- Starting in prior periods	-	(20,341)	-	-	(20,341)
Taxable base (tax result)	**18,188**	**(721,486)**	**1,003,640**	**(1,003,640)**	**(703,298)**

2015 (Restated)

	Thousands of euros				
	Statement of profit or loss		Income and Expense Recognised Directly in Equity		Total
Net income and expense balance from the period. Profit / (loss)		(102,561)		192,080	89,519
	Increases	Decreases	Increases	Decreases	
Income tax	-	(32,603)	-	(410,336)	(442,939)
Permanent differences	12,766	(17,621)	-	-	(4,855)
Temporary differences	-	-	-	-	-
- Starting in the period	14,495	-	118,916	-	133,411
- Starting in prior periods	-	-	-	(2,064,098)	(2,064,098)
Taxable base (tax result)	**27,261**	**(152,785)**	**118,916**	**(2,282,354)**	**(2,288,962)**

At 31 December 2016 and 2015, the main temporary differences arose from period depreciation and amortisation charges, among other items. The origin of the permanent differences correspond to surcharges, sanctions, the results provided by the FAB's (see Note 4.7) and rent exemptions derived from transferring certain properties.

The foregoing tables are presented in accordance with the model required by the 2007 Spanish National Chart of Accounts. The amounts included under "Income and Expense Recognised Directly in Equity" relate to accounting adjustments that are not reflected in the tax loss for income tax purposes and, therefore, are not included in an effective manner in the tax loss for income tax purposes for the year.

The significant tax effect recognised directly in equity at 31 December 2016 relates to the financial derivatives designated as hedging instruments, amounting to EUR 662,557 thousand (31 December 2015: EUR 647,768 thousand) (see Note 11.4), in addition to the tax effect associated with the impairment of the unit of financial assets amounting to EUR 99,814 and 682,148 thousand (see Notes 2.5 and 7.1). Furthermore, in 2016, the Company derecognised tax credits directly capitalised in the equity amounting to EUR 582,334 thousand from the balance.

The reconciliation of the income tax expense recognised by Sareb to the result of multiplying the applicable income tax rate by the total recognised income and expense before tax for 2016 and 2015 is as follows:

2016

	(Income) / Expenses (thousands of euros)		
	Statement of profit or loss	Amounts registered directly against the equity	Total recognised income and expenses
Profit / (losses) before taxes	(662,648)	(436,095)	(1,098,743)
Permanent differences	(22,735)	-	(22,735)
Total	(685,383)	(436,095)	(1,121,478)
Income tax rate	25%	25%	25%
Total	(171,346)	(109,024)	(280,370)
Deductions and bonuses	(141)	-	(141)
(Profit) / Loss accrued from income tax	**171,487**	**109,024**	**280,511**
Tax adjustment from the prior year	-	-	-
Income tax for FABs not derecognised at Sareb (Note 4.6.1.)	(143)	-	(143)
Adjustment for limiting tax assets for prior years	-	(582,334)	(582,334)
Adjustment for limiting tax assets in the current year	(171,487)	(94,235)	(265,722)
Total income / (expense) registered in the statement of profit or loss	**(143)**	**(567,545)**	**(567,688)**

2015 (Restated)

	(Income) / Expenses (thousands of euros)		
	Statement of profit or loss	Amounts registered directly against the equity	Total recognised income and expenses
Profit / (losses) before taxes	(135,164)	(520,313)	(655,477)
Permanent differences	(4,855)	-	(4,855)
Total	(140,019)	(520,313)	(660,332)
Income tax rate	28%	28%	28%
Total	(39,205)	(145,688)	(184,893)
Deductions and bonuses	-	-	-
(Profit) / Loss accrued from income tax	**39,205**	**145,688**	**184,893**
Adjustment for tax change	(4,201)	(15,609)	(19,810)
Tax adjustment from the prior year	(2,542)	-	(2,542)
Capitalising tax credits from previous years	141	426,728	426,869
Adjustment for limiting tax assets	-	(70,957)	(70,957)
Total income / (expense) registered in the statement of profit or loss	**32,603**	**485,850**	**518,453**

In 2016, the Company requested a rulings from the Spanish Directorate-General of Taxes in respect of several tax matters, including the tax treatment of impairment losses recognised and calculated in accordance with Bank of Spain Circular 5/2015. In this regard, the response received from the Directorate-General of Taxes establishes that such impairment losses are considered deductible for income tax purposes.

As indicated in Notes 2.1 and 2.5, RD 4/2016 was published on 3 December 2016, by virtue of which the Company has recognised the impairments originated as a result of applying Circular 5/2015 in Equity under "Valuation Adjustments". The accounting elements of this RD were realised retrospectively. However, at the discretion of the Company and its advisers, this accounting restatement did not change the conclusion expressed in the previous paragraph about the tax deductibility of the impairment from 2015 and prior years.

Furthermore, the Company considers that the increase of the provision balance was recognised in the year, in Equity under "Valuation Changes" account of Sareb, by applying RD 4/2016, and is considered a non-deductible line item. The Company will make its best efforts to obtain a confirmation of the aforementioned criteria with the Tax Administration.

At 3 December 2016, Royal Decree-Law 3/2016 of 2 December was published in the Official Gazette, which adopts measures in the tax environment aimed at consolidating public finances and other urgent corporate measures. This legislation introduces some modifications to Law 27/2014, of 27 November, on Income Tax. Specifically, Additional Provision Fifteen was added, which indefinitely establishes compensation for tax losses with a limit of 25 percent of the prior tax base, when the net amount of the business figure of the prior 12 months is less than 60 million euros.

The Company has performed the analysis on the recovery of all deferred tax assets, based on the Spanish Accounting and Audit Institute Resolution of 9 February 2016, which develops the rules for the recognition, measurement and preparation of financial statements to account for income tax, including the commented modification and according to the forecasts of the Business Plan, which included a time horizon greater than ten years.

As a result, the deferred tax assets recognised at the Company at 2016 year-end, at the rate of 25 percent (applicable income tax rate), are those that are considered probable to be applied, according to the future tax earnings. Specifically, the Company has decided to derecognise EUR 582,334 thousand from their balance, with a total figure of EUR 894,117 thousand recognised deferred tax assets remaining. This was made taking into account the time horizon envisaged in the Company's business plan, which provides for the generation of future taxable profits enabling the tax assets recognised to be offset.

The reconciliation of the tax loss to net income tax payable for 2016 and 2015 is as follows:

	Thousands of euros	
	2016	2015
Taxable base (tax result)	**(703,298)**	**(2,526,794)**
Taxable base by tax rate (25%/28%)	(175,825)	(707,502)
Deductions and bonuses	(141)	-
Tax withholdings and pre-payments	(1,935)	(3,950)
Net income tax (receivable)/payable	**(1,935)**	**(3,950)**

The detail of the tax loss carryforwards recognised at 31 December 2016 and 2015 is as follows:

2016

	Thousands of euros	25 %	2016 Amount capitalised
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	**3,872,277**	**968,069**	**139,372**

2015

	Thousands of euros	25 %	2015 Amount capitalised
Tax losses			
2012	200	50	50
2013	106,561	26,640	26,640
2014	535,424	133,856	133,856
2015	2,526,794	631,698	560,742
Total	**3,168,979**	**792,244**	**721,288**

The previous tax losses have no maturity and may be compensated throughout the entire life of the Company.

The Company maintained the following deductions at the year-end of 2016 and 2015:

	Deduction amount	Maturity date
Deductions for R + D		
2014	337	2032
2015	221	2033
Total	**538**	

The income tax expense accrued for 2016 and 2015 related in full to continuing operations.

15.3 Deferred tax assets

The detail of "Deferred Tax Assets" at 31 December 2016 and 2015 is as follows:

	Amounts in thousands of euros	
	2016	2015
Tax credit		
- Tax losses	139,372	721,288
- Deductions pending application	-	440
2013 Temporary differences	18,626	44,551
2014 Temporary differences	69,998	44,073
2015 Temporary differences	3,624	3,602
Valuation of market derivatives	662,557	647,768
Other		
Total deferred tax assets	**894,177**	**1,461,722**

Both the deferred taxes payable and tax credits for tax losses were recognised on the balance sheet because the Company Directors considered that, in accordance with the best estimate of the Company's future results, including certain tax planning actions, it is likely that these assets would be recovered.

15.4 Years open for review by the tax authorities

Under current legislation, taxes cannot be deemed to have been definitively settled until the tax returns filed have been reviewed by the tax authorities or until the four-year statute-of-limitations period has expired. At 31 December 2016, all taxes applicable to the Company that it had filed since its incorporation were open for review by the tax authorities. As a result of, among other factors, varying interpretations of current legislation, additional liabilities may arise as a result of a tax audit. In any case, the directors consider that these liabilities, should they arise, would not have a material effect on the financial statements.

At 2016 year-end, the Company did not have any tax audits in progress.

16. Income and expenses

16.1 Revenue

The detail, by line of business, of "Revenue" at 2016 and 2015 year-end is as follows:

	Amounts in thousands of euros	
	2016	2015
Income from sales of loans and credit facilities (Note 7.1.1)	474,285	395,848
Income from financial interests from loans and credit facilities (Note 7.1.1)	890,563	588,706
Income from sales of Investment Property (Note 5)	986,238	769,076
Income from sale of inventory	23,659	14,086
Rent income (Note 6)	42,135	42,011
Remuneration of Bank Asset Fund (FAB) Securities (see Note 7.2.2)	903	9,496
Recoveries of Gains on Loans and Credit Facilities - net waivers (Note 7.1.1)	(283,634)	382,776
Total	**2,134,149**	**2,201,999**

The Company obtained all its revenue in Spain.

In 2016, and as a result of the principle of applying the amounts recovered by Sareb from their borrowers, which applies, in the first place, to interests and later to capital, the figure of "Recoveries of Gains on Loans and Credit Facilities" is negative for an amount of EUR 283,634 thousand. However, the total income, taking into account the total income for interests amounts to EUR 890,563 thousand.

16.2 Cost of sales and changes in inventories

The detail of these line items in the accompanying statement of profit or loss is as follows:

	Amounts in thousands of euros	
	2016	2015
Changes in inventories	(17,483)	(10,327)
Total changes in inventories	**(17,483)**	**(10,327)**
Cost of the Investment Properties (Note 5)	(886,246)	(606,554)
Cost of Financial Asset sales (Note 7.1.1)	(593,115)	(369,728)
Total cost of sales	**(1,479,361)**	**(976,282)**

16.3 Staff costs

The detail of "Staff Costs" in 2016 and 2015 is as follows:

	Amounts in thousands of euros	
	2016	2015
Wages, Salaries and Similar Expenses	34,606	31,773
Social costs	4,795	5,201
Total	**39,401**	**36,974**

The average number of employees in 2016 and 2015, by professional category, was as follows:

	Number of employees	
	2016	2015
Executives	65	61
Bosses and Technicians	227	198
Directors and sales representatives	64	66
Total	**356**	**325**

The distribution of employees by gender and by professional category at 31 December 2016 and 2015 was as follows:

	2016			2015		
	Women	Men	Number of employees	Women	Men	Number of employees
Executives	14	51	65	14	52	66
Bosses and Technicians	94	133	227	81	133	214
Directors and sales representatives	40	24	64	46	26	72
Total	**148**	**208**	**356**	**141**	**211**	**352**

In 2016 and 2015 the Company employed one person with a disability greater than 33%.

16.4 Outside services

The detail of “Outside Services” in 2016 and 2015 is as follows:

	Amounts in thousands of euros	
	2016	2015
Fees for managing and marketing assets (Note 1)	236,962	221,537
Leases and royalties	3,254	9,048
Repair and upkeep expenses	89,976	54,023
Independent professional services	96,506	79,091
Insurance premiums	5,437	2,625
Publicity, advertising and public relations	1,946	688
Banking services	314	392
Utilities	7,338	6,962
Other services	3,642	920
Total Outside Services	**445,375**	**375,286**
Total Taxes	**197,205**	**192,902**

In 2016 "Repair and Upkeep Expenses" includes mainly the expenses of community associations relating to the property assets, amounting to EUR 53,689 thousand (2015: EUR 45,485 thousand). "Taxes Other than Income Tax" includes mainly the cost of property tax on the Company's property assets, and non-deductible input VAT borne by it in 2016 and 2015.

The fees paid to PricewaterhouseCoopers Auditores, S.L. for the audit of the Company's separate financial statements for 2016 amounted to EUR 1,031 thousand (2015: EUR 1,135 thousand). Furthermore, in 2016, fees amounting to EUR 85 thousand were paid to other companies using the PricewaterhouseCoopers brand for other services (2015: EUR 95 thousand).

16.5 Finance Costs

The detail of “Finance Costs - On Debts to Third Parties” in the statements of profit or loss for 2016 and 2015 is as follows:

	Thousands of euros	
	2016	2015
Interests from debt instruments and marketable securities (Note	54,526	398,255
Interests from financial derivatives (Note 13.3)	469,034	302,058
Finance cost - ineffective derivatives (Note 4.9)	36,572	-
Other finance costs	17,333	24,141
Total	**577,465**	**724,454**

"Other Finance Costs" includes mainly the finance charge arising from the funding granted in 2016 by the investor of FAB Bull 2013 amounting to EUR 12,466 thousand (2015: EUR 7,744 thousand), which was not derecognised from the accompanying balance sheet (see Note 4.6.1), and the effect of discounting the Íbero guarantees amounting to EUR 4,116 and 16,283 thousand, respectively (see Note 13.4).

16.6 Finance Income

The detail of “Finance Costs - On Debts to Third Parties” in the statements of profit or loss for 2016 and 2015 is as follows:

	Thousands of euros	
	2016	2015
For cash and cash equivalent remuneration (Note 10)	4	11,868
For “Other financial asset” remuneration	-	741
Other finance income (Note 13.4)	19,170	106
Total	**19,174**	**12,715**

17. Related party transactions and balances and legal information relating to the Board of Directors

17.1 Related party transactions

The detail of the balances held and the transactions performed by Sareb with related parties recognised in these financial statements in 2016 and 2015 is as follows:

2016

	Amounts in thousands of euros				
	FROB and institutions under control by FROB	Significant Shareholders	Bank asset funds and other associates	Board of Directors (*)	Senior Executive (*)
Asset:					
Loans and credit facilities	-	-	-	-	-
Non-Current Investments in Associates	-	-	41,369	-	-
Current Investments in Associates	-	-	-	-	-
Cash and cash equivalents	135	-	-	-	-
Liability:					
Non-current debt instruments and other marketable securities	22,695,374	-	-	-	-
Current debt instruments and other marketable securities	1,122,226	-	-	-	-
Profit and loss:	-	-	-	-	-
Income from sales of Inv. Properties	-	-	20,362	-	-
Remuneration of Bank Asset Fund (FAB) Securities	-	-	903	-	-
Other Operating Expenses	(2,259)	-	-	(1,181)	(4,830)
Impairment of Financial Instruments	-	-	(2,427)	-	-
Finance income	-	-	19,170	-	-
Finance Costs	(31,220)	-	(12,467)	-	-
Contingent Risks:					-
Guarantees Provided	-	-	-	-	-

(*) These amounts relate to the remuneration received by the Company's directors and senior executives in 2016 (see Note 17.3).

2015

	Amounts in thousands of euros				
	FROB and institutions under control by FROB	Significant Shareholders	Bank asset funds and other associates	Board of Directors (*)	Senior Executive (*)
Asset:					
Loans and credit facilities	319,288	-	-	-	-
Non-Current Investments in Associates	-	-	32,232	-	-
Current Investments in Associates	-	-	-	-	-
Cash and cash equivalents	-	-	-	-	-
Liability:					
Non-current debt instruments and other marketable securities	23,660,263	-	-	-	-
Current debt instruments and other marketable securities	1,169,937	-	-	-	-
Profit and loss:	-	-	-	-	-
Income from sales of Inv. Properties	-	-	45,591	-	-
Remuneration of Bank Asset Fund (FAB) Securities	-	-	9,113	-	-
Other Operating Expenses	(9,081)	-	-	(1,191)	(3,833)
Impairment of Financial Instruments	-	-	(5,604)	-	-
Finance income	-	-	-	-	-
Finance Costs	(227,451)	-	(7,095)	-	-
Contingent Risks:					-
Guarantees Provided	-	-	-	-	-

(*) These amounts relate to the remuneration received by the Company's directors and senior executives in 2015 (see Note 17.3).

The changes recognised in "Debt instruments and marketable securities" relate to the amortisations of senior debt realised by the Company in 2016 (see Note 13). The changes recognised in "Loans and credit facilities" relate to sales and partial payments resulting from the ordinary course of the Company's business.

17.2 Disclosure of directors' ownership interests and activities

With regard to conflicts of interest, pursuant to Article 22 of the Board Regulations and the Conflict of Interest and Related Party Transactions Policy, the directors are obliged to notify the Board of any direct or indirect conflict of interest with the interests of the Company in which they may be involved.

Pursuant to the procedure established in the Conflict of Interest and Related Party Transactions Policy, once the Company becomes aware of the existence of a conflict of interest, either on its own or through notification by the director, it shall not provide information about the transaction in question to the affected director, and the latter shall not take part in the debate, or vote, on the matter giving rise to the conflict of interest.

As part of their duties to avoid conflicts of interest with the Company's interests, the directors who held positions on the Board of Directors in the year complied with the obligations set forth in Article 228 of the Consolidated Spanish Limited Liability Companies Law and in the Company's Conflict of Interest and Related Party Transactions Policy. Furthermore, the directors and persons related to them did not become involved in the cases of conflict of interest provided for in Article 229 of the aforementioned law.

17.3 Remuneration and other benefits of directors and senior executives

For the purpose of preparing these financial statements at 31 December 2016, 19 persons were considered senior executives (31 December 2015: 17 persons), of which 13 were men and 6 women (13 men and 4 women in 2015), and were classified as key personnel for Sareb.

The salaries, attendance fees and remuneration of all kinds earned in 2016 by the members of the Company's governing bodies and senior executives amounted to EUR 6,011 thousand (2015: EUR 5,024 thousand), the detail being as follows:

2016

	Amounts in thousands of euros		
	Board of Directors	Senior Executives	Total
Fixed Remuneration	1,102 (1)	3,270 (3)	4,372
Variable Remuneration	79 (2)	506 (4)	585
Loyalty plan	-	1,054 (5)	1,054
Total	**1,181**	**4,830 (6)**	**6,011**

(1) Includes the fixed remuneration at 31 December 2016 of the Company's executive director, which amounts to EUR 385 thousand.

In addition to the fixed remuneration included in this section, payments were made as a result of the changes that took place on the Board in 2016, the detail being as follows:

At 1 April, an independent director submitted his resignation, having received EUR 28 thousand for services rendered until that date.

In June, two Independent Directors submitted their resignation, made effective 28 November, and received EUR 45 and 49 thousand, respectively, for services rendered until that date.

(2) Including the last third of variable remuneration for 2014 (28 thousand euros), a third received in 2015 (25.5 thousand euros) and another third in January 2016 (25.5 thousand euros) received in January 2017, with the remaining third of the variable remuneration from 2015 to be received in the first quarter of 2018.

In addition, the executive director earned EUR 97.5 thousand in variable remuneration in 2016, the payment of which, pursuant to the Remuneration Policy for the members of Sareb's Board of Directors, is deferred over three years.

(3) This section includes aggregate information for 19 members of Sareb's senior management at 31 December 2016.

(4) Including the variable remuneration for 2015 received in 2016; 2 of the 19 members of senior management only received the last third pending variable remuneration from 2014, and the two-thirds of the variable remuneration of 2015, because it was deferred; the remaining third is to be received in the first quarter of 2018. This figure also includes the last third pending variable remuneration from 2014 (EUR 12 thousand) of two members of senior executives, who at that date had deferred variable remuneration.

In addition, the senior executives earned an aggregate total amount of EUR 715 thousand in variable remuneration in 2016, the payment of which, for those to whom it is applicable, is deferred over three years.

(5) Fifteen of the 19 members of senior management received 2014-2016 loyalty plan payments in January 2017.

(6) In addition to this remuneration, two members of senior management ceased to perform their duties, having received an aggregate total amount of EUR 627 thousand for services rendered until their respective terminations.

2015

	Amounts in thousands of euros		
	Board of Directors	Senior Executives	Total
Fixed Remuneration	1,135 (1)	3,183 (3)	4,318
Variable Remuneration	56 (2)	367 (4)	423
Loyalty plan	-	283 (5)	283
Total	**1,191**	**3,833** (6)	**5,024**

(1) Includes the fixed remuneration at 31 December 2015 of the Company's executive director, which amounts to EUR 385 thousand.

In addition to the fixed remuneration included in this section, payments were made as a result of the changes that took place on the Board in 2015, the detail being as follows:

In the first quarter of 2015, the former executive chairwoman of Sareb submitted her resignation, having received a total of EUR 28 thousand for services rendered until that date. In March, an independent director submitted his resignation, having received EUR 28 thousand for services rendered until that date.

In May an independent director and proprietary director submitted their resignations, having received EUR 48 thousand and EUR 38 thousand, respectively, and in October a proprietary director submitted his resignation, having received EUR 78 thousand.

(2) Including the two-thirds of variable remuneration for 2014 received in 2015 (one third) and in January 2016 (another third), with the remaining third to be received in the first quarter of 2017.

The executive director earned EUR 75 thousand in variable remuneration in 2015, the payment of which, pursuant to the Remuneration Policy for the members of Sareb's Board of Directors, is deferred over three years.

(3) This section includes aggregate information for 17 members of Sareb's senior management at 31 December 2015.

(4) Including the variable remuneration for 2014 received in 2015; five of the 17 members of senior management only received two-thirds of this variable remuneration because it was deferred; the remaining third is to be received in the first quarter of 2017.

The senior executives earned an aggregate total amount of EUR 560 thousand in variable remuneration in 2015, the payment of which, for those to whom it is applicable, is deferred over three years.

(5) Only nine of the 17 members of senior management received loyalty plan payments in January 2015.

(6) In addition to this remuneration, in the first half of 2015 two members of senior management ceased to perform their duties, having received an aggregate total amount of EUR 225 thousand for services rendered until their respective terminations.

The Company has taken out third-party liability insurance for directors and senior executives. Pursuant to current tax legislation, Sareb stated the cost of the premium for each director as remuneration. However, the cost of this premium (which amounted to EUR 87 thousand) was passed on to each director and senior executive as a reduction to their monetary remuneration and, therefore, it did not represent remuneration in excess of the total remuneration approved at Sareb's 2016 Annual General Meeting.

At 31 December 2016 and 2015, the Company had not granted to the executive directors or senior executives any guarantee or golden parachute clauses in the event of termination of the employment contract caused by changes in control of the Company or by events depending in full or in part on the executive's volition.

The Company does not have any pension obligations to the directors or senior executives.

The Company has granted no advances, loans or guarantees to the members of the Board of Directors and has made no share-based payments to any director or senior executive.

18. Guarantee commitments to third parties and other contingent liabilities

At 31 December 2016 and 2015, the Company had provided the following guarantees to third parties:

	Thousands of euros	
	2016	2015
For debt instruments pending on land, development and others	21,179	18,193
Total	**21,179**	**18,193**

The Company's directors do not expect any additional liabilities to arise for the Company in connection with these guarantees.

19. Events after the reporting period

On 28 February 2017, the Company simultaneously carried out a partial redemption and novation of the maturity of the outstanding senior debt issued in 2013 to acquire the Group 2 assets.

Name	2016 Opening balance	Amortisation	Novation	Outstanding amount	Maturity	Current applicable rate	New ISIN novation
Sareb/VAR BO 20170228 2015-2	5,704,100	-	5,704,100	5,704,100	28/02/2019	Eur 3m +0.07%	ES0352506 184
Sareb/VAR BO 20170228 2016-1	4,073,300	-	4,073,300	4,073,300	28/02/2018	Eur 3m + 0.01%	ES0352506 192
Sareb/VAR BO 20190228 2016-2	2,529,500	671,900	-	1,857,600	28/02/2019		N/A
Group 2 Total	**12,306,900**	**671,900**	**9,777,400**	**11,635,000**			

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

Directors' Report for the year ended 31 December 2016

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

Directors' Report for the year ended 31 December 2016

1. Significant Aspects from the Period

Prior years

The extent of the original challenge facing Sareb at the end of 2012 was borne out by the size of the figures involved: EUR 50,781 million in transferred assets in the form of almost 200,000 property and financial assets, over 18,000 borrowers, and more than 400,000 properties securing loans and credit facilities.

This challenge was even more manifest in view of the need to create a human structure and a technical structure to navigate the difficulties arising from the technological and business dependence on the banks transferring assets, even more so since they differed greatly from each other and showed signs of weakness as a result of their own restructuring processes. As such, the information they provided on the assets was at times limited and their asset management and sales efforts were not always sufficiently active.

In 2013, Sareb addressed two matters. On one hand, it built its own internal structure, forging teams and creating procedures that permitted advancing the process of orderly liquidation of its assets. On the other hand, it generated growth mechanisms for the transferors' activity, while creating units so that through the sale of the portfolio, the budget deviations could be compensated for the possible inactivity of the transferors.

In 2014, knowledge-gaining processes of different transferred assets were undertaken to generate systematic marketing, unifying the criteria of centralised management of the assets received, focusing the business on disposing of assets with a degree of maturity considered ideal for this purpose, strengthening the Company's logistical aspects and rolling out the implementation of the technical, legal and human infrastructure required for carrying on the Company's activities.

The management structure was improved by clarifying the roles and responsibilities of the business, the map of policies and business strategies were completed, and the information and knowledge of the assets under management continues to improve and be more precise in the definition of divestment strategies and channels and in the related management approaches. That year was the start of the most defined sales growth in which they were strengthened and streamlined and, above all, Sareb's position as a significant actor in the institutional market was consolidated, thereby contributing significantly to growth in this segment.

The second quarter of 2014, the Íbero project started, with the Company having become aware of the difficulties of maintaining the administration and sales arrangement with the transferor institutions once the agreements matured at the end of the year, in the second quarter of 2014. The main purpose of the project was to move on to an externalised management model that is professional and vocational, and to achieve a clearer identification and alignment of objectives among the parties, based on the principles of wilfulness, specialised management and commitment to service. The process concluded at the end of the year with the allocation of the various portfolios to four servicers, as described in Note 1 to the financial statements - servicers that in 2015 performed the operational and management migration processes.

In parallel to the performance of the tender process, and forming part of the subscribed agreements, Sareb commenced a process of re-engineering its internal procedures structured around complex information projects (Colabora, Medea, Alejandría, Carcasa, etc.) which, having commenced at the end of 2014, required great effort by the Company in 2015 and 2016, in the first phase of implementation (the Objective I model) had been in operation until 2016. These information projects form a structure that provides greater and more direct control by Sareb of the activities carried out by the new servicers.

This process was implemented without neglecting the Company's main task, which is to maximise the value of its assets and their orderly liquidation, and to meet the business targets set forth in its business plan.

For Sareb, once the Íbero project was completed, 2015 was marked by the operational migrations from the transferor institutions to the new servicers. The complexity of the process (14 migrations) made it a challenge for the Company, which it resolved satisfactorily. Fortunately, all were undertaken during the year (except for the two concluded in the first quarter of 2016). Even if they were not without incidents, they were resolved in the subsequent months. This challenge undertaken is even greater not just because of the number, but in many cases, the same transferor institutions were the result of previous mergers whose operational integration had not always been completed to satisfaction.

These technical and organisational efforts in the transferor-to-servicer transition brought along with it a waning of the business, especially in the first six months, to the extent that the transferor institutions cut back on their marketing efforts in view of the upcoming cessation of management, and the servicers took time to put into place an efficient commercial management of the portfolios received.

As regards the gradual incorporation of the servicers, Sareb reconfigured its internal organisation to meet the needs arising from the management model sought to be implemented with them. This reconfiguration marked not just 2015, but continued throughout 2016, to the point that this year must be understood as a continuation and consolidation of the progress being made.

Thus, in operational aspects, specific specialised units were created to support the operational migrations between the transferors and servicers, along with transformation units at each servicer to coordinate steps to be taken by both parties to achieve Period Objective I and in which the operational and information connection arranged in the agreements will take place.

In commercial aspects, Sareb centrally reorganised its commercial areas with a dual product and servicer parameter. The former manages, guides and drives the various lines of business for all agents; the latter manages the performance at each servicer of the business proposals and budgets. It also controls the activity, especially, the growth of sales activity.

Within this framework, started at the end of 2014, and practically all of 2015, several technological projects were in progress under the "Híspalis" name that aimed to complete a proprietary technological infrastructure to facilitate interaction with the new servicers' systems. These projects include, most notably:

- Medea: generation of a data warehouse at Sareb containing both the inventory of assets with regard to their master data and other business data required, and any economic events occurring in relation to them.

- Alejandría: a document manager associated with the assets, and to their static and dynamic data.

- Colabora: a set of tools to channel the work flows (authorisations, communications, service levels, etc.) and the interconnection between Sareb's systems and those of the servicers in order to ensure agile, systematic communication among the parties.

- Carcasa: construction at Sareb, and subsequent connection with the servicers, of a proprietary, independent accounting system for property assets.

Lastly, of particular relevance to the life of the Company was the publication in October 2015 of Bank of Spain Circular 5/2015. Bank of Spain Circular 5/2015 establishes the central methodological lines around which the valuation of Sareb's assets must revolve. The main issues are referenced in the various notes to the financial statements, although note should be made of the principle of offsetting gains and losses within the two units that are established for practical purposes - the property assets unit and the financial assets unit, with the nexus of value being the mortgage value relating to valuations performed using ECO appraisals.

Its first application was marked by impairment losses on financial assets - impairment losses that most certainly had been latent since the very date of transfer of the assets to Sareb. Because it was carried out against profit and loss, it led to the consumption of all of its shareholders equity and the commencement of the process to convert a highly substantial amount of its subordinated debt into capital (see Note 11).

In this regard, Bank of Spain Circular 5/2015 changed, through accounting legislation, the management rules of the Company, since the significant effect on equity of its first-time application is combined with the introduction of severe volatility in its balance sheet and statement of profit or loss and, therefore, its assets must be reassessed regularly.

2016

Among the aforementioned technological projects, which require vast efforts by Sareb and the servicers, at the end of 2016, the three first development phases at Sareb culminated, while operationalisation, understood as the verified and certified operative connection, presented different levels of achievement in the servicers (from 51% to 86%). Total achievement is forecasted for the first quarter of 2017.

Beyond the significance of these technological projects, the Company redoubled its efforts in 2016, continuing with the task already started in 2015 in order to apply Bank of Spain Circular 5/2015, to improve the information on and status of its assets (legal situation, ownership, characteristics, location, identification, etc.) This is because this information is necessary for asset management and to focus the marketing of the assets in order to meet the dual objective of generating funds and sustaining margins.

This process was also prompted by the legislative requirement resulting from Circular 5/2015 after assessing Sareb's entire profile, which logically required an enormous effort to obtain information on the assets, in addition to an additional valuation effort (through appraisals or AVM) of the vast profile of property and collaterals. The effort is remarkable, as it covers more than 400 thousand assets or collateral identified with very high-quality information. The organisation actively participated in this improvement under the coordination of a group created for that purpose within the company. This group also had participation from an external expert in the information filtering process, which in many cases, included opening records from transactions, as well as tracking and analysing the simple notes (as well as assets) that allowed reliably identifying the associated assets and properties.

In parallel these specific processes of massive filtering, the legal and court-related filtering working lines have continued to be strengthened, the monitoring of the court proceedings in progress in relation to the foreclosure of assets that extends and makes more precise the information underlying the loans and related collateral has been extended and improvements have been made to the systems monitoring the information on the prices and volumes of transactions performed by the Company and third parties, in order to evaluate market trends and apply intelligence measures enabling it to offer more competitive prices.

In terms of lines of business, the lines already developed in the prior year were developed more, in accordance with the postulates laid out in the business plan, in which both Sareb and our servicers participated. Thus:

- Development of assets under construction that were received as property assets.
- Encouragement, from the borrower's balance sheet, of the development and sale of the assets under construction that represent the guarantee for the loans in the Company's portfolio.
- Urban transformation of land, promoting increases in the value of land that is foreseen to be used.
- Maximisation of the profitability of the commercial assets and those residential assets held by the Company that do not have immediate sale prospects.

Regarding the business structure, and taking into account that Sareb was functioning under the valuation structure established by the aforementioned Bank of Spain Circular 5/2015, the decision guideline resulted from the commercial network in the sense of using the regulatory value (as the best approximation of the market value) as reference prices, without considering the transfer prices to Sareb, every time the impairment losses compensated for the imbalances between these values.

This operation resulted in Sareb's financial assets incurring losses of margin (sales price versus transfer price) compensated with profits in transferring the impairment (releasing funds).

This fact is especially important to the degree that at year-end, RD 4/2016 was published, by which the impairment loss does not have a balancing entry in the statement of profit and loss, rather it is done as an account of equity adjustment.

Considering that this regulation is effective retroactively, in addition to the adjustment in the reserves indicated in Note 11.4 with an impact of EUR 3,289 million at 31 December 2016 (EUR 2,330 million at 31 December 2015), the important matter is that it notably influences the statement of profit or loss in which it only considers the margin that results from the sales value versus the acquisition or transfer price. Fortunately, those operations were evaluated in the prior legislative framework as correct, because they exceeded the regulatory value, they could have a negative accrual on the balance sheet if this margin were negative.

The following items of the 2016 financial statements are worthy of note:

- The losses of the year after taxes is at EUR 663 million, versus the losses of EUR 103 million from the restated prior year. It must be taken into account that these losses are caused by the accounting standards applicable to the Company, which require derecognising financial assets for their carrying amount without provisions, reversing these directly against the Company's equity.
- At 31 December 2016, in application of the valuation methodology established by Bank of Spain Circular 5/2015, the Company recognised impairment of EUR 3,389 million at its Financial Asset Unit (31 December 2015: EUR 3,012 million).

- The recognition of this impairment, taking into account the tax effects associated with it, were directly recognised in equity. The effect of these charges on equity in 2016 and 2015 entailed reducing it by EUR 959 million and 103 million, respectively. It must be considered that in 2016, the Company derecognised EUR 582 million of tax credits that were directly capitalised on equity based on its best estimates and the changes in the tax legislation (see Note 15).

- As regards ordinary business data, 2016 was marked by not only the technical challenge but also the business difficulties arising from the migration processes between its former transferors and the new servicers.

- Accordingly, it is also important to note that the Company's revenue slightly diminished from EUR 2,202 million in 2014 to EUR 2,134 million in 2015.

- The following aspects in relation to profit from operations are also noteworthy:

  - Losses from operations before impairment amounted to EUR 105 million. This implies a reduction of EUR 679 million with respect to 2015. This decrease was caused by the increase of costs of maintaining the Company's property assets, in addition to the reduction of the margins obtained from sales.

  - Property sales amounted to EUR 1,010 million versus EUR 783 million of the prior year, which represents an increase of EUR 227 million. The margin obtained for the sale of sale property assets reached a figure of EUR 106 million (12% of the average).

  - In the financial asset sales, the Company also increased their income levels by 20%, caused by a greater appetite for investment both in Spain and internationally.

  - Finance income totalling EUR 607 million (2015: EUR 972 million), of which EUR 891 million (2015: EUR 589 million) related to the interest accrued on loans and credit facilities and EUR 284 million of losses (2015: EUR 383 million of profit) related to recoveries, through the collection of nominal amounts on loans and credit facilities acquired at a discount. It must be taken into account that the order of priority of the recovered amounts is first, unpaid interests, which caused an increase in said line item on the balance sheet, and resulted in a decrease from "Recoveries of Gains on Loans and Credit Facilities". The worse margin is because, as indicated above, the Company made its decisions based on the regulatory value of the assets in 2016 without considering their carrying amount.

  - Maintenance and overhead costs (operating expenses, depreciation and amortisation and staff costs) amounted to EUR 766 million (2015: EUR 688 million), most of which related to building maintenance expenses, local taxes (property tax), management fees and commissions on asset sales and to the tax-related costs arising from the foreclosure and dation in payment processes that Sareb cannot pass on. This item mostly explains the increase experienced.

With regard to cash generation, in its third year in existence, the Company managed to generate a sufficient cash surplus to repay EUR 1,842 million in addition to the EUR 1,976 million paid with cash from the previous year. This was in addition to the Company's overhead costs, the asset maintenance expenses, the management fees, sales commissions and, in particular, somewhat more than EUR 577 million in finance charges relating to the senior debt and its hedging derivatives.

In relation to the reduction in senior debt, the main aspect of the Company's activity, in addition to the ordinary redemptions, bonds amounting to EUR 37 million were cancelled in 2015 as a result of the corrections to the transfer process. As a result, the Company reduced the volume of issued senior debt in 2016 by EUR 1,879 million. Together with the EUR 7,305 million from the previous years, this reduction in the original debt is EUR 9,184 million in total, i.e. 18.08%, which would increase to 19.4% were the redemption of EUR 672 million performed in February 2017 with a charge to the funds generated in the previous year.

Lastly, it should be noted that the average period of payment to suppliers in 2016 was 30 days, as detailed in Note 14.

2. Outlook for the Company

The Company faces 2016 as a year of consolidation of its new internal and external structure with the full operation of the new servicers -given the completion of the migration processes- so that the servicers can devote greater efforts to their sales tasks. This commercial management will be guided by obtaining margins that make it possible to support the Company's structural costs, while generating sufficient cash resources to gradually repay its debt.

Another strategic goal for the Company is to strengthen its corporate infrastructure in order to streamline its activities and optimise its efforts in relation to management and information, thereby enabling it to achieve greater operating efficiency. To this end, the organisation is configured under a dynamic principle of change, improvement and adaptation, with the necessary reorganisations and restructurings of the various areas and extension of the coordination mechanisms among them, while continuing to increase functional specialisation.

Thus, it started an operations improvement programme (OS17) aimed at the efficiency of activities related to marketing assets, and more swiftly interacting with our servicers.

Even if the exercise of completing the entire valuation and filtering of the portfolio required by Bank of Spain Circular 5/2015 brought along with it an effort of improving the information on assets, Sareb will not relax the continuous effort to know about its portfolio. Let's think that beyond legislative compliance, the effort must serve to streamline sales by establishing some values or prices that even if they are not totally transactionable, they must be clearly less of a guideline. Thus, managers can know to what degree their commercial actions will have approval after closing the operations at the prices established, and the actions can be optimised.

As a result of this range of improvements, it is clear there is more information, which is more granular and of a higher quality and enables the Company in 2017 to better identify assets for either sale or property development. This information was also used to carry out the annual update of the Business Plan, which is a contractual requirement. This plan includes the improvements to the business model that are required in order to ensure that the Company meets the objectives for which it was created.

The aforementioned Business Plan delves into the lines of value creation drawn since a few years ago, with special emphasis paid to the early marketing of assets with a limited range vis-à-vis their price expectations and to value created by improving the possible marketing conditions of those assets in which price growth is forecast. This is sustained on the aforementioned greater and better knowledge of our portfolio of assets, and the degree to which said actions do not entail significant negative accounting margins.

The Company's Business Plan has a time horizon encompassing the whole lifetime of the Company and is updated each year. This plan is based on the Company's cash flow projections arising from the orderly disposal of the assets according to the amount expected to be recovered on each asset at the disposal date.

In relation to the cash flows, like in 2016, the 2017 Business Plan includes in its projections the effects on equity that might arise from the changes in the impairment of assets, even if it does not incorporate them into the statements of profit and loss. Any losses will be included in the cash flows at the disposal date. Accordingly, the principle of offsetting the value of assets and their value over a long-term time horizon is applied to the Business Plan. In this regard the write-downs do not have a material impact on the expected cash flows or on the return for shareholders over the life of the Company as a whole.

With regard to the market performance forecast for 2017, it seems evident that, although the property market is highly fragmented, after the phase of political uncertainty in Spain passed, signs of a slight recovery in residential assets are being observed in general, most notably in certain sub-markets such as the provinces of Madrid, Barcelona and the Mediterranean coastline. It is true that this does not equally affect Sareb's portfolio, given what type it is.

This movement generated hope in contrast to the indications for a large part of 2015. However in recent months, the return of confidence to the Spanish market, and the monetary environment, encouraged the appearance of new players in the property market with a strong investment appetite. This has led to a market rally and higher levels of competition on the demand side. As indicated, after overcoming the sensitivities of macroeconomic progress internationally and the situation of political uncertainty in Spain, both institutional investors and domestic acquirers have recovered the upward trend.

In this regard, this year, the volume of transactions in the domestic end-customer market is expected to grow substantially on last year. Prices of housing (our main property asset and collateral) are expected to stabilise with a slight upward trend. As we already indicated, modest growth in prices and transactions is already clear in certain geographic areas of Spain (Andalusia, Catalonia, Valencia, Murcia and Madrid), which will enable the Company to focus its sales efforts in these areas. There is even new growth in the land market in unsaturated areas or in those that already present clear signs of viability of being promoted given the incipient demand for new housing.

Overall, the consolidation of positive expectations in the macroeconomic environment, the infrastructure that has been created, the strong operational capabilities of our retail channels and, above all, the commercial dynamism of the servicers (once they have taken effective control of the migrated portfolios) should enable us in 2017 to earn revenue better than in 2016, both in volume and in margins, maintaining our objective of being one of the main actors in Spain in the property market.

3. Main risks inherent to the business, risk management and use of financial instruments

In addition to the financial risk factors and the related management described in Note 7 to the accompanying financial statements, the Company had initially identified the following risk factors that may potentially affect its ability to meet its objectives:

- Crisis in the property market (prices, occupancy and non-payment).

- Falling asset values, although the recent market trend points not only to stabilisation in the property market, but also to an incipient upward trend.

- The financial and liquidity crisis that may affect future purchasers of the Company's assets. This risk is mitigated by a certain macroeconomic improvement in the Spanish market, although the effects on purchasers are not yet very evident. At Sareb, we are seeing slight signs of possible increases in rates.

- Impact of possible changes in tax and legal legislation. The financial statements and this management report have indicated the effects derived from RD 3 and 4/2016 in the accounting and tax environments. For Sareb, certain changes in tax legislation would be very significant, especially one that would improve the conditions of compensation for tax losses. In other matters, the possibility of certain changes in the regional legislation that affect the property market must also be considered.

- Throughout most of 2016, most of the risks of the servicing model adopted with the Íbero Project (migration, taking control), and continuing to advance in improving our operations along with them, 2017 will tackle the challenge of consolidating the levels of business foreseen in a situation in which the accounting structure (versus the carrying amount without provisions) makes it difficult to manage the search of economic and accounting profitability for operations.

With regard to the use of interest rate hedging instruments, it is important to note that in 2016 the Company maintained the hedge structure that it had defined in 2013 for the purpose of reducing the potential negative impact of an upward interest rate trend that could jeopardise the viability of the Company.

4. Acquisition of treasury shares

In 2016, the Company did not realise operations with treasury shares nor did it maintain any at 31 December 2016.

5. Related party disclosures

Note 17 of the present financial statements details the transactions with related parties. Most of these transactions relate to financing agreements and the related finance costs, and management fees and sales commissions accrued in the year, payable to the financial institutions entrusted with the management and sale of the Company's assets.

6. Events after the reporting period

No subsequent events took place other than those detailed in Note 19 to the financial statements.

7. Research and development

Due to the nature of its business activities, the Company did not incur any significant research and development expenditure in 2016.

In compliance with the provisions of Article 253 of the Spanish Limited Liability Companies Law and Article 37 of the Spanish Commercial Code, on 29 March 2017 the Board of Directors of Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria, S.A. authorised for issue the financial statements and the directors' report for the year ended 31 December 2016, which consist of the attached documents preceding this page.

Jaime Echegoyen Enríquez de la Orden

Chairman

Rodolfo Martín Villa

Director

Enric Rovira Masachs

Director

Javier García-Carranza Benjumea

Director

Antonio Massanell Lavilla

Director

José Ramón Montserrat Miró

Director

Francisca Ortega Fernández-Agero

Director

Fund for Orderly Bank Restructuring (represented by Jaime Ponce Huerta)

Director

Rafael de Mena Arenas

Director

Iñaki Goikoetxeta González

Director

Pedro Antonio Merino García

Director

Isidoro Lora-Tamayo Rodríguez

Director

José Poveda Díaz

Director

Francisco Javier Bartolomé Delicado

Director

Lucía Calvo Vérgez

Director

For further information, visit the Sareb website (www.sareb.es) or call the company's Communications Department (+34 915563700) or send an email o comunicacion@sareb.es

Sareb

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