

Testa Residencial SOCIMI, S.A. and Subsidiaries

Consolidated Financial Statements for the
year ended 31 December 2017 and
Consolidated Directors' Report, together
with Independent Auditor's Report

Translation of a report originally issued in Spanish based on our work performed in accordance with the audit regulations in force in Spain and of consolidated financial statements originally issued in Spanish and prepared in accordance with the regulatory financial reporting framework applicable to the Group in Spain (see Notes 2 and 27). In the event of a discrepancy, the Spanish-language version prevails.

Translation of a report originally issued in Spanish based on our work performed in accordance with the audit regulations in force in Spain and of consolidated financial statements originally issued in Spanish and prepared in accordance with the regulatory financial reporting framework applicable to the Group in Spain (see Notes 2 and 27). In the event of a discrepancy, the Spanish-language version prevails.

INDEPENDENT AUDITOR'S REPORT ON CONSOLIDATED FINANCIAL STATEMENTS

To the Shareholders of Testa Residencial SOCIMI, S.A.,

Opinion

We have audited the consolidated financial statements of Testa Residencial SOCIMI, S.A. (the Parent) and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2017, and the consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows and notes to the consolidated financial statements for the year then ended.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated equity and consolidated financial position of the Group as at 31 December 2017, and its consolidated results and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union (EU-IFRSs) and the other provisions of the regulatory financial reporting framework applicable to the Group in Spain.

Basis for Opinion

We conducted our audit in accordance with the audit regulations in force in Spain. Our responsibilities under those regulations are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report.

We are independent of the Group in accordance with the ethical requirements, including those pertaining to independence, that are relevant to our audit of the consolidated financial statements in Spain pursuant to the audit regulations in force. In this regard, we have not provided any services other than those relating to the audit of financial statements and there have not been any situations or circumstances that, in accordance with the aforementioned audit regulations, might have affected the requisite independence in such a way as to compromise our independence.

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

Most Significant Audit Matters

The most significant audit matters are those matters that, in our professional judgement, were considered to be the most significant risks of material misstatement in our audit of the consolidated financial statements of the current period. These risks were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on those risks.

Valuation of investment property

Description

The Testa Residencial SOCIMI, S.A. and subsidiaries Group manages a portfolio of residential property assets earmarked for lease located in Spain. Investment property is stated at its fair value at the reporting date and is not depreciated. At 31 December 2017, the investment property assets was valued at EUR 2,106 million.

The Testa Residencial SOCIMI, S.A. and subsidiaries Group periodically uses an independent expert to determine the fair value of its property assets. The aforementioned expert has substantial experience in the market in which the Group operates and employs valuation methodologies and standards widely used in the market.

The valuation of the Investment property is one of the most significant matters in our audit, since it requires the use of estimates with a significant degree of uncertainty. Specifically, the valuation method generally used for the rental property assets is the discounted cash flow method, which requires estimates of:

- the future net revenue from each property based on available historical information and market surveys
- the internal rate of return or opportunity cost used when discounting

Procedures applied in the audit

Our audit procedures included, among others, the review of the design and implementation of the relevant controls that mitigate the risks associated with the valuation of investment property, as well as tests to verify that the aforementioned controls operate effectively.

We obtained the valuation reports of the expert hired by the Group to value all of the property portfolio and assessed the competence, ability and objectivity of the expert and the suitability of the expert's work for use as audit evidence. In this connection, with the cooperation of our internal valuation experts, we:

- analysed and concluded on the reasonableness of the valuation procedures and methodology used by the experts hired by Group management,
- performed, for a sample of assets chosen on a selective basis, an independent valuation, taking into account the information available on the industry and transactions with property assets similar to the property asset portfolio owned by the Group,
- assessed, in conjunction with our internal experts, the matters involving greater risk, including the occupancy rates and expected returns on the property assets, and

Valuation of investment property

Description

- the residual value of the assets at the end of the projection period
- the exit yield

Also, small percentage variations in the assumptions used in the valuations of property assets may give rise to significant adjustments or reclassifications.

Procedures applied in the audit

- held meetings with the experts hired by Group management to check the findings of our work and obtain the necessary explanations.

We also analysed the suitability of the disclosures made by the Group in relation to these matters, which are included in Note 7 to the consolidated financial statements for 2017.

Emphasis of Matter

We draw attention to Note 2.2 to the accompanying consolidated financial statements, which indicates the conclusion reached by the Group in relation to the accounting treatment of the integration of the residential businesses of Metrovacesa, S.A. and Testa Residencial SOCIMI, S.A. in 2016. Our opinion is not modified in respect of this matter.

Other Information: Consolidated Directors' Report

The other information comprises only the consolidated directors' report for 2017, the preparation of which is the responsibility of the Parent's directors and which does not form part of the consolidated financial statements.

Our audit opinion on the consolidated financial statements does not cover the consolidated directors' report. Our responsibility relating to the consolidated directors' report, in accordance with the applicable audit regulations, consists of evaluating and reporting on whether the consolidated directors' report is consistent with the consolidated financial statements, based on our knowledge of the Group obtained in the audit of those consolidated financial statements and excluding any information other than that obtained as evidence during the audit. Also, our responsibility consists of evaluating and reporting on whether the content and presentation of the consolidated directors' report are in conformity with the applicable regulations. If, based on the work we have performed, we conclude that there are material misstatements, we are required to report that fact.

Based on the work performed, as described in the preceding paragraph, the information in the consolidated directors' report is consistent with that contained in the consolidated financial statements for 2017 and its content and presentation are in conformity with the applicable regulations.

Responsibilities of the Directors and Audit Committee of the Parent for the Consolidated Financial Statements

The Parent's directors are responsible for preparing the accompanying consolidated financial statements so that they present fairly the Group's consolidated equity, consolidated financial position and consolidated results in accordance with EU-IFRSs and the other provisions of the regulatory financial reporting framework applicable to the Group in Spain, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

The Parent's audit committee is responsible for overseeing the process involved in the preparation and presentation of the consolidated financial statements.

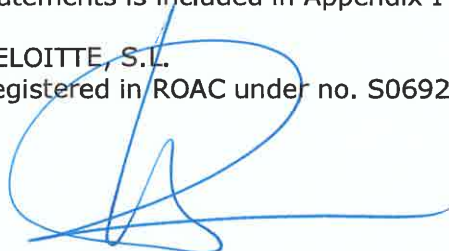
Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

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

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

A further description of our responsibilities for the audit of the consolidated financial statements is included in Appendix I to this auditor's report.

DELOITTE, S.L.
Registered in ROAC under no. S0692



Antonio Sánchez-Covisa Martín-González
Registered in ROAC under no. 21251

March 26th, 2018

Appendix I to our auditor's report

Further to the information contained in our auditor's report, in this Appendix we include our responsibilities in relation to the audit of the consolidated financial statements.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

As part of an audit in accordance with the audit regulations in force in Spain, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Parent's directors.
- Conclude on the appropriateness of the use by the Parent's directors of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

From the significant risks communicated with the Parent's audit committee, we determine those risks that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the most significant assessed risks.

We describe those risks in our auditor's report unless law or regulation precludes public disclosure about the matter.

TESTA RESIDENCIAL, SOCIMI, S.A. and Subsidiaries

Consolidated Financial Statements for the year ended 31 December 2017, prepared in accordance with International Financial Reporting Standards (IFRS) adopted by the European Union and consolidated directors' report

Translation of a report originally issued in Spanish based on our work performed in accordance with the audit regulations in force in Spain and of consolidated financial statements originally issued in Spanish and prepared in accordance with the regulatory financial reporting framework applicable to the Group in Spain (see Notes 2 and 27). In the event of a discrepancy, the Spanish-language version prevails.

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with the regulatory financial reporting framework applicable to the Group in Spain (see Notes 2 and 27). In the event of a discrepancy, the Spanish-language version prevails.

TESTA RESIDENCIAL SOCIMI, S.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2017 (Thousands of euros)

ASSETS	Notes	31/12/2017	31/12/2016	EQUITY AND LIABILITIES	Notes	31/12/2017	31/12/2016
NON-CURRENT ASSETS:				EQUITY:			
Concession projects	Note 6	156,343	159,376	Share capital	Note 13	125,863	46,766
Other intangible assets	Note 6	99	34	Issue premium		1,332,879	411,032
Property, plant and equipment		70	-	Reserves	Note 13.2	(133,046)	192,295
Investment property	Note 7	2,106,079	912,304	Prior years' losses		(1,754)	-
Non-current financial assets -		9,812	7,401	Profit/(loss) for the year attributable to the Parent		70,146	24,781
Collection rights, Service concession arrangements	Note 8	4,738	3,587	Valuation adjustments		(336)	(489)
Other financial assets	Note 10	5,074	3,814	Equity attributable to the Parent		1,393,752	674,385
Deferred tax assets	Note 17.3	11,083	296	Non-controlling interests		772	-
Total non-current assets		2,283,486	1,079,411	Total equity		1,394,524	674,385
				NON-CURRENT LIABILITIES:			
				Provisions	Note 15	320	1,410
				Non-current financial liabilities -		841,232	366,099
				Non-current bank borrowings	Note 14	470,545	347,911
				Derivatives	Note 14	120	940
				Other non-current liabilities	Note 15	370,567	7,248
				Deferred tax liabilities	Note 17.4	105,953	60,649
				Total non-current liabilities		947,505	418,158
				CURRENT LIABILITIES:			
				Provisions	Note 15	1,019	1
				Non-current financial liabilities -		2,639	12,633
				Current bank borrowings	Note 14	2,539	12,633
				Current payables to related companies		5,400	-
				Trade and other payables	Note 16	5,092	6,380
				Payable to suppliers		3,168	4,321
				Current tax liabilities	Note 17.1	107	523
				Other payables to public authorities	Note 17.1	243	317
				Other payables		1,158	1,635
Total current assets		72,593	28,901	Total current liabilities		14,050	19,014
TOTAL ASSETS		2,356,079	1,111,557	TOTAL EQUITY AND LIABILITIES		2,356,079	1,111,557

The accompanying Notes 1 to 27 to the consolidated financial statements and Appendix I are an integral part of the consolidated statement of financial position at 31 December 2017.

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with the regulatory financial reporting framework applicable to the Group in Spain (see Notes 2 and 27). In the event of a discrepancy, the Spanish-language version prevails.

TESTA RESIDENCIAL SOCIMI, S.A. AND SUBSIDIARIES

CONSOLIDATED INCOME STATEMENT

FOR 2017

(Thousands of euros)

	Notes	31/12/2017	31/12/2016
CONTINUING OPERATIONS:			
Revenue	Note 19.1	52.943	9.586
Other operating income		141	3
Personnel expenses	Note 19.2	(3.214)	(2.000)
Other operating expenses	Note 19.3	(25.023)	(4.733)
Depreciation charge		(3.145)	(810)
Gains/(losses) from asset disposals	Note 7	286	163
Changes in fair value of investment property	Note 7	65.209	23.953
OPERATING PROFIT/(LOSS)		87.197	26.162
Finance income		165	1
Financial expenses	Note 19.4	(11.338)	(1.141)
Change in fair value of financial instruments		(5.542)	-
PROFIT/(LOSS) BEFORE TAX		70.482	25.022
Corporate income tax	Note 17.2	(296)	(241)
PROFIT/(LOSS) FOR THE YEAR FROM CONTINUING OPERATIONS		70.186	24.781
Attributable to shareholders of the Parent		70.146	24.781
Attributable to non-controlling interests		40	-
BASIC EARNINGS PER SHARE (in euros):	Note 13.4	0,0076	0,0053
DILUTED EARNINGS PER SHARE (in euros):		0,0076	0,0053

The accompanying Notes 1 to 27 to the consolidated financial statements and Appendix I are an integral part of the consolidated income statement for 2017.

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with the regulatory financial reporting framework applicable to the Group in Spain (see Notes 2 and 27). In the event of a discrepancy, the Spanish-language version prevails.

**TESTA RESIDENCIAL SOCIMI, S.A.
AND SUBSIDIARIES**

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR 2017
(Thousands of euros)

	31/12/2017	31/12/2016
PROFIT/(LOSS) PER THE INCOME STATEMENT (I)	70.186	24.781
OTHER COMPREHENSIVE INCOME:		
Income and expenses recognised directly in equity-		
Arising from cash flow hedges	414	-
TOTAL COMPREHENSIVE INCOME RECOGNISED DIRECTLY IN EQUITY (II)	414	-
Amounts transferred to income statement		
Arising from cash flow hedges	(261)	-
TOTAL AMOUNTS TRANSFERRED TO INCOME STATEMENT (III)	(261)	-
TOTAL COMPREHENSIVE INCOME (I+II+III)	70.339	24.781
Attributable to shareholders of the Parent	70.299	24.781
Attributable to non-controlling interests	40	-

The accompanying Notes 1 to 27 to the consolidated financial statements and Appendix I are an integral part of the consolidated statement of comprehensive income for 2017.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR 2017

(Thousands of euros)

	Share office	Issue premium	Reserves	Previous years' profit/(loss)	Profit/(loss) for the year	Valuation adjust ments	Equity attributable to the Company Parent	Non-controlling interests	Total equity
Opening balance, 2016	46.766	411.032	192.295	-	-	(489)	649.604	-	649.604
Consolidated comprehensive income	-	-	-	-	24.781	-	24.781	-	24.781
Balance at 31 December 2016	46.766	411.032	192.295	-	24.781	(489)	674.385	-	674.385
Consolidated comprehensive income	-	-	-	-	70.146	153	70.299	40	70.339
Capital increases (Notes 3 and 13)	52.643	612.477	(2.115)	-	-	-	663.005	-	663.005
Business combinations (Notes 3 and 13)	26.454	309.370	(349.761)	-	-	(1.938)	(15.875)	732	(15.143)
Allocation of 2016 loss	-	-	26.535	(1.754)	(24.781)	-	-	-	-
Other changes	-	-	-	-	-	1.938	1.938	-	1.938
Balance at 31 December 2017	125.863	1.332.879	(133.046)	(1.754)	70.146	(336)	1.393.752	772	1.394.524

The accompanying Notes 1 to 27 to the consolidated financial statements and Appendix I are integral part of the consolidated statement of total changes in equity for 2017.

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with the regulatory financial reporting framework applicable to the Group in Spain (see Notes 2 and 27). In the event of a discrepancy, the Spanish-language version prevails.

TESTA RESIDENCIAL SOCIMI, S.A. AND SUBSIDIARIES

CONSOLIDATED CASH FLOW STATEMENT FOR 2017

(Thousands of euros)

	Notes	31/12/2017	31/12/2016
CASH FLOWS FROM OPERATING ACTIVITIES:		56.070	(538)
Profit/(loss) for the year before tax		70.482	25.022
Adjustments to profit/loss-		(46.315)	(20.720)
Depreciation of fixed assets	Note 6	3.145	810
Change in fair value of investment property	Note 7	(65.209)	(23.953)
Impairment	Notes 8 and 11	300	65
Changes in provisions for liabilities and charges		1.019	1.170
Gains/(losses) on derecognition and disposal of non-current assets	Note 7	(286)	(163)
Financial revenue		(165)	(1)
Financial expenses		11.338	1.141
Change in fair value of financial instruments		5.542	-
Other income and expenses		(1.999)	211
Changes in working capital-		3.930	(4.458)
Trade and other receivables		(918)	(46)
Trade and other payables		(3.069)	(4.766)
Other assets and liabilities		7.917	354
Other cash flows from/(used in) operating activities-		27.973	(382)
Interest paid		(11.784)	(1.141)
Interest collection		165	1
Income tax payments	Note 17.1	(114)	(133)
Other receipts/(payments)	Note 3	39.706	891
CASH FLOWS FROM INVESTING ACTIVITIES:		(49.121)	4.687
Payments for investments-		(53.492)	-
Investment properties		(53.960)	-
Property, plant and equipment		(99)	-
Intangible assets	Note 6	(148)	-
Financial assets		715	-
Proceeds from sale of investments-		4.371	4.687
Investment properties	Note 7	4.371	4.687
CASH FLOWS FROM FINANCING ACTIVITIES:		35.408	(463)
Proceeds from and payments for equity instruments-		(2.115)	-
Payment of capital increases		(2.115)	-
Proceeds from and payments for financial liability instruments-		37.493	(463)
Proceeds from issue of bank borrowings		377.000	-
Refund on bank borrowings		(339.102)	(463)
Repayment of other debts		(405)	-
Capital increases	Note 13	30	-
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		42.357	3.686
Cash and cash equivalents at start of year		28.801	25.115
Cash and cash equivalents at end of period		71.158	28.801

accompanying Notes 1 to 27 to the consolidated financial statements and Appendix I form an integral part of the consolidated cash flow statement for 2017.

Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with the regulatory financial reporting framework applicable to the Group in Spain (see Notes 2 and 27). In the event of a discrepancy, the Spanish-language version prevails.

TESTA RESIDENCIAL, SOCIMI, S.A. and Subsidiaries

Notes to the consolidated financial statements for the year ended 31 December 2017

1. Nature and Group activity

TESTA RESIDENCIAL, SOCIMI, S.A. (hereinafter, the Parent), was formed as a public limited company with the company name Vallehermoso Patrimonio, S.A., in Madrid on 4 January 2001, before the Notary José Aristónico García Sánchez, for an indefinite period.

On 24 June 2005, the company changed its name from Vallehermoso Patrimonio, S.A. to Testa Residencial, S.L.U.

On 7 April 2006, the Sole Shareholder of Testa Residencial, S.L.U., Testa Inmuebles en Renta, S.A., entered into a public deed before the Madrid Notary José Aristónico García Sánchez, with number 836/2006 of his notarial record book, with respect to the contribution by the Sole Shareholder of the business line involving the rental of homes located in Spain, in accordance with the decision of the Board of Directors of Testa Inmuebles en Renta, S.A. on 20 December 2005.

On 8 June 2015, Merlin Properties SOCIMI, S.A. and the sole shareholder of Testa Residencial, S.L.U. (Testa Inmuebles en Renta SOCIMI, S.A.) entered into a binding agreement for the acquisition by Merlin Properties SOCIMI, S.A. of a majority stake (99.9%) in the share capital of Testa Inmuebles en Renta SOCIMI, S.A. In 2016, Merlin Properties SOCIMI, S.A. became the Parent of the Testa Inmuebles Group at Renta SOCIMI, S.A. and its subsidiaries, which included Testa Residencial, S.L.U.

On 15 September 2016, the reverse merger took place between the residential business of Merlin Properties SOCIMI, S.A. (Testa Residencial, S.L.U.) and the residential business of Metrovacesa, S.A., whereby the latter acquired control over Testa Residencial, S.L.U., although this latter legal entity was the one that survived from the standpoint of company law (see Note 3).

On 22 September 2016, the General Shareholders' Meeting requested the inclusion of the Parent in the REIT tax system (as defined below), applicable from 1 January 2016, changing its company name from Testa Residencial, S.A.U. to Testa Residencial, SOCIMI, S.A. The Parent with tax ID no. A82865890 was legally registered in the Madrid Mercantile Register.

Since 23 February 2017, the Parent's registered office has been located at Paseo de la Castellana 257 in Madrid. Previously, its registered office was found at calle Ventura Rodríguez, 7, Madrid.

The Parent's object consists of the lease of homes in Spain that have been built, promoted or acquired.

Testa Residencial, SOCIMI, S.A. and Subsidiaries (hereinafter, "the Group"), engage mainly in the acquisition and management (through leases to third parties) of homes, and may also invest to a lesser extent in other leased assets.

The tax regime of the Parent is regulated by Real Estate Investment Trust (REIT) Law 11/2009, of 26 October, amended by Law 16/2012 of 27 December. Article 3 establishes the investment requirements of this type of company, namely:

1. REITs must have invested at least 80% of the value of their assets in urban properties earmarked for lease, in land to develop properties to be used for that purpose, provided that development begins within three years following its acquisition, and in equity investments in other companies referred to in Article 2.1 of the aforementioned Law.

The value of the asset is calculated based on the average of the quarterly individual balance sheets of the year. To calculate this value, the Company may opt to substitute the carrying amount for the market value of the items contained in these balance sheets, which will apply to all the balance sheets of the year. Any money or collection rights arising from the transfer of the aforementioned properties or investments made in the year or in prior years will not be included in the calculation unless, in the latter case, the reinvestment period referred to in Article 6 of the aforementioned Law has expired.

2. Similarly, at least 80% of the rental income for the tax period corresponding to each year, excluding the rental income deriving from the transfer of ownership interests and properties used by the company to achieve its principal object, once the retention period referred to below has elapsed, should be obtained from the lease of properties and dividends or shares of profits arising from the aforementioned investments.

This percentage must be calculated on the basis of the consolidated profit if the company is the parent of a group, in accordance with the criteria established in Article 42 of the Spanish Commercial Code, regardless of its place of residence and of the obligation for formally prepare consolidated financial statements. Such a group must be composed exclusively of the REIT and the other entities referred to in article 2.1 of the aforementioned Law.

3. The properties included the REIT's assets should remain leased for at least three years. The time during which the properties have been made available for lease will be included in calculating this term, with a maximum of one year. The term will be calculated:

- a) For properties included in the REIT's assets before the company avails itself of the regime, from the beginning of the first tax period in which the special tax regime established in Law 11/2009, of 26 October, applies, provided that at that date, the asset is leased or made available for lease. Otherwise, the following shall apply.

- b) For properties developed or acquired subsequently by the Company, from the date on which they were leased or made available for lease for the first time.

- c) In the case of shares or ownership interests in the companies referred to in Article 2.1 of the aforementioned Law, these should be retained as assets of the REITs for at least three years following their acquisition or, as the case may be, from the beginning of the first tax period in which the special tax regime established in that Law applies.

As established by Transitional Provision One of Real Estate Investment Trust Law 11/2009, of 26 October, amended by Law 16/2012, of 27 December, the Company may opt to apply the special tax regime under the terms and conditions established in Article 8 of Law 11/2009, of 26 October, even if it does not meet the requirements therein, provided that such requirements are met within two years after the date of the option to apply that regime.

Failure to meet this condition will require the Parent to file corporate income tax returns under the general tax regime from the tax period in which the aforementioned condition is not met, unless the situation is rectified the following tax period. The Company will also be obliged to pay, together with the amount relating to the aforementioned tax period, the difference between the amount of tax payable under the general tax regime and the amount paid under the special tax regime in the previous tax periods, including any applicable late payment interest, surcharges and penalties.

The corporate income tax rate for REITs was set at 0%. However, where the dividends that the REIT distributes to its shareholders holding an ownership interest exceeding 5% are exempt from tax or are subject to tax rate lower than 10%, the REIT shall be subject to a special charge of 19%, which shall be considered to be the corporate income tax charge, on the amount of the dividend distributed to these shareholders. If applicable, this special charge must be paid by the REIT within two months after the dividend payment date.

The 2016 separate financial statements of Testa Residencial, SOCIMI, S.A., which were authorised for issue by the Directors, were adopted at the Annual General Meeting of 30 June 2017. The separate financial statements of the other company within the Group, Metrovacesa Alquileres Urbanos, S.L.U. (currently, "Testa Alquileres Urbanos S.L.U.") for 2016, prepared by its corresponding Sole Director, were approved by the Sole Shareholder on 30 June 2017.

The consolidated financial statements were authorised for issue by the Board of Directors of Testa Residencial, SOCIMI, S.A. at its meeting of 26 March 2018. They will be submitted for approval, along with the financial statements of subsidiaries, by the respective Annual General Meetings, and it is considered that they will be approved without any changes.

In view of the business activities currently carried out by the Group, 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, no specific disclosures relating to environmental issues are included in these consolidated financial statements.

2. Basis of presentation of the consolidated financial statements and basis of consolidation

2.1 Regulatory framework

The regulatory financial reporting framework applicable to the Group consists of:

- The Code of Commerce and other corporate legislation,
- The International Financial Reporting Standards (IFRSs) as adopted by the European Union in accordance with Regulation (EC) No. 1606/2002 of the European Parliament and Spanish Law 62/2003, of 30 December, on tax, administrative and social order measures.
- Law 11/2009, of 26 October, amended by Law 16/2012, of 27 December, regulating Real Estate Investment Trusts (REITs) and all other Spanish corporate law.
- All other applicable Spanish accounting regulations.

2.2 Bases of presentation of the consolidated financial statements

The consolidated financial statements for 2017 were obtained from the accounting records of the Parent and of the companies included in the scope of consolidation, and they were prepared in accordance with the financial reporting regulatory framework detailed in Note 2.1 above; accordingly, they present fairly the Group's consolidated equity and consolidated financial position at 31 December 2017 and the consolidated results of its operations, the changes in consolidated equity and the consolidated cash flows generated at the Group in the year then ended.

As described in Note 3, in relation with the integration agreement of the residential businesses of Metrovacesa, S.A. and Testa Residencial SOCIMI, S.A. in 2016, the directors of the Parent have estimated that, given the shareholders of Metrovacesa, S.A. acquired the majority of the voting rights over Testa Residencial SOCIMI, S.A. once the integration was completed, such transaction is, by accounting analogy, a reverse acquisition in which the residential business of Metrovacesa, S.A. is the acquirer.

In reaching that conclusion the Group took into account, primarily, the economic substance of the transaction considering that the residential business of Metrovacesa, S.A. can be treated as a reporting entity. However, as this specific transaction is not considered under IFRS-EU, to make this judgment the directors of the Parent have applied what is established in paragraphs 10 and 12 of IAS 8, to consider, by analogy, the pronouncements of other standard-setting bodies that use a similar conceptual framework to IFRS-EU to develop accounting standards. In this particular case, the directors of the Parent have considered the Recognition and Measurement Standard 19.2.1 of the Spanish General Accounting Plan that indicates that "the acquirer is the company that obtains control of the acquired business or businesses. For the purposes of this standard, the acquirer could also be a part of a company which, as a result of the combination, is spun off from the entity of which it formed part and obtains control over another business or other businesses."

The maximum impact on the consolidated financial statements for the year 2017 of the application by the Group of an alternative criteria in relation to this transaction as describe in Note 3 would have not been significant. In this sense, the maximum impact estimated by the directors of the Parent would be a decrease of 67.7 million euros in total equity and total assets of the Group, a 4.8% and 2.8%, respectively, compared to the amounts shown in the consolidated statement of financial position as of 31 December 2017, being this impact not significant.

Given that the accounting policies and measurement bases applied in preparing the Group's consolidated financial statements for the year 2017 may differ from those applied by some of the companies making up the Group, the necessary adjustments and reclassifications have been made in the consolidation process to unify these policies and basis and to adapt them to the IFRSs adopted by the European Union.

In order to present the various items that make up the consolidated financial statements on a consistent basis, the accounting policies and measurement bases used by the Parent were applied to all the companies included in the scope of consolidation.

2.2.1 First application of International Financial Reporting Standards

The consolidated financial statements for the year 2017 are the first that the Group presents in accordance with IFRS-EU, because in the year ended 31 December 2016 the Parent Company was exempt from consolidation, under the prevailing legislation, since it only held equity interests in subsidiaries that did not own a significant interest, neither individually nor as a whole, to present fairly the equity, financial position and results of the Group companies.

The Group has considered 15 September 2016 as the date of transition to IFRS-EU, the same day on which the reverse acquisition of the residential businesses of Metrovacesa, S.A. (economic acquirer) and Merlin Properties, SOCIMI, S.A. (Testa Residencial, S.L.U.), and therefore the formation of the Group, took place.

According to the above, these financial statements do not include any reconciliation between the previous GAAP (Spanish General Accounting Plan) and IFRS-EU.

As to application of IFRS, the main options taken by the Group are as follows:

- Items on the consolidated statement of financial position were to be classified as current or non-current.
- Itemise expenses on the consolidated income statement by nature.
- The consolidated statement of cash flows is presented using the indirect method.
- Income and expense is presented in two separate statements: a consolidated income statement and a consolidated statement of comprehensive income.
- The residential rental business of Metrovacesa, S.A. (economic acquirer) opted to reevaluate to fair value its investment property and concession projects and to use such fair value as the deemed cost at the transition date. The effect of this option, expressly allowed by IFRS 1, is as follows:

	Thousand euros		
	Previous GAAP amounts	Fair Value adjustment	IFRS deemed cost
Concession projects	10.600	69.455	80.055
Investment property	622.266	14.785	637.051
Deferred tax liabilities	-	(17.436)	(17.436)
Total net assets	632.866	66.804	699.670

To estimate the fair value of the concession projects (which have an specific real estate nature as are based on the surface rights granted by the Basque government for housing building and renting) and investment property, the Group has used independent experts' appraisals. The estimated tax effect associated with the fair value adjustments amounted to 17,436 thousand euros, which has been recorded in the "Deferred tax liabilities" line item of the consolidated statement of financial position.

2.2.2 Adoption of International Financial Reporting Standards effective beginning on or after 1 January 2017

The following standards and amendments and interpretations of standards became effective in 2017, and have been used by the Group, where applicable, in preparing the 2017 consolidated financial statements:

Standards, Amendments and Interpretations	Description	Obligatory application in annual reporting periods beginning on or after:
Amendment to IAS 7 Disclosure Initiative (published in January 2016)	Introduces additional disclosure requirements in relation to the reconciliation of the movement of financial liabilities with the cash flows from financing activities.	1 January 2017
Amendments to IAS 12 Recognition of Deferred Tax Assets for Unrealised Losses (issued in January 2016)	Clarification of the principles established in relation to the recognition of deferred tax assets for unrealised losses.	1 January 2017
Improvements to IFRS 2014-2016 Cycle (clarification in respect of IFRS 12)	Clarification in respect of the scope of IFRS 12 and its interaction with IFRS 5.	1 January 2017

The standards and amendments did not have a material impact on the consolidated financial statements for 2017.

All accounting policies and measurement bases with a material effect on the consolidated financial statements were applied.

2.2.3 Standards not in force in 2017

The following standards had not come into force in 2017, either because their effective date is subsequent to the date of the consolidated financial statements or because they had not yet been adopted by the European Union:

Standards, Amendments and Interpretations	Description	Obligatory application in annual reporting periods beginning on or after:
IFRS 15 Revenue from Contracts with Customers (issued in May 2014).	New standard for recognising revenue. Supersedes IAS 11, IAS 18, IFRIC 13, IFRIC 15, IFRIC 18 and SIC-31. The new IFRS 15 model is much more restrictive and, in addition to adopting a very different approach, is based on rules and, therefore, the application of the new requirements may give rise to changes in the revenue profile.	1 January 2018
IFRS 9 Financial Instruments (published in July 2014)	This new standard will supersede the current IAS 39. The change in concept is significant in all sections. This changes the classification and measurement model for financial assets whose central axis will be the business model. The focus of the hedge accounting model aims for closer alignment with economic risk management and demands fewer rules. Lastly, the impairment model changes from the current incurred losses to a forecast losses model.	1 January 2018
Clarifications to IFRS 15 (published in April 2016)	Relates to identification of performance obligations, principal versus agent considerations, the granting of licences and their transfer at a point in time or over time, and clarifications on transition rules.	1 January 2018
IFRS 16 Leases (issued in January 2016)	A new standard on leases which supersedes IAS 17. It proposes an accounting model unique for lessees, which will include all leases in the balance sheet (with a few limited exceptions) with similar impact to that of current financial leases.	1 January 2019
IFRS 17 Insurance Contracts (issued in May 2017)	Replaces IFRS 4. Sets out the recognition, measurement, presentation and disclosure requirements for insurance contracts, so that entities provide relevant and reliable information allowing users to determine the effect that the contracts have on the financial statements.	1 January 2021 (1)
Amendments to IFRS 2 Classification and Measurement of Share-based Payment Transactions (issued in June 2016)	These are limited amendments that clarify specific matters such as the accounting for the effects of vesting conditions on cash-settled share-based payment transactions, the classification of share-based payment transactions with net settlement clauses and certain aspects of the modifications to the type of share-based payment.	1 January 2018 (1)
Amendments to IAS 40 Reclassification of Investment Property (issued in December 2016)	The amendment clarifies that a reclassification of an investment as investment property shall only be permitted when it can be demonstrated that there has been a change in use.	1 January 2018 (1)
Improvements to IFRSs 2014-2016 Cycle (issued in December 2016)	Minor amendments to a series of standards (different effective dates)	1 January 2018
IFRIC 22 Foreign Currency Transactions and Advance Consideration (issued in December 2016)	This interpretation establishes the "transaction date" in order to establish the exchange rate applicable to transactions with advance considerations in foreign currency.	1 January 2018 (1)
IFRIC 23 Uncertainty over Income Tax Treatments (issued in June 2017)	This interpretation clarifies how to apply the recognition and measurement criteria set out in IAS 12 when there is uncertainty regarding whether a tax authority will accept a given tax treatment applied by the entity.	1 January 2019 (1)
Amendments to IFRS 9 Prepayment Features with Negative Compensation (issued in October 2017)	Enables certain financial instruments with prepayment features to be measured at amortised cost, enabling the payment of a lower amount than the unpaid amounts of capital and interest.	1 January 2019 (1)
Amendments to IAS 28 Investments in Associates and Joint Ventures (issued in	Clarifies that IFRS 9 must be applied to long-term investments in associates or joint ventures if the equity	1 January 2019 (1)

Standards, Amendments and Interpretations	Description	Obligatory application in annual reporting periods beginning on or after:
October 2017)	method is not applied.	
Improvements to IFRS 2015-2017 Cycle (issued in December 2017)	Minor amendments to certain standards	1 January 2019 (1)
Amendment to IAS 19, on Plan Amendment, Curtailment or Settlement (issued in February 2018)	In accordance with the proposed amendments, if a defined benefit plan is changed (owing to an amendment, curtailment or settlement), the entity must use updated assumptions to determine service cost and net interest for the period after the plan we measurement.	1 January 2019 (1)
Amendment to IFRS 10 and IAS 28, Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	A very significant clarification in relation to the result of these operations, because there had been a discrepancy between the standards. When concerning a business, a full gain or loss will be recognised and should the object of the transaction be assets, a partial gain or loss will be recognised.	Its adoption in the EU and its application in accordance with IASB has been deferred indefinitely.

(1) Not yet adopted by the European Union.

In relation to IFRS 15, the Group considers that the impact of its application will not be significant, to the extent that such standard excludes the lease arrangements from its scope, which continue to be regulated by the accounting standard (IAS 17/IFRS 16). Given the obligations arising under the SOCIMI statutory scheme, the Group has no significant income other than lease income.

With regard to IFRS 9, the Group does not deem its impact to be material to the extent that no refinancing has occurred, derivative instruments arranged by the Group come under the same recognition and measurement criteria under the new standard as under IAS 39, and the balance of accounts receivable is not significant either, taking into account that the insolvency risk is less than 1% of revenue.

The Group is currently assessing the impact of the future application of the standards – which is mandatory from 1 January 2019 onwards – on the consolidated financial statements once they enter into force. It cannot reasonably estimate the impact until this analysis is complete. IFRS 16 Leases will supersede the current IAS 17 and will be effective as of 1 January 2019. The main change is that it includes a single accounting model for lessees, including all leases in the statement of financial position (with certain limited exceptions) as if they were financed purchases, with a similar impact to that of current finance leases. In contrast, lessor accounting will continue to use a dual model, similar to IAS 17. The Group accordingly believes the impact of adoption of this standard will be immaterial.

2.3 Functional currency

The presentation currency of the consolidated financial statements is the euro, which is the Group's functional currency.

2.4 Comparison of information

The information contained in the consolidated financial statements for 2016 is presented solely for comparison purposes with the information relating to the year ended 31 December 2017.

As indicated in Note 3, in September 2016, a reverse merger took place between Testa Residencial, SOCIMI, S.A. and the residential business of Metrovacesa, S.A., with the latter being the acquiring company. Hence the consolidated income statement for 2016 comprises only the period elapsed after the business combination date, i.e., three months, since Metrovacesa's residential business lacked separate financial statements, as they were included in those of Metrovacesa, S.A.

2.5 Responsibility for information and estimates

The information included in these consolidated financial statements is the responsibility of the Parent's directors.

In the Group's consolidated financial statements for 2017, estimates were occasionally made by the senior executives of the Group and of the consolidated companies, later ratified by the directors, in order to quantify certain of the assets, liabilities, income, expenses and obligations reported herein. These estimates relate basically to the following:

1. The market value of the net assets acquired in business combinations (see Note 3).
2. The market value of the Group's investment property (see Note 5.2). The Group obtained valuations from independent experts at 31 December 2017.
3. The fair value of certain financial instruments (see Note 5.6).
4. The measurement of provisions and contingencies (see Note 5.11).
5. Management of financial risk and, in particular, of liquidity risk (see Note 24).
6. The recovery of deferred tax assets and the tax rate applicable to temporary differences (see Note 5.13).
7. The definition of the transactions performed by the Group as a business combination pursuant to IFRS 3 or as an asset acquisition (see Note 3).
8. Compliance with requirements regulating Real Estate Investment Trusts.
9. In the opinion of the Directors of the Parent Company, at 31 December 2017 the Parent Company and its subsidiaries were compliant with the requirements under the SOCIMI (Spanish REIT) statutory scheme, except the requirement relating to listing its shares on the stock exchange, the deadline for which is 22 September 2018.

At its meeting of 30 November 2017, the Board greenlighted the start of the process for listing the Parent Company's shares on Spain's "continuous market" in the coming months. For this reason, having regard to the support from shareholders, the Directors of the Parent Company believe that the listing requirement will be satisfied before the deadline, and are confident that the Parent Company will remain within the SOCIMI scheme.

Changes in estimates:

Although these estimates were made on the basis of the best information available at 31 December 2017, future events may require these estimates to be modified prospectively (upwards or downwards), in accordance with IAS 8. The effects of any change would be recognised in the corresponding consolidated income statement.

2.6 Consolidation principles applied

The companies over which the Group can exercise effective control by virtue of ownership of a majority of the voting rights in their representation and decision-making bodies and the power to govern their financial and operational policies were fully consolidated; and, where appropriate, the companies over which there is a significant influence but not ownership of a majority of the voting rights and the ownership interest held is over 20% were accounted for using the equity method. At 31 December 2017 and 2016, there was no Group company accounted for using the equity method.

In order to bring the accounting policies of Group companies into line with those used by the Parent, certain uniformity adjustments were made, including most notably the application of IFRSs to all Group companies.

It was not necessary to make any timing uniformity adjustments since the reporting periods of all the Group companies and associates end on 31 December 2017.

2.6.1 Subsidiaries

Subsidiaries are companies that the Parent controls, either directly or indirectly, through its subsidiaries. The Parent has control over a subsidiary when it is exposed, or has rights to variable returns from its involvement with the investee, and when it has the ability to use its power to affect its returns. The Parent has power when the voting rights are sufficient to give it the ability to direct the relevant activities of the investee. The Parent is exposed, or has rights, to variable returns from its involvement with the subsidiary when its returns from its involvement have the potential to vary as a result of the subsidiary's performance.

The financial statements of the subsidiaries are consolidated with those of the Parent using the full consolidation method. Accordingly, all material balances and effects of the transactions between consolidated companies are eliminated on consolidation.

Interests owned by third parties in Group equity and third parties' share in profit or loss for the year are recorded under "Non-controlling Interests" in the consolidated statement of financial position, consolidated income statement and consolidated statement of comprehensive income.

The results of subsidiaries that are acquired or sold during 2017 are included in the consolidated income statement from the effective date of acquisition or until the effective date of disposal, as appropriate.

2.6.2 Transactions between Group companies

Gains or losses on internal transactions between consolidated companies are eliminated and deferred until they are realised with third parties outside the Group. Group work on in-house non-current assets is measured at production cost, eliminating the intra-group results. Receivables and payables between companies included in the consolidated group were eliminated from the consolidated financial statements, together with intra-Group income and expenses included in this group.

2.6.3 First-time consolidation differences

On acquisition, the assets and liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired and liabilities assumed is recognised as goodwill. When the cost of acquisition is lower than the fair value of the identifiable net assets acquired and liabilities assumed, in other words, the acquisition is completed at a discount, the measurements of net assets and liabilities are reviewed and the difference is recognised, where appropriate, in profit/loss in the acquisition period.

2.6.4 Business combinations

The Group accounts for business combinations using the acquisition method. The acquisition date is the date on which the Group obtains control of the acquiree.

The consideration transferred is the sum of the acquisition-date fair values of the assets given, the liabilities incurred or assumed facing the former owners and the equity interests issued by the Group in exchange for control over the acquiree. Acquisition-related costs, such as professional fees, do not form part of the cost of the business combination and are taken to the consolidated income statement.

Meanwhile, any contingent consideration is measured at the acquisition-date fair value. Subsequent changes in the fair value of the contingent consideration are recognised in consolidated profit or loss for changes that arise from events occurring after the acquisition date, such as fulfilling a profit target, reaching a certain share price or achieving a milestone in a research and development project. However, changes in the fair value of contingent consideration recognised by the acquirer after the acquisition date as a result of further information that becomes available to the acquirer after that date as to facts and circumstances already existing at the acquisition date constitute adjustments to the measurement period, which involve a modification of goodwill.

Goodwill is measured as the aggregate of the consideration transferred, the non-controlling interests and the fair value of any previously acquired interest, less the net fair value on the acquisition date of identifiable assets acquired

and liabilities assumed.

If the acquisition cost of the net identifiable assets acquired and liabilities assumed is lower than their net fair value, this lower value is recognised in the consolidated income statement for the year.

2.6.5 Changes in the scope of consolidation

The changes in the scope of consolidation of the Testa Group (comprising Testa Residencial, SOCIMI, S.A. and its subsidiaries) in 2017 were as follows:

Inclusions of companies in the scope of consolidation

In 2017, and following the business combination with Acciona Real Estate S.L. described in Note 3, Compañía Urbanizadora del Coto, S.L. and Valgrand 6, S.A.U. were included in the scope of consolidation.

Exclusions from scope of consolidation

In 2017, no companies were excluded from the Group's scope of consolidation.

2.6.6 Scope of consolidation

The companies forming the Testa Residencial, SOCIMI, S.A. and Subsidiaries Group at 31 December 2017, together with the information relating to the consolidation method are detailed in Appendix I to the consolidated financial statements.

3. Changes in the scope of consolidation and other variations

2017-

Non-monetary contribution of investment property from shareholder financial institutions

On 30 January 2017, the Extraordinary General Shareholders' Meeting of the Parent signed a non-monetary capital increase agreement, through the contribution of residential investment property, mainly from the Group's shareholder financial institutions, Banco Santander, S.A. Banco Bilbao Vizcaya Argentaria S.A. and Banco Popular, S.A. On 7 March 2017, this operation was ratified by the Parent's General Shareholders' Meeting in the amount of 659,723 thousand euros, through the contribution of 60 residential developments. The resolutions adopted by the respective shareholders' meetings were filed at the Companies Registry on 3 April 2017.

As consideration for the investment property received, the Parent performed a capital increase, through the issuance of 5,221,817,098 new shares of 0.01 euros par value each, with an issue premium of 0,11633977722 euros per share issued.

Integration agreement with the residential business of Acciona Real Estate, S.L.

On 27 July 2017, the Parent signed an agreement to take on the residential rentals business of Acciona Real Estate, S.L., in order to maintain its leadership position on the Spanish residential rental asset market. On 14 September 2017, it was ratified by the General Shareholders' Meetings of the Parent and Acciona Real Estate, S.L. The resolutions adopted by the respective shareholders' meetings were filed in the Companies Registry on 17 October 2017.

The operation was organised through the contribution to the Group of the residential business of Acciona Real Estate, S.L., consisting of 99,655% of the equity interests of Compañía Urbanizadora del Coto, S.L., all of the equity interests of Valgrand 6, S.A.U. and certain homes located in Lérida. As consideration, the Parent performed a capital increase, through the issuance of 2,645,404,051 shares of 0.01 euros par value each, with an issue premium of 0,116946213484044 euros per share issued. In accordance with the partners agreement subscribed with Acciona Real Estate, S.L., the contributions made by the latter, once the commitment the Parent has with one of its shareholders is capitalized (see Note 26), must not be less than 20% of the Group's value at the date of the

agreement, having only to make a cash compensation in case the stake of Acciona Real Estate, S.L. is below the aforementioned value.

The Parent estimates that it must pay to Acciona Real Estate, S.L. and amount of 5,400 thousand euros, which is recognised under "Current payables to related companies" in the accompanying consolidated statement of financial position (see Note 20.2).

Moreover, the shareholder agreement stipulates at clause 8.7 that if the Group fails to list its shares on the stock exchange before 21 September 2022, Acciona Real Estate S.L. may, within the six months following that date, exercise an option to redeem the shares subscribed for in the context of the contribution referred to above. In exchange, Acciona Real Estate, S.L. would receive an amount equal to the percentage represented by its shares of the Group's EPRA NAV at the date of redemption. Settlement would be made, at the Parent's election, in cash or by means of transferring the assets received in the context of the contribution made in 2017, and if this were the case, the difference with respect to the Group's EPRNAV at the date of the amortisation would be settled in cash.

Under prevailing accounting rules and standards, the right held by Acciona Real Estate, S.L. represents for the Group a potential obligation to repurchase shares issued for the purpose of the capital increase subscribed for by Acciona Real Estate, S.L. The Group has accordingly recognised a non-current liability measured as the present value of that obligation, using a discount rate equivalent to the Group's incremental interest rate which initially came to 349,761 thousand euros, within "Other non-current liabilities" in the consolidated statement of financial position. The liability is later carried at fair value, with changes in value being taken to the consolidated income statement.

The Directors of the Parent believe it is highly probable the Group will list its shares on the stock exchange before 21 September 2022, and Acciona Real Estate S.L.'s option to redeem its shares will lapse, such that the liability will immediately become equity for the same amount.

The summary of this business combination is as follows:

	Thousands of euros		
	Carrying amount	Fair Value	adjustment value
Investment property (Note 7)	332,313	81,288	413,601
Service concession arrangements (Note 8)	1,993	973	2,966
Non-current financial assets	1,082	-	1,082
Deferred tax assets (Note 17.3)	10,706	-	10,706
Other property, plant and equipment	40,540	-	40,540
Deferred tax liabilities (Note 17.4)	(39,657)	(5,903)	(45,560)
Non-current liabilities	(79,563)	-	(79,563)
Current liabilities	(1,388)	-	(1,388)
Total net assets included	266,026	76,358	342,384
Non-controlling interests included			(732)
Consideration transferred (a)			341,652
Goodwill (negative difference) arising on the business combination			-

- (a) The fair value of the consideration transferred was calculated by applying to issued shares (2,645,404,051) the value of the Group (€0,126946213484044) as at 14 September 2017, the date of transfer of control, increased by 5,400 thousand euros in respect of the obligation arising to compensate for the decrease of the Group value to below 20%. The integration agreement of the business of Acciona Real Estate, S.L. did not include any other type of contingent consideration.

In order to estimate the fair value of the net assets of the Acciona Real Estate, S.L. business, which mainly engages in real estate, the Parent used appraisals performed by independent experts not related to the Group. The tax effect estimated by the Group's directors associated with the recognition of such increased value amounted to 5,903 thousand euros, which was recognised under "Deferred tax liabilities" in the accompanying consolidated statement of financial position (see Note 17.4).

This transaction was performed in accordance with the special tax system envisaged in Chapter VII of Title VII of article 89 of the Corporate Income Tax Law 27/2014, of 27 November. The tax benefits received for the integration of the business of Acciona Real Estate, S.L. relate mainly to deferred tax assets and liabilities amounting to 10,706 thousand euros and 41,756 thousand euros, respectively (see Note 17).

The associated transaction costs in the operation amounted to 554 thousand euros, and were recognised under "Other operating expenses" in the accompanying 2017 consolidated income statement.

The fair value of the accounts receivable acquired, mainly of a commercial nature, amounted to 680 thousand euros and did not differ from its gross contractual amounts. The Directors do not consider that, at the acquisition date, there were signs that such accounts would not be collected in full.

The net profit and the revenue obtained from Acciona Real Estate, S.L.'s residential business incorporated in 2017 and included in the 2017 consolidated income statement amounted to 11,370 thousand euros and 2,890 thousand euros, respectively.

Had the business been acquired on 1 January 2017, the net profit would have risen by 10,107 thousand euros, and the income contributed to the Group would have risen by 8,786 thousand euros, approximately, in comparison with these financial statements. The directors consider that these proforma figures represent a reasonable estimate of annual performance of the new business combination and constitute an initial benchmark for comparison with future years. In order to determine these proforma revenue and profit/loss, the Group's management took into account the following:

- The impairment on non-current assets was calculated on the basis of their fair values at the date of the business combination.
- Finance costs have been calculated on the basis of the debt position following the business combination.

Net cash flows from the acquisition-

	Thousands of euros
Cash paid	-
Cash and cash equivalents included	39,706
Total	39,706

In any case, in conformity with IFRS 3, these initial estimates are provisional and the Group has a one-year period to adjust them in line with any subsequent more significant or complete information that it could receive.

2016 -

Integration agreement of the residential businesses of Metrovacesa, S.A. and Merlin Properties SOCIMI, S.A. (sole shareholder of Testa Residencial S.L.U.)

On 21 June 2016, Merlin Properties SOCIMI, S.A. (Sole Shareholder of Testa Residencial, S.L.U.) signed on that date an integration agreement with Metrovacesa, S.A. and its main shareholders (Banco Santander, S.A., Banco Bilbao Vizcaya Argentaria, S.A. and Banco Popular Español, S.A.) in order to create one of the main Spanish real estate companies engaging in leased residential assets. On 26 August 2016, the integration was approved by the Spanish competition authorities and on 15 September 2016 it was approved by the General Shareholders' Meetings of Merlin Properties SOCIMI, S.A. and Metrovacesa, S.A. The resolutions adopted by the respective shareholders' meetings were filed in the Companies Registry on 26 October 2016.

The transaction was performed through the total spin-off of Metrovacesa, S.A., leading to the extinguishment of that company and to the integration into the Parent of the residential business unit of Metrovacesa, consisting of the residential real estate assets earmarked for lease (including part of the Metrovacesa Group's personnel and residential assets, shares or equity interests in subsidiaries or investees, contracts and, in general, all non-financial assets and liabilities of Metrovacesa associated with residential assets and, additionally, 250 million euros of financial debt). As consideration for the business received, Testa Residencial S.L.U. (currently Testa Residencial, SOCIMI, S.A.) performed a capital increase, through the issuance of 3,075,278,154 shares of 1 eurocent par value each, with an issue premium of 0,133656923 euros per share issued. This increase was fully subscribed by the shareholders of Metrovacesa, S.A. As a result of this transaction, the shareholders of Metrovacesa, S.A. acquired 65.76% of the Parent's share capital (Banco Santander 46.21%, Banco Bilbao Vizcaya Argentaria 13.34% and Banco Popular 6.21%).

The following aspects have been considered with respect to the recognition of the transaction for accounting purposes:

- The integration of the residential businesses of Testa Residencial and Metrovacesa, in line with that stipulated in the international financial reporting standards (IFRSs), is a reverse acquisition due to, among other reasons, the preexisting shareholders of Metrovacesa maintain the majority of the voting rights in the resulting entity (Testa Residencial SOCIMI, S.A.), all this considering that the residential rental business of Metrovacesa is a "reporting entity" itself in conformity with Exposure Draft ED 2015/3 on the accounting framework and, therefore, the interpretation of IFRIC reached in September 2011, that concluded that an acquirer which is a "reporting entity" but not a "legal entity" can be considered as the acquirer in a reverse acquisition. The net assets of Testa Residencial (the business acquired from an economic point of view), in accordance with IFRS 3, are incorporated at fair value at the business combination date, as follows:

	Thousands of euros		
	Carrying amount	Value Fair	adjustment included
Intangible assets	14,149	65,943	80,092
Investment property	116,671	139,153	255,824
Service concession arrangements	3,392	759	4,151
Other non-current assets	1,997	-	1,997
Deferred tax assets	266	-	266
Current assets	2,420	-	2,420
Deferred tax liabilities	-	(43,216)	(43,216)
Non-current provisions	-	(108,563)	(108,563)
Non-current liabilities	(112,750)	-	(112,750)
Current liabilities	(2,403)	-	(2,403)
Total net assets	23,742	162,639	186,381
Fair value of consideration received (a)			186,381
Goodwill (negative difference) arising on the business combination			-

(a) Based on the number of equity instruments of the residential business operated by Metrovacesa, S.A. that would have had to have been issued to give Merlin Properties SOCIMI, S.A. a 34.33% stake in the combined entity arising from the reverse takeover.

In accordance with accounting regulations relating to reverse acquisitions, the Group's combined initial equity relates to Metrovacesa's residential business, plus the increased assets equivalent to the fair value of the net assets of Testa Residencial, SOCIMI, S.A., although the share capital corresponds to that of Testa Residencial, SOCIMI, S.A., the company that legally remains.

In order to estimate the fair value of the net assets of the company, which mainly engages in real estate, the Group used appraisals performed by independent experts. The tax effect estimated by the Group's directors associated with the recognition of such increased value amounted to 43,216 thousand euros, which was recognised under "Deferred tax liabilities" in the accompanying consolidated statement of financial position.

This operation was performed in accordance with the special tax system envisaged in Chapter VII of Title VII of article 89 of the Corporate Income Tax Law 27/2014, of 27 November. The tax effects of the business combination related chiefly to deferred tax assets and liabilities, which came to 266 thousand euros and 43,216 thousand euros, respectively (see Note 17). The residential businesses recognised in the aforementioned business integration did not include unused tax loss carryforwards or tax credits.

Transaction costs came to 1,394 thousand euros, and were recognised in the consolidated income statement for 2016.

The fair value of the accounts receivable recognised, mainly of a commercial nature, amounted to 196 thousand euros and did not differ from its gross contractual amounts. The directors of the Parent did not consider that, at the acquisition date, there were signs that such accounts would not be collected in full.

Net cash flows from the acquisition-

	Thousands of euros
Cash paid	-
Cash and cash equivalents included	891
Total	891

4. Appropriation of profit of the Parent

The proposed distribution of the loss for 2017 put forward by the directors of the Parent, which is yet to be approved by the General Shareholders' Meeting, is as follows:

	euros
Basis of apportionment: Loss for the year	(10,161,937.59)
Application: Prior years' losses	(10,161,937.59)

5. Accounting policies

The main accounting principles, policies and measurement criteria applied by the Group in preparing the consolidated financial statements, which comply with the IFRS in force at the date thereof, are detailed below:

5.1 Intangible assets

This heading includes the computer software and intangible assets relating to concession projects. They are stated at acquisition or production cost, less accumulated amortisation and accumulated impairment losses. An intangible asset shall be recognised if, and only if, it is probable that the expected future economic benefits attributable to the asset will flow to the Group, and its cost can be measured reliably.

The gain or loss on the derecognition of an intangible asset is calculated as the difference between the net profit on the sale and the carrying amount of the asset, and is recognised in the separate consolidated income statement when the asset is derecognised.

Computer software

“Computer software” includes the amount of the computer programmes, acquired from third parties, exclusively in those cases in which it is envisaged that it will be used over various years. It is amortised over its useful life, which is commonly four years.

Concession projects

This heading includes the administrative concessions, which are stated at acquisition or production cost, less accumulated amortisation and accumulated impairment losses.

The administrative concession recorded in the business integration described in Note 5 has been recorded at fair value on the date of said integration, and it is amortised on a straight-line basis over the years of the concession.

The gain or loss on the derecognition of a concession project is calculated as the difference between the net profit on the sale and the carrying amount of the asset, and is recognised in the separate consolidated income statement when the asset is derecognised.

This heading includes the “Bentaberri” concession in San Sebastián (Guipúzcoa). It is amortised on a straight-line basis over the concession period, which ended in 2069, with a total initial duration of 75 years. This concession was granted by the Basque Government.

5.2 Investment property

Investment properties are properties held to earn rentals and/or for capital appreciation or both (including property under construction for such purposes) rather than for use in production or supply of goods or services or for administrative purposes of the Group or for sale in the ordinary course of business.

All assets classified as investment property are leased by various tenants. These properties are held for lease to third parties. The directors of the Parent are not considering the disposal of these assets in the near term and, accordingly, have decided to keep them as investment property in the consolidated statement of financial position.

Investment property is stated at fair value at the end of the reporting period and is not depreciated. Investment property comprises land, buildings or other constructions held to earn rents or for capital appreciation upon disposal due to future increases in their respective market prices.

Gains or losses arising from fluctuations in the fair value of investment property are taken to profit or loss in the same period in which they occur.

While construction work is in progress, the costs of construction work and finance costs are capitalised. When the asset is put to use, it is recognised at its fair value.

In accordance with IAS 40, the Group periodically determines the fair value of its investment property so that, at year end, the fair value reflects the market conditions of the items of investment property at that date. Fair value is determined half-yearly based on independent expert appraisals.

The fair value of the investment property was calculated by independent valuers in accordance with the Appraisal and Valuation Standards issued by the Royal Institute of Chartered Surveyors (RICS) of the United Kingdom, and the International Valuation Standards (IVS) issued by the International Valuation Standards Committee (IVSC). The methodology used to calculate the fair value of investment property is detailed in Note 7.

5.3 Impairment of intangible assets

At least at year-end the Group reviews the carrying amounts of its intangible assets to determine whether there is any indication that those assets might have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) 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 (cash-generating unit) in prior years.

The fair value of the concession project was calculated by independent valuers in accordance with the Appraisal and Valuation Standards issued by the Royal Institute of Chartered Surveyors (RICS) of the United Kingdom, and the International Valuation Standards (IVS) issued by the International Valuation Standards Committee (IVSC). The methodology used to calculate the fair value of investment property is detailed in Note 7.

5.4 Leases

5.4.1 Classification of leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially the risks and rewards of ownership to the Group, which usually has an option of acquiring the asset at the end of the lease under the conditions agreed when the transaction was arranged. Other leases are classified as operating leases.

All the Group's leases are classified as operating leases.

5.4.2 Lessor accounting

Operating leases

Assets leased out under operating leases are presented according to the nature of the asset.

Rental income from operating leases, net of incentives granted, is recognised on a straight-line basis over the lease term.

Contingent rents are recognised as income when it is probable that they will be obtained, which is generally when the conditions agreed in the contract are met.

5.4.3 Lessee accounting

Operating leases

Operating lease payments, net of incentives received, are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern of the proceeds from the leased asset.

The Group recognises the initial direct costs incurred in operating leases as an expense when incurred. Contingent rents are charged as expenses when it is probable that they will be incurred.

5.5 Financial instruments

Financial instruments are classified on initial recognition as a financial asset, a financial liability or an equity instrument in accordance with the economic substance of the contractual arrangement and the definitions of a financial asset, a financial liability or an equity instrument set out in IAS 32 "Financial Instruments: Presentation".

Financial instruments are recognised when the Group becomes party to the contract or legal transaction, in accordance with the provisions thereof.

For measurement purposes, financial instruments are classified as financial assets and liabilities at fair value through profit or loss, separating those initially designated from those held for trading, loans and receivables, held-to-maturity investments, available-for-sale financial assets and financial liabilities at amortised cost. The classification in the aforementioned categories is performed on the basis of the characteristics of the instrument and the Group's intention upon initial recognition.

Financial assets

Financial assets are recognised in the consolidated statement of financial position when they are acquired and are initially measured at fair value. The financial assets held by the Group companies are classified as:

1. Loans and receivables are initially measured at the fair value of the consideration given plus directly attributable transaction costs and, thereafter, at amortised cost. The Group has recognised provisions to cover uncollectability risks. These provisions are calculated according to the probability of recovering the debt based on its age and the debtor's solvency. At 31 December 2017, the fair value of these assets was not materially different from their value in the consolidated statement of financial position.
2. Held-to-maturity investments: assets with fixed or determinable payments and fixed maturity dates that the Group has the positive intent and ability to hold to maturity.

The concession agreements whose consideration received consists of an unconditional right to receive cash or another financial asset, are classified as a financial asset within the category of loans and receivables. These are initially valued at the fair value of the service rendered, which in principle equates to the cost plus the construction margin.

In the case of concession agreements classified as financial assets, replenishment actions, major repairs, those necessary to revert and / or conserve the infrastructure, as well as improvements or expansions of capacity, originate the recognition of the corresponding financial asset. The financial expenses accrued until the infrastructure is in operating conditions, as well as those that occur subsequently, are charged to the consolidated income statement at the time of accrual

At least at each reporting date, the Group tests its financial assets not measured at fair value for impairment. 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 consolidated income statement.

The Group derecognises a financial asset when the rights to cash flows from the asset expire or have been transferred and substantially all the risks and rewards of ownership of the financial asset have been transferred. However, the Group does not derecognise financial assets and recognises a financial liability for an amount equal to the consideration received, in transfers of financial assets in which substantially all the risks and rewards of ownership are retained.

Financial liabilities

The main financial liabilities held by Group companies are held-to-maturity financial liabilities, which are measured at amortised cost. The financial liabilities held by the Group companies are as follows:

1. Bank and other loans: loans from banks and other lending institutions are recognised at the amount received, net of related transaction costs. They are subsequently measured at amortised cost. Borrowing costs are recognised on an accrual basis in the consolidated income statement using the effective interest method and are added to the carrying amount of the financial instrument to the extent that they are not settled in the period in which they arise.
2. Trade and other payables: Trade payables are recognised initially at fair value and are subsequently measured at amortised cost using the effective interest rate method.

The Group derecognises financial liabilities when the obligations giving rise to them are extinguished.

5.6 Derivative financial instruments and hedging transactions

The Group uses derivative financial instruments to hedge the risks to which its business activities, operations and cash flow are exposed. These risks are mainly due to variations in interest rates. Among the various transactions, the Group arranges certain financial instruments as economic hedges.

For these financial instruments to qualify for hedge accounting, they are designated as hedges at inception and the hedging relationship is documented. The Group also verifies the effectiveness of the hedge initially and on an ongoing basis throughout the term of the hedge (at least at the end of each reporting period). A hedge is effective if it is expected, prospectively, that the changes in the fair value or the cash flows from the hedged item (attributable to the hedged risk) are almost entirely offset by the changes in those of the hedging instrument and that, retrospectively, the gains or losses on the hedge have fluctuated within a range of 80% to 125% of gains or losses on the hedged item.

Derivatives are initially recognised at acquisition cost in the consolidated statement of financial position and the necessary valuation adjustments are subsequently made to reflect their fair value at any given time. These are classified in the consolidated statement of financial position under "Non-current investments - Derivatives" and "Other current financial assets - Derivatives" if they are positive, and under "Non-current investments - Derivatives" and "Non-current financial liabilities - Derivatives" if they are negative. Gains or losses on such fluctuations are recognised in the consolidated income statement unless the derivative instrument has been designated as a hedging instrument and is highly effective, in which event the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised temporarily in equity and taken to profit and loss in the same period during which the hedged item affects profit or loss.

Hedge accounting is discontinued when the derivative instrument expires or is sold, terminated or exercised or no longer meets the criteria for hedge accounting. Any accumulated gain or loss for the derivative recognised in equity remains in equity until the planned 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.

The fair value of the various derivative financial instruments is calculated using the valuation techniques described in Note 5.7 below.

5.7 Valuation techniques and assumptions used to measure fair value

The fair values of financial assets and financial liabilities are determined as follows:

- Fair values of financial assets or liabilities with standard terms and conditions traded on active liquid markets are determined by reference to their quoted market price.
- The fair values of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally-accepted valuation models on the basis of discounted cash flows using the prices of observable market transactions and contributor quotes for similar instruments.
- The fair value of interest rate swaps is calculated by discounting the future settlements between fixed and floating interest rates to their present value, in line with implicit market rates, obtained from long-term rate swap curves. Implied volatility is used for the calculation by means of option pricing formulas of the fair values of caps and floors.

Also, in the measurement of derivative financial instruments, the risk inherent in the hedged item or position must be effectively eliminated throughout the term of the hedge, and the fact that the financial derivative was arranged specifically to hedge certain balances or transactions and the manner in which this effective hedge was to be achieved and measured must be properly documented. In addition, the inherent risk requires including the credit risk of the parties participating in the agreement (both own risk and counterparty risk) in the measurement of the derivatives. The Group applied the discounted cash flow method, considering a discount rate affected by the Testa Group's own risk.

Financial instruments measured subsequent to their initial recognition at fair value are categorised into levels 1 to 3, based on the extent to which the fair value is observable.

- Level 1: measurements derived from (unadjusted) quoted prices in active markets for identical assets or liabilities.
- Level 2: measurements derived from "inputs" other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).

- Level 3: valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The Group's financial assets and liabilities measured at fair value at 31 December 2017 are as follows:

2017

	Thousands of euros			
	Level 1	Level 2	Level 3	Total
Liability-side derivative financial instruments (Note 14)	-	120	-	120
Other financial liabilities in the long-term	-	-	355,565	355,565
	-	120	355,565	355,685

2016

	Thousands of euros			
	Level 1	Level 2	Level 3	Total
Liability-side derivative financial instruments	-	940	-	940
	-	940	-	940

Note 14 provides information on calculating the fair value of investment property, in accordance with the valuation techniques described therein.

5.8 Equity instruments

An equity instrument is any contract that evidences a residual interest in the equity of the Parent after deducting all of its liabilities.

Equity instruments issued by the Parent are recognised in equity at the proceeds received, net of issue costs.

The Parent's equity instruments acquired by the Group are recognised separately at acquisition cost and deducted from equity in the consolidated statement of financial position, irrespective of the reason for which they were acquired. No gains or losses from transactions involving own equity instruments are recognised in profit or loss.

If the Parent's equity instruments are subsequently redeemed, capital is reduced by the nominal amount of such shares and the positive or negative difference between the acquisition price and nominal amount of the shares is debited or credited to reserves.

The transaction costs related with own equity instruments are recognised as a reduction of equity, once any tax effect has been considered.

5.9 Distribution to shareholders

Dividends are paid in cash, and are recognised as a reduction of equity when their distribution is approved by the General Shareholders' Meeting.

The Parent has opted to apply the special regime for REITs. Pursuant to Article 6 of Law 11/2009, of 26 October 2009, amended by Law 16/2012, of 27 December, REITs that have opted for the special tax regime are required to distribute the profit for the year to shareholders in the form of dividends, once the related corporate obligations have been met. The dividend distribution must be approved within six months of each year-end and paid in the month following the date of the distribution resolution.

Also, as established by Law 11/2009, of 26 October, amended by Law 16/2012, of 27 December, the Parent shall distribute as dividends:

- All the profit from dividends or shares in the profits paid by the entities referred to in Article 2.1 of Law 11/2009.
- At least 50% of the profits arising from the transfer of property, shares or investments to which Article 2.1 of Law 11/2009 refers, performed once the time periods referred to in Article 3.2 of Law 11/2009 have elapsed, which are used to achieve the Company's principal object. The remainder of these profits should be reinvested in other buildings or investments related to the performance of this object within three years from the transfer date. Otherwise, these profits should be distributed in full, together with any profits arising in the year in which the reinvestment period expires. If the items subject to reinvestment are transferred before the retention deadline, the related profits must be distributed in full, together with any profits proceeding in the year in which they were transferred. The distribution obligation does not extend to the portion of these profits, if any, that may be allocated to years in which the Company did not file tax returns under the special tax regime established in Law 11/2009.
- At least 80% of the remaining profits obtained. When dividends are distributed with a charge to reserves out of profit for a year in which the special tax regime has been applied, the distribution must be approved as set out above.

5.10 Cash and cash equivalents

The Group classifies under "Cash and Cash Equivalents" cash and short-term, highly liquid investments that are easily convertible into cash, have an investment term of less than three months and are not subject to a significant risk of changes in value. The interest associated with these transactions is recognised as income on an accrual basis and the interest not yet due at the end of the reporting period is included as an increase in "Cash and Cash Equivalents" in the consolidated statement of financial position.

5.11 Provisions

In preparing the consolidated financial statements, the Parent's directors made a distinction between:

- Provisions: credit balances covering obligations deriving from past events, where cancellation is likely to give rise to an outflow of funds, which are indeterminate with regard to their amount and/or timing of cancellation.
- Contingent liabilities: possible obligations arising from past events, the materialisation of which will be confirmed only by the occurrence or non-occurrence of one or more future events beyond the control of the Group.

The consolidated financial statements disclose all provisions in respect of which it is thought that it is more likely than not that the Company will have to settle the obligation. Contingent liabilities are not recognised in the consolidated financial statements, but rather disclosure is provided in the explanatory notes, unless the possibility of an outflow in settlement is considered remote.

Provisions are stated at the present value of the best possible estimate of the amount necessary to cancel or transfer the obligation, taking into account the information available regarding the event and its consequences, and recognising those adjustments that arise from the restatement of those provisions as a finance cost as they accrue.

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 Group 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.

5.12 Revenue recognition

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. Rental income is measured at the fair value of the consideration received, less discounts and tax.

Discounts (rent waivers and rebates) granted to customers are recognised as a reduction to rental income when it is probable that the conditions determining the granting thereof will be fulfilled.

Discounts are recognised by expensing the total rent waiver or rebate on a straight-line basis over the term of the lease agreement in force. If the lease agreement is cancelled earlier than expected, any outstanding rent waiver or rebate is recognised in the last period prior to the end of the agreement.

Leases of investment property to third parties

The companies forming part of the Group engage mainly in the acquisition and lease of residential buildings. The Group's revenue is generated from the lease of these investment properties to third parties.

The revenue arising from the lease of investment property is recognised by reference to the stage of completion of the transaction at the end of the reporting period, provided the result of the transaction can be estimated reliably. The Group's lease revenue is recognised by the companies on a monthly basis, in accordance with the terms and conditions and amounts agreed in the various lease agreements with the lessees. This revenue is only recognised when it can be measured reliably and it is probable that the economic benefits will arise from the lease.

Where the outcome of services rendered cannot be estimated reliably, revenue is recognised to the extent that the expenses incurred are deemed recoverable.

Community expenses invoiced to lessees are recognised net of other operating expenses.

5.13 Income tax expense

5.13.1 General regime

Income tax expense (tax revenue) comprises current tax expense (current tax revenue) and deferred tax expense (deferred tax revenue).

Current tax is the amount of taxes the Group pays as a result of income tax settlements for a period. Tax credits and other tax benefits, excluding withholdings and prepayments, and tax loss carryforwards from prior years effectively offset in the current year reduce the current income tax expense.

Deferred tax expense or income relates to the recognition and settlement of deferred tax assets and liabilities. These include the temporary differences, measured at the amount expected to be payable or recoverable, between the carrying amounts of assets and liabilities and their tax bases, as well as unused tax loss carryforwards and tax credits. These amounts are measured by applying to the corresponding temporary difference or tax asset the tax rate at which the asset is expected to be realised or the liability is expected to be settled.

Deferred tax liabilities are recognised for all taxable temporary differences, except for those arising from the initial recognition of goodwill, the amortisation of which is not deductible for tax purposes, or of other assets and liabilities in a transaction that affects neither accounting profit (loss) or taxable profit (tax loss).

Deferred tax assets are recognised to the extent that it is probable that the Company will have taxable profit available in the future against which the deferred tax assets can be utilised.

Deferred tax assets and liabilities arising from items directly charged or credited to equity accounts are also recognised with a charge or credit, respectively, to equity.

At each year end recognised deferred tax assets are reassessed and all appropriate adjustments are made to the extent that there are any doubts regarding future recovery. Unrecognised deferred tax assets are also reassessed at the end of each reporting period, and are recognised to the extent it is likely they will be recovered through future taxable profit.

5.13.2 REIT regime

The REIT special tax regime, as amended by Law 16/2012, of 27 December, provides a 0% corporate income tax rate provided certain requirements are met. These requirements include most notably the need for at least 80% of their assets to consist of either urban properties earmarked for lease and taken into full ownership, or investments in companies that meet the same investment and profit distribution requirements, whether Spanish or foreign, listed or otherwise on organised markets. Also, the main sources of revenue for these entities must be the property market, whether through rent, the subsequent sale of properties after a minimum rental period or income from investments in entities with similar characteristics. However, income tax accrues in proportion to the dividends distributed. Dividends received by shareholders are tax-exempt, unless the recipient is a legal person subject to income tax or a permanent establishment of a foreign entity, in which case, a tax credit will be taken on the gross tax payable so that the income will be taxed at the rate applicable to the shareholder. However, all other income will not be taxed provided that it is not distributed to shareholders.

As provided for in Transitional Provision Nine of Law 11/2009, of 26 October, as amended by Law 16/2012, of 27 December, governing REITs, the entity shall be taxed at a 19% rate on the total amount of dividends or profit shares distributed to owners with a shareholding in the entity of 5% or more, when these dividends are exempt or taxed at a rate below 10% at the owners. Accordingly, the Group has established a procedure guaranteeing confirmation by shareholders of their tax status, withholding, where applicable, 19% of the amount of the dividend distributed to shareholders that do not meet the aforementioned tax requirements.

5.14 Termination benefits

Under current legislation, the Group companies are required to pay termination benefits to employees terminated under certain conditions without justified cause. 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. The consolidated financial statements at 31 December 2017 did not include any provision in this connection, since no situations of this nature are expected to arise.

5.15 Current assets and liabilities

The Group classifies assets and liabilities as current or non-current in the consolidated statement of financial position. For these purposes, current assets and liabilities are those that meet the following criteria:

- Assets are classified as current when they are expected to be realised in, or are intended for sale or consumption in the Group's normal operating cycle, are held primarily for the purpose of being traded, are expected to be realised within twelve months of the end of the reporting period or when they involve cash or cash equivalents, unless they cannot be exchanged or used to settle a liability for at least 12 months after the end of the reporting period.
- Liabilities are classified as current when they are expected to be settled within the Group's normal operating cycle, when they are held primarily for the purposes of being traded, they are due to be settled within twelve months of the end of the reporting period, or the Group does not have an unconditional right to defer settlement of the liability within 12 months following the end of the reporting period.
- Derivative financial instruments not held for trading are classified as current or non-current on the basis of their term of regular settlement or maturity.

5.16 Segment reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses and whose operating results are regularly reviewed by the Group's chief operating decision-maker to make decisions about resources to be allocated to the segment and assess its performance, and for which different financial information is available.

The Parent's directors consider that the Group's sole business is the lease of homes, all located in Spain. Accordingly, all activities performed by the Group constitute a unique business operating segment.

5.17 Basic earnings per share

Basic earnings per share are calculated by dividing net profit for the period attributable to the Parent by the weighted average number of ordinary shares outstanding during the period, excluding the average number of shares of the Parent held by Group companies.

5.18 Diluted earnings per share

Diluted earnings per share are calculated by adjusting the profit or loss for the year attributable to holders of equity instruments of the Parent and the weighted average number of outstanding ordinary shares by all the dilutive effects inherent to the potential ordinary shares, i.e. as if all the potentially dilutive ordinary shares had been converted.

The Parent does not have different classes of potentially dilutive ordinary shares.

5.19 Environmental information

The Group carries out activities designed mainly to prevent, reduce or repair any damage to the environment that could be caused by its activities.

Expenses related to environmental activities are recognised as operating expenses in the period in which they are incurred. Nevertheless, given the nature of the Group's activity, it does not have a significant impact on the environment.

5.20 Consolidated statements of cash flows

The consolidated cash flow statements have been prepared using the indirect method and the terms used are defined as follows:

1. Cash flows: inflows and outflows of cash and cash equivalents, defined as short-term, highly liquid investments that are subject to an insignificant risk of changes in value.
2. Operating activities: regular activities engaged in by companies that belong to the consolidated group, in addition to other activities that do not fall under the categories of investing or financing activities.
3. Investing activities: the acquisition, disposal or holding by other means 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 equity and borrowings and that are not operating activities.

6. Concession projects and other intangible assets

The changes in the Intangible assets heading in 2017 and 2016 were as follows:

2017

	Thousands of euros		
	31.12.2016	Additions or provisions	31.12.2017
Cost:			
Computer software	37	98	135
Concession projects	162,523	50	162,573
Accumulated amortisation:			
Computer software	(3)	(33)	(36)
Concession projects	(3,147)	(3,083)	(6,230)
Total intangible assets	159,410		156,442

2016

	Thousands of euros		
	Business integration	Additions or provisions	31.12.2016
Cost:			
Computer software	37	-	37
Concession projects	162,523	-	162,523
Accumulated amortisation:			
Computer software	-	(3)	(3)
Concession projects	(2,340)	(807)	(3,147)
Total intangible assets	160,220		159,410

The concession projects (which are owned by Testa Residencial SOCIMI, S.A. and Testa Alquileres Urbanos, S.L.U. at 50%) related to the administrative concession for the "Bentaberri" housing complex located in San Sebastián (Guipúzcoa). This housing complex was operated under an administrative concession granted by the Basque Government for a total of 75 years, maturing in 2069.

All the Group's intangible assets are used in business activities in line with its activity and are located in Spain. The Group's concessions relate to properties earmarked for rental to be used exclusively as homes.

At 31 December 2017 and 2016, the Group operated under this heading 47,302.06 square meters of leasable gross surface area with an occupancy rate of 97% and 99%, respectively.

At 31 December 2017 and 2016, the Group had no fully amortised intangible assets.

At 31 December 2017, the Group had a mortgage guarantee on the Bentaberri housing complex, to secure a loan amounting to 24,246 thousand euros (see Note 14).

The Group has taken out adequate insurance coverage for this non-current asset.

Impairment

The fair value of the concession project was calculated by independent valuers in accordance with the Appraisal and Valuation Standards issued by the Royal Institute of Chartered Surveyors (RICS) of the United Kingdom, and the International Valuation Standards (IVS) issued by the International Valuation Standards Committee (IVSC). The methodology used to calculate the fair value of investment property is detailed in Note 7.

The recoverable value of the concession project at 31 December 2017, calculated on the basis of appraisals carried out by Savills Consultores Inmobiliarios, S.A., not related to the Group, totalled 164,704 thousand euros (162,820 thousand euros at 31 December 2016). According to this independent expert appraisal, no assets existed with a recoverable value lower than their carrying amount.

Related income and expenses

Revenue in 2017 and 2016 relating to income from the Group's concessions amounted to 3,986 thousands euros and 1,092 thousand euros, respectively, and the net operating expenses for all items relating to these concessions totalled 360 thousand euros and 150 thousand euros, respectively.

7. Investment property

The detail of and changes in this heading in 2017 and 2016 were as follows:

2017

	Thousands of euros					
	31.12.2016	Business combination (Note 3)	Additions/	Withdrawals	Change in value of investment property	31.12.2017
Buildings for lease	912,304	413,601	719,050	(4,085)	65,209	2,106,079
Investment property	912,304	413,601	719,050	(4,085)	65,209	2,106,079

2016

	Thousands of euros				
	Business integration	Additions	Retirements	Change in value of investment property	31.12.2016
Buildings for lease	892,875	-	(4,524)	23,953	912,304
Investment property	892,875	-	(4,524)	23,953	912,304

Buildings for lease

The changes in buildings for lease recognised in 2017 relate to the following:

- In March 2017, the Group's Parent incorporated investment property amounting to 659,723 thousand euros, as a result of subscribing to the non-monetary capital increase with the shareholder financial institutions, described in Note 3, which correspond mainly to homes located in Andalusia, Aragón, Asturias, the Canary Islands, Madrid, the Basque Country, Catalonia, the Balearic Islands, Navarre, Valencia Autonomous Community, Castilla León, Castilla La Mancha, Galicia and Navarre.
- In September 2017, the Group included investment property totalling 413,601 thousand euros, as a result of the business combination with Acciona Real Estate S.L., described in Note 3, which relate mainly to homes located in Madrid and Lérida.
- In September 2017, the Group's Parent included investment property totalling 5,367 thousand euros, as a result of the non-monetary capital increase subscribed with Real Estate Deal II, S.A. (Company in liquidation), which relate to homes located in calle Calcio, Madrid.
- In September 2017, the Group's Parent acquired investment property from a third party totalling 45,217 thousand euros, which relate to homes located in Madrid.
- In December 2017, the Group's Parent acquired investment property from a third party totalling 4,140 thousand euros, which relate to homes located in Vallecas, Madrid.
- Furthermore, in 2017 the Parent and the rest of the Group's subsidiaries invested in improving their assets in an amount of 4,603 thousand euros, of which 1,157 thousand euros related to increased acquisition costs of those assets.
- In relation to derecognitions, in 2017, the Group sold 12 homes located in the Madrid Autonomous Community totalling 4,371 thousand euros. This transaction generated a gain of 286 thousand euros, which was recognised under "Gains/(Losses) on disposal of non-current assets" in the 2017 consolidated income statement.

The changes in buildings for lease recognised in 2016 relate to the following:

- Following the integration of residential businesses of Merlin and Metrovacesa described in Note 3, the Group included investment property therefrom, which related mainly to homes located in Madrid, the Basque Country, Catalonia, the Balearic Islands, Navarre, Valencia Autonomous Community, Castilla León and Castilla La Mancha.
- Also, the Dominant Society sold 15 homes located in the Madrid Autonomous Community and Catalonia, totalling 4,687 thousand euros. This transaction generated a gain of 163 thousand euros, which was recognised under "Gains/(Losses) on disposal of non-current assets" in the 2017 consolidated income statement.

Investment property is stated at fair value. The amount of revenues recognised in the consolidated income statement for 2017, arising from the measurement at fair value of investment property, came to 65,209 thousand euros (23,953 thousand euros in 2016).

The Group takes out the insurance policies it considers necessary to cover the risks that might affect its investment property. At 31 December 2017, the Parent's directors estimated that all these risks had been adequately covered.

At 31 December 2017, the Group did not have any firm investment property purchase commitments. No finance costs were capitalised in 2017.

At 31 December 2017, the Group had a mortgage guarantee on various properties, to secure loans amounting to 101,216 thousand euros (see Note 14).

As at 31 December 2017 and 2016, the Group was operating, within this caption, 790,436.53 square metres of gross leasable housing and 41,605.27 square metres of gross commercial premises at 31 December 2017, and 392,567.51 square metres of gross leasable housing and 17,522.78 square metres of gross commercial premises at 31 December 2016, with occupancy of 90% and 91%, respectively.

Related income and expenses

In 2017 and 2016, revenue arising from investment property rentals owned by the Group stood at 48,244 thousand euros and 7,914 thousand euros, respectively, and the net operating expenses for the items related thereto came to 12,731 thousand euros and 2,199 thousand euros, respectively.

Measurement of fair value and sensitivity

All investment property leased or earmarked for lease through operating leases is classified as investment property.

In accordance with IAS 40, the Group periodically determines the fair value of its investment property so that, at the end of each semester, the fair value reflects the market conditions of the investment property items at that date. The fair value is determined by reference to the appraisals carried out every six months by independent valuers.

The market value of the Group's investment property at 31 December 2017 and 2016, calculated on the basis of valuations made by Savills Consultores Inmobiliarios, S.A., independent appraisers not linked to the Group, amounted to 2,106,079 thousand euros (912,304 thousand euros at 31 December 2016). The valuation was carried out in accordance with the Appraisal and Valuation Standards issued by the Royal Institute of Chartered Surveyors (RICS) of the United Kingdom, and the International Valuation Standards (IVS) issued by the International Valuation Standards Committee (IVSC), using discounted cash flows, applying two assumptions. These entail the following:

Profitability Assumption (used for all those properties over which the Group has all the units): the method used to calculate the market value of investment property involves drawing up 10-year income and expense projections for each asset, adjusted at the reporting date using a market discount rate. The residual amount at the end of year 10 is calculated by applying an exit yield or cap rate to the projections of net revenues in year 11. The market values thereby obtained are analysed through the calculation and analysis of the capitalisation of return implicit in such values. The projections are designed to reflect the best estimate of future revenues and expenses from the investment properties. Both the exit yield and the discount rate are determined by taking into account Spanish and institutional market conditions. The percentage of real estate investments valued under this assumption as of December 31, 2017 amounted to 51% of the total.

Liquidation Assumption (used for all those properties over which the Group does not have all the units): the method used to calculate the market value of investment property assumes the asset liquidation when the leasing contract expires. It involves drawing up income and expense projections for each asset, adjusted at the reporting date using a market discount rate. The sale price is obtained by comparing the property with other similar properties that have been sold recently or are being offered in the market, after making the pertinent adjustments based on their differentiating factors. The projections are designed to reflect the best estimate of future revenues and expenses from the investment properties. The discount rate is defined by taking into account Spanish and institutional market conditions. The percentage of real estate investments valued under this assumption as of December 31, 2017 amounted to 49% of the total.

In any event, considering the situation of the rental property market, significant differences might arise between the fair value of the Group's investment property and their effective realisable values.

Fees paid by the Group to appraisal companies for appraisals at 31 December 2017 and 2016 were as follows:

	Thousands of euros	
	2017	2016
Appraisal services	131	55
Total	131	55

Disclosure of the fair value of investment property

The detail of assets measured at fair value by their level in the fair value hierarchy is as follows:

2017

	Thousands of euros			
	Total	Level 1	Level 2	Level 3
Recurring fair value measurements	2,106,079	-	-	2,106,079
<i>Investment property</i>				
Housing	2,106,079	-	-	2,106,079
Total assets measured at fair value on a recurring basis	2,106,079	-	-	2,106,079

2016

	Thousands of euros			
	Total	Level 1	Level 2	Level 3
Recurring fair value measurements	912,304	-	-	912,304
<i>Investment property</i>				
Housing	912,304	-	-	912,304
Total assets measured at fair value on a recurring basis	912,304	-	-	912,304

There were no transfers of assets between the different levels during 2017 or 2016.

The detail of the gross surface area at 31 December 2017 and 2016 is as follows:

31 December 2017	Square meters								% occupancy
	Gross leasable area								
	Madrid Autonomous Community	Catalonia	Castilla y León	Galicia	Andalusia	Valencia Autonomous Community	Rest of Spain	Total	
Investment property	457,302	36,764	32,516	54,612	4,700	47,571	198,576	832,042	89%
% weight	54.96%	4.42%	3.91%	6.56%	0.56%	5.72%	23.87%		

31 December 2016	Square meters								% occupancy
	Gross leasable area								
	Madrid Autonomous Community	Catalonia	Castilla y León	Galicia	Andalusia	Valencia Autonomous Community	Rest of Spain	Total	
Investment property	237,782	10,196	20,284	-	-	32,600	109,229	410,090	91%
% weight	57.98%	2.49%	4.95%	0.00%	0.00%	7.95%	26.63%		

The main assumptions used to calculate the fair value of investment property were as follows:

2017

Autonomous Communities	Discount rate (%)	Exit Yield (%)	Average market rent (€/ sqm/ month)	Average sale price (€/ sqm)
Madrid	6.29	4.51	11.82	3,115
Catalonia	5.97	4.59	11.70	3,176
Galicia	6.89	5.17	5.71	1,959
Remaining autonomous communities	6.75	5.16	7.41	1,868
Total	6.29	4.62	9.89	2,666

The effect of a change of 25, 50 or 100 basis points in the required capitalisation rate, under both assumptions profitability and liquidation, calculated as rent divided by the market value of the assets, on investment property in consolidated assets and in the consolidated income statement, would be as follows:

	Thousands of euros					
	31.12.2017					
	Assets			Consolidated net profit/(loss)		
	0.25%	0.50%	1%	0.25%	0.50%	1%
One-quarter of one point increase in the rate of return	(25,886)	(51,043)	(100,200)	(25,886)	(51,043)	(100,200)
One-quarter of one point decrease in the rate of return	26,456	53,516	109,475	26,456	53,516	109,475

The effect of the change of 1%, 5% and 10% in the rent considered, under both assumptions profitability and liquidation, has the following impact on consolidated assets and on the consolidated income statement with respect to investment property:

	Thousands of euros					
	31.12.2017					
	Assets			Consolidated net profit/(loss)		
	1%	5%	10%	1%	5%	10%
Increase of 10% in market rent	10,266	51,001	102,199	10,266	51,001	102,199
Decrease of 10% in market rent	(10,732)	(53,795)	(108,407)	(10,732)	(53,795)	(108,407)

The effect of the variation of a 25 and 50 basis points in the Exit Yield, under both assumptions profitability and liquidation, calculated as the result of dividing the net operating income of the last year of the period analyzed between the estimated exit value, has the following impact on consolidated assets and on the consolidated income with respect to investment property:

	Thousands of euros			
	31.12.2017			
	Assets		Consolidated net profit/(loss)	
	0.25%	0.50%	0.25%	0.50%
Increase in the Exit Yield	(48,944)	(91,959)	(48,944)	(91,959)
Decrease in the Exit Yield	56,221	121,553	56,221	121,553

The effect of the variation of 1%, 5% and 10% in the sale price considered, both in the assumption based on liquidation, has the following impact on the consolidated asset and on the consolidated profit and loss account, with respect to the real estate investments, would be the following:

	Thousands of euros					
	31.12.2017					
	Assets			Consolidated net profit/(loss)		
	1%	5%	10%	1%	5%	10%
Increase in sale price	9,424	47,43	94,796	9,424	47,143	94,796
Decrease in sale price	(9,436)	(47,153)	(94,451)	(9,436)	(47,153)	(94,451)

8. Concession arrangements, collection rights

The detail of and changes in this heading in 2017 and 2016 were as follows:

2017

	Thousands of euros				
	31.12.2016	Business combination (Note 3)	Revaluation	Proceeds	31.12.2017
Cost:					
Concession arrangements, collection rights	3,587	2,966	416	(2,231)	4,738
Concession arrangements, collection rights	3,587	2,966	416	(2,231)	4,738

2016

	Thousands of euros			
	Business integration	Revaluation	Proceeds	31.12.2016
Cost:				
Concession arrangements, collection rights	4,151	(211)	(353)	3,587
Concession arrangements, collection rights	4,151	(211)	(353)	3,587

At 31 December 2016, the Parent recognised the concession arrangements for the "Campo de Tiro" housing complexes in Leganés and "Usera", both in Madrid, under this heading in the consolidated statement of financial position.

In September 2017, the Group included concession arrangements totalling 2,966 thousand euros, as a result of the business combination with Acciona Real Estate S.L. (see Note 3).

The Group classified the consideration received from the aforementioned concession arrangements as a financial asset, since the consideration received consisted of an unconditional right to receive cash, enabling the recovery of the investment made, obtaining a reasonable margin. Accordingly, the Group does not assume the demand risk in the concession arrangement.

The main characteristics of these concession arrangements are as follows:

- Campo de Tiro (Leganés)

Through a public deed signed on 20 April 1998, the Madrid Housing Institute (IVIMA) granted the Parent an onerous surface right with a 20-year duration, from its filing in the register (22 May 1998) on a lot located in the municipality of Leganés (Madrid). Such surface right consists of the construction, within the first three years of the concession, of 80 subsidised homes under a special lease arrangement, together with 103 parking spaces associated therewith, and the subsequent lease to IVIMA to operate such subsidised homes under a lease system, in line with the requirements set forth in the award specifications.

On 28 December 2000, in compliance with that set forth in the specifications and in the surface right award deed, a lease arrangement was entered into with IVIMA, which will end on 22 May 2018, the same date on

which the surface right concession ends and the building reverts to the IVIMA without the payment of indemnity and without any option to renew or terminate. The lease arrangement stipulates a rent payment of 36 thousand euros per month, as the surface right award price, to be updated annually in line with the corresponding CPI.

- Usera (Madrid)

Through a public deed signed on 8 March 2000, the Madrid Housing Institute (IVIMA) granted the Parent an onerous surface right with a 20-year duration, from its filing in the register (1 June 2000), on a lot located in the municipality of Madrid, in the district of Usera. Such surface right consists of the construction, within the first three years of the concession, of 148 subsidised homes under a lease arrangement, together with 148 parking spaces associated therewith, and the subsequent lease to IVIMA itself to operate them in line with the requirements set forth in the award specifications.

On 8 July 2003, in compliance with that set forth in the specifications and in the surface right award deed, a lease arrangement was entered into with IVIMA, which will end on 31 May 2020, the same date on which the surface right concession ends and the building reverts to the IVIMA without the payment of indemnity and without any option to renew or terminate. The lease arrangement stipulates a rent payment of 59 thousand euros per month, as the surface right award price, to be updated annually in line with the corresponding CPI.

- Torrejón de Ardoz (Madrid)

Through a public deed signed on 9 July 1998, the Madrid Housing Institute (IVIMA) granted to the subsidiary Valdgrand, S.A.U. an onerous surface right with a 20-year duration, from its filing in the register (9 September 1998), on a lot located in the municipality of Torrejón de Ardoz, Madrid province. Such surface right consists of the construction, within the first three years of the concession, of 64 subsidised homes under a lease arrangement, together with 64 parking spaces associated therewith, and the subsequent lease to IVIMA itself to operate them in line with the requirements set forth in the award specifications.

On 20 June 2001, in compliance with that set forth in the specifications and in the surface right award deed, a lease arrangement was entered into with IVIMA, which will end on 9 September 2018, the same date on which the surface right concession ends and the building reverts to the IVIMA without the payment of indemnity and without any option to renew or terminate. The lease arrangement stipulates a rent payment of 28 thousand euros per month, as the surface right award price, to be updated annually in line with the corresponding CPI.

- Ventilla (Madrid)

Through a public deed signed on 22 July 2005, the Madrid Housing Institute (IVIMA) granted the subsidiary Valdgrand, S.A.U. an onerous surface right with a 20-year duration, from its filing in the register (28 July 2003) on a lot located in the municipality of Ventilla (Madrid). Such surface right consists of the construction, within the first three years of the concession, of 90 subsidised homes under a lease arrangement, together with 90 parking spaces associated therewith, and the subsequent lease to IVIMA itself to operate them in line with the requirements set forth in the award specifications.

On 20 October 2005, in compliance with that set forth in the specifications and in the surface right award deed, a lease arrangement was entered into with IVIMA, which will end on 28 July 2023, the same date on which the surface right concession ends and the building reverts to the IVIMA without the payment of indemnity and without any option to renew or terminate. The lease arrangement stipulates a rent payment of 48 thousand euros per month, as the surface right award price, to be updated annually in line with the corresponding CPI.

The common characteristics of these arrangements is that all the expenses and charges on the property will be met by the lessor (the Group), except the Property Tax, which will be assumed by the lessee.

The lessor will also meet the costs of repairing, conserving and maintaining the property, its facilities and services, and binds itself to provide the IVIMA with an annual report on the procedures performed and having carried out the works at the request of the latter.

In 2017, no significant procedures were conducted at any of the properties, worthy of mention in these notes to the financial statements, and no processes of importance are planned in the future either.

The significant aggregates included in the Economic-Financial Plan for the concession arrangements are rental income, expenses, the estimated Consumer Price Index and the market return for each of the projects.

In 2017, the concession arrangements were not subject to any contractual amendments.

The fair value of the concession arrangements was calculated by independent valuers in accordance with the Appraisal and Valuation Standards issued by the Royal Institute of Chartered Surveyors (RICS) of the United Kingdom, and the International Valuation Standards (IVS) issued by the International Valuation Standards Committee (IVSC). The methodology used to calculate the fair value of the assets is detailed in Note 7.

The recoverable value of concession agreements of the Group at 31 December 2017, calculated on the basis of appraisals carried out by Savills Consultores Inmobiliarios, S.A., not related to the Group, totalled 4,738 thousand euros (3,484 thousand euros at 31 December 2016). According to this independent expert appraisal, no assets existed with a recoverable value lower than their carrying amount.

At 31 December 2017, the Parent had a mortgage guarantee on the Campo de Tiro housing complex owned by the Company, located in Leganés (together with other properties within "Investment Property"), to secure a loan drawn down in the amount of 21,016 thousand euros (see Note 14). The mortgage agreement allows for the possibility of releasing the mortgage on one or more of the properties under it.

9. Leases

a) Operating leases - Lessee

At the end of 2017 and 2016, the Group had agreed with the lessors the following minimum lease payments in accordance with the leases in force, without factoring in common expenses, future rises in the CPI or future contractually agreed rent increases (in euros):

Operating leases Minimum lease payments	Nominal value	
	2017	2016
Less than one year	158	132
Between 1-5 years	169	254
Total	327	386

Since 1 February 2017, the Parent has entered into an arrangement for the lease of its new offices at Paseo de la Castellana 257, 2ª planta, Madrid, for a three-year duration. The annual rent to be paid by the Parent amounts to 157 thousand euros.

The total lease expense accrued by the Group in 2017 amounted to 216 thousand euros and was recorded under the "Other operating expenses" caption in the accompanying consolidated income statement for 2017 (see Note 19.3). The main expense included in this figure related to the lease of the offices at Paseo Castellana 257, planta 2ª (place of its registered office).

b) Operating leases - Lessor

At the end of 2017 and 2016, the Group had agreed with the lessees the following minimum lease payments in accordance with the leases in force, excluding common expenses, future increases in the CPI or contractually agreed rent increases:

Minimum lease payments	Thousands of euros	
	2017	2016
Less than one year	58,094	9,686
Between 1-5 years	72,733	28,400
More than five years	5,887	11,454
Total	136,714	49,540

The main difference between the figures for 2017 and 2016 related to the non-monetary contributions by the financial institutions and Acciona Real Estate, S.L., which were made on 7 March 2017 and 14 September 2017, respectively, together with the rest of acquisitions of investment property in 2017 (see Note 7).

The amount of operating leases and the passing on of common expenses recognised respectively as revenue in 2017 and 2016 was as follows:

	Thousands of euros	
	2017	2016
Rental income accrued (Note 19.1)	52,439	9,035
Passing on of common expenses (Note 19.3)	2,319	509
Total	54,758	9,544

The passing on of expenses to lessees in 2017 and 2016 is recognised in the accompanying consolidated income statement as a reduction of "Other operating expenses".

10. Other non-current financial assets

This heading in the consolidated statement of financial position includes mainly the deposits provided as a guarantee, amounting to 5,074 thousand euros and 3,814 thousand euros, respectively.

11. Trade and other receivables

The breakdown of "Trade and other receivables" at 31 December 2017 and 2016 includes the following items:

	Thousands of euros	
	2017	2016
Trade receivables for sales and services	702	1,723
Sundry debtors	632	1,541
Impairment of trade receivables for sales and services	-	(813)
Current tax assets	13	-
Other receivables from public authorities	385	1
	1,432	2,452

In general, these receivables do not accrue any interest and they are mainly collected in cash.

The Group periodically analyses the risk of insolvency of its accounts receivable by updating the related provision for impairment losses. The Parent's directors consider that the carrying amount of trade and other receivables approximates their fair value.

The change in provisions for impairment and non-payment in 2017 and 2016 was as follows:

	Thousands of Euros
Business integration	(748)
Charges	(65)
Applications	-
Balance at 31 December 2016	(813)
Provisions (Note 19.3)	(300)
Applications	813
Balance at 31 December 2017	(300)

Most of the impaired accounts receivable are over 6 months past due. Accounts receivable not covered by provisions are immaterial. The average period for collection is approximately seven days.

	Thousands of euros
	2017
Trade receivables for sales and services	702
Total revenue	52,439
Average collection period	6.5 days

12. Cash and cash equivalents

"Cash and cash equivalents" includes the Group's cash and short-term bank deposits with an original maturity of three months or less. The carrying amount of these assets approximates their fair value.

Current accounts accrue interest at the market rate for this type of account.

13. Equity and shareholders' equity

13.1 Share capital and issue premium

The detail of and changes in equity are presented in the consolidated statement of changes in equity.

Share capital

At 31 December 2015, the Parent's share capital comprised 102,696,108 shares with a par value of 1 euro each, all of the same class and which were fully subscribed and paid.

On 21 June 2016, the Boards of Directors of Merlin Properties SOCIMI, S.A. and Testa Inmuebles en Renta SOCIMI, S.A. (Sole Shareholder of the Company at that date) approved the merger by absorption project, which involved the integration of Testa Inmuebles en Renta SOCIMI, S.A. into Merlin Properties SOCIMI, S.A., through the transfer en bloc of the assets of the former to the latter. On 6 September 2016, the shareholders at the General Meeting of Testa Inmuebles en Renta, SOCIMI, S.A. approved the merger, which was filed at the Mercantile Registry on 14 October 2016.

This operation meant that Testa Inmuebles en Renta SOCIMI, S.A., whose direct ownership interest in the Company amounted to 100%, ceased to be its Sole Shareholder, with it becoming Merlin Properties, SOCIMI, S.A.

On 24 June 2016, the Sole Shareholder approved the transformation of the Parent into a public limited company and the redenomination of shares, from 102,696,108 shares of 1 euro par value each to 10,269,610,800 shares of 0.01 euros par value each. It performed a capital increase with a non-monetary contribution of property, issuing 2,238,551,888 new shares of 0.01 euros par value each and, lastly, it performed a capital reduction through the redemption of 10,906,847,110 shares. Consequently, the Parent's share capital consisted of 1,601,315,578 shares with a par value of 0.01 euros each.

As mentioned in Note 3, on 15 September 2016, the General Shareholders' Meetings of the Parent and of Metrovacesa, S.A. approved a capital increase through the issue of 3,075,278,154 shares of 0.01 euros par value each, with an issue premium of 13,3656923984379 cents per share issued. This increase was subscribed in full by the shareholders of Metrovacesa, S.A., through the contribution of its residential rental asset business. As a result of this transaction, the shareholders of Metrovacesa, S.A. acquired 65.67% of the Parent's share capital.

Following the aforementioned operations, at 31 December 2016, the share capital of Testa Residencial, SOCIMI, S.A. amounted to 46,765,937 euros, and was represented by 4,676,593,732 fully subscribed and paid ordinary shares of 0.01 euros par value each. All shares are of the same class and confer holders the same rights.

As mentioned in Note 3, on 30 January 2017, the Extraordinary General Shareholders' Meeting of Testa Residencial, SOCIMI, S.A. approved a non-monetary capital increase, through the contribution of residential investment property, mainly from the Group's shareholder financial institutions, Banco Santander, S.A. Banco Bilbao Vizcaya Argentaria S.A., Banco Popular, S.A. and nine other minority shareholders. As consideration for the investment property received, the Parent performed a capital increase in the amount of 659,723 thousand euros, through the issuance of 5,221,817,098 new shares of 0.01 euros par value each (52,218 thousand euros), with an issue premium of 0,11633977722 euros per share issued (607,505 thousand euros).

Also on 23 May 2017, the Extraordinary General Shareholders' Meeting of Testa Residencial, SOCIMI, S.A. approved a monetary capital increase by the shareholder Banco Santander, amounting to 30 thousand euros, through the issue of 237,407 new shares of the Parent of 0.01 euros par value each (2 thousand euros), with an issue premium of 0,11636527145 euros per share issued (28 thousand euros).

Later, as mentioned in Note 3, on 20 September 2017 the Extraordinary General Shareholders' Meeting of the Parent adopted a non-monetary capital increase in the form of contribution by Acciona Real Estate, S.L.U. of its residential rentals business, consisting of its shares in Compañía Urbanizadora del Coto, S.L., 100% of shares in Valgrand 6, S.A.U, and houses located in Lérida. As consideration for the investment property received, the Parent performed a capital increase in the amount of 335,824 thousand euros, through the issuance of 2,645,404,051 new shares of 0.01 euros par value each (26,454 thousand euros), with an issue premium of 0,116946213484044 euros per share issued (309,370 thousand euros).

At the same time, also on 20 September 2017, the Extraordinary General Shareholders' Meeting of Testa Residencial, SOCIMI, S.A. approved a non-monetary capital increase through the contribution of residential investment property, mainly from Real Estate Deal II, S.A. (Company in liquidation). As consideration for the investment property received, the Parent performed a capital increase in the amount of 5,367 thousand euros, through the issuance of 42,274,627 new shares of the Parent of 0.01 euros par value each (423 thousand euros), with an issue premium of 0,116946213484044 euros per share issued (4,944 thousand euros).

The significant shareholders of the Parent, with direct or indirect ownership interests at 31 December 2017 and 2016, were as follows:

2017

	Shares			% of share capital
	Direct	Indirect	Total	
Banco Santander, S.A.	1,733,179,100	3,143,288,876	4,876,467,976	38.74%
Merlin Properties SOCIMI S.A	1,601,315,578	-	1,601,315,578	12.72%
Banco Bilbao Vizcaya Argentaria, S.A.	488,962,085	2,850,130,717	3,339,092,800	26.53%
Acciona Real Estate S.L.	2,645,404,051	-	2,645,404,051	21.02%
Other	12,046,508	-	81,771,881	0.99%

2016

	Shares			% of share capital
	Direct	Indirect	Total	
Banco Santander, S.A.	1,614,458,396	546,399,222	2,160,857,618	46.21%
Merlin Properties SOCIMI S.A	1,601,315,578	-	1,601,315,578	34.24%
Banco Bilbao Vizcaya Argentaria, S.A.	488,962,085	142,114,953	631,077,038	13.49%
Banco Popular, S.A.	281,078,284	-	281,078,284	6.01%
Other	2,265,214	-	2,265,214	0.05%

Issue premium

The Consolidated Spanish Limited Liability Companies Law expressly permits the use of the issue premium to increase capital and places no specific restrictions as to its use.

This reserve is unrestricted so long as its allocation does not lower the equity of the Parent to below the amount of share capital.

13.2 Reserves

Details of reserves at 31 December 2017 and 2016 are as follows:

	Thousands of euros	
	2017	2016
Legal reserve	3,203	3,203
Other reserves	(162,073)	189,092
Reserves in consolidated companies	25,824	-
Total reserves	(133,046)	192,295

Legal reserve

Pursuant to article 274 of the Consolidated Spanish Limited Liability Companies Law, 10% of profit in each year must be transferred to the legal reserve until the balance of this reserve is at least 20% of share capital.

The legal reserve may not be distributed and if it is used to offset losses -only insofar as no other sufficient reserves are available for this purpose- it must be replenished with future profits.

At 31 December 2017 and 2016, the Group had not attained the minimum level of the legal reserve stipulated in the Consolidated Spanish Limited Liability Companies Law.

Pursuant to the Real Estate Investment Trusts Law 11/2009, the legal reserve of the companies that have opted to avail themselves of the special tax regime established in the aforementioned law, must not exceed 20% of the share capital.

As mentioned in Notes 3 and 15, under the terms of the shareholder agreement Acciona Real Estate, S.L. is entitled to redeem the shares subscribed for in the context of the contribution referred to above in this Note if the Group fails to list its securities on a stock exchange before 21 September 2022. If that situation arises, the Parent must pay in exchange for the redeemed shares an amount equal to the percentage that those shares represent of the Group's EPRA NAV at the date of the amortization. Payment would be made, at the Parent's election, in cash or by means of transferring the net assets received in the context of the contribution made for the capital increase subscribed for by Acciona Real Estate, S.L. this period, and if this were the case, the difference with respect to the Group's EPRA NAV at the date of the amortisation would be settled in more or less, in cash.

In accordance with IAS 32, the Group has recognised that commitment to Acciona Real Estate, S.L. as a financial liability equal to the present value of the redeemable amount, which at the date of execution of the shareholder agreement was 349,761 thousand euros, recorded in "Reserves" of the consolidated statement of financial position for 2017.

The Directors of the Parent believe it is highly probable the Group will list its shares on the stock exchange before 21 September 2022, and Acciona Real Estate S.L.'s option to redeem its shares will lapse, such that the liability will immediately become equity.

Reserves in consolidated companies

The detail of the breakdown of reserves at consolidated companies at 31 December 2017 and 2016 was as follows:	Thousands of euros	
	2017	2016
Testa Alquileres Urbanos S.L.U. (*)	(66)	-
Testa Residencial, SOCIMI, S.A.	25,890	-
	25,824	-

(*) Called Metrovacesa Alquileres Urbanos S.L.U. in 2016

13.3 Non-controlling interests

The changes in "Non-controlling Interests" in 2017 and 2016, together with the gains/(losses) attributed to non-controlling interests, were as follows:

	Thousands of euros	
	2017	2016
Opening balance	-	-
Minority interests arising from business combinations (Note 3)	732	-
Profit/(loss) attributable to non-controlling interests	40	-
Closing balance	772	-

The detail of "Non-controlling interests" in the consolidated statement of financial position at 31 December 2017 relates to the minority shareholders (0,345%) of Compañía Urbanizadora del Coto, S.L.

13.4 Capital management

The Group manages its capital to ensure that it will be able to continue as a going concern, while providing returns to shareholders and stakeholders and maintaining an optimum capital structure to reduce the cost of capital.

In line with the practices of other groups present in the sector, the Group controls its capital structure through the leverage ratio. The ratio is calculated as net debt divided by total capital. Net debt is determined as the sum of financial liabilities, less cash and cash equivalents. Total capital is calculated as the sum of net equity and net debt.

	Thousands of euros	
	2017	2016
Total bank borrowings	473,204	361,486
Less- Cash and cash equivalents and Other current financial assets	(71,158)	(28,801)
Net debt	402,046	332,685
Equity	1,394,524	674,385
Total	1,796,450	1,007,070
Debt/Equity ratio	23.38%	33.03%

13.5 Earnings per share

Basic

Basic earnings per share are calculated by dividing profit or loss for the year attributable to the Parent's ordinary shareholders by the weighted average number of ordinary shares outstanding during the year, excluding treasury shares.

The detail of the calculation of basic earnings per share is as follows:

	2017	2016
Profit/(loss) for the period attributable to: holders of equity instruments of the Parent (thousands of euros)	70,146	24,781
Weighted average number of shares outstanding (in thousands)	9,265,054	4,676,594
Basic earnings per share (euros)	0,0076	0,0053

The average number of ordinary shares outstanding is calculated as follows:

	Number of shares	
	2017	2016
Ordinary shares at beginning of the period	4,676,593,732	-
Capital increases	7,909,733,011	4,676,593,732
Average effect of outstanding shares	(3,321,272,506)	-
Weighted average number of ordinary shares outstanding	9,265,054,237	4,676,593,732

Diluted

Diluted earnings per share are calculated by adjusting the profit or loss for the year attributable to holders of equity

instruments of the Parent and the weighted average number of outstanding ordinary shares by all the dilutive effects inherent to the potential ordinary shares, i.e. as if all the potential dilutive ordinary shares had been converted.

14. Non-current and current financial liabilities

Bank borrowings

The detail of “Non-current and current financial liabilities” at 31 December 2017 and 2016 is as follows:

	Thousands of euros	
	2017	2016
Non-current:		
<i>Measured at amortised cost</i>		
Syndicated loan	350,000	250,000
Syndicated loan arrangement costs	(1,819)	(287)
Total syndicated loan	348,181	249,713
Mortgage loans	123,224	98,462
Arrangement expenses	(860)	(264)
Total other loans	122,364	98,198
<i>At fair value</i>		
Derivative financial instruments	120	940
Total measured at fair value	120	940
Total non-current	470,665	348,851
Current:		
<i>Measured at amortised cost</i>		
Mortgage loans	2,238	11,998
Debt interest	301	635
Total amortised cost	2,539	12,633
Total current	2,539	12,633

For financial liabilities measured at amortised cost, the difference between the carrying amount and the fair value is not significant.

Loans

At 31 December 2017 and 2016, the details of loans were as follows:

31 December 2017

	Thousands of euros				
	Bank borrowings				
	Limit	Debt arrangement expenses	31.12.2017		Current interest
Non-current			Current		
Syndicated loan	800,000	(1,819)	350,000	-	191
Mortgage loans	125,462	(860)	123,224	2,238	110
Total	925,462	(2,679)	473,224	2,238	301

31 December 2016

	Thousands of euros				
	Bank borrowings				
	Limit	Debt arrangement expenses	31.12.2016		Current interest
Non-current			Current		
Syndicated loan	250,000	-	250,000	-	592
Mortgage loans	110,460	(551)	98,462	11,998	43
Total	360,460	(551)	348,462	11,998	635

Syndicated loan

Parent Company syndicated loan

On 20 December 2017, the Parent entered into a syndicated loan without a mortgage guarantee, in the amount of 800 million euros. Such loan was earmarked to repay the Parent's former syndicated loan, amounting to 250 million euros, set to mature in May 2018, and to repay the syndicated mortgage loan taken out by the subsidiary Compañía Urbanizadora del Coto S.L., totalling 77 million euros, set to mature in September 2022. The main terms and conditions of this syndicated loan not secured by a mortgage are as follows:

- This loan comprises three tranches:
 - a) The first tranche consists of a bank loan with a corporate guarantee of 350 million euros, maturing in December 2022, with an interest rate tied to the Euribor + 1.2 basis points. The total amount of the first tranche is repaid on maturity and was earmarked in full to repay the syndicated loans of the Parent and of Compañía Urbanizadora del Coto S.L. At 31 December 2017, the first tranche was fully drawn down.
 - b) The second tranche consists of a bridge loan for 350 million euros, maturing in December 2019, with an initial cost of Euribor + 0.5 basis points. At 31 December 2017, the Parent had not drawn down this tranche.

- c) The third tranche is a revolving credit line, amounting to 100 million euros. This credit facility matures in December 2022, and accrues an interest rate of Euribor + 1.2 basis points, tied to the company's rating. This financing will be used for general corporate purposes. At 31 December 2017, the Parent had not made any drawdowns on this credit facility.

This bank financing with a corporate guarantee has reporting obligation commitments with respect to the individual and consolidated financial statements and to budgets. Also, on a quarterly basis, the Group must comply with certain hedging ratio commitments such as Loan to Value, the proportion existing between Group revenue and interest on the debt ("ICR"). At 31 December 2017, the Group complies with the financial ratios established in this agreement, and the directors consider that they will also be complied with at the end of 2018 and in the coming years.

Mortgage loans

At 31 December 2017, the Group had taken out the following mortgage loans:

Financial entity	Thousands of euros				Mortgage guarantee
	Original Loan	Long-Term	Short-Term	Interest	
Banco Santander, S.A.	22,016	20,016	1,000	28	Property of Osuna, Campo de Tiro and Benquerencia-Toledo
ING Direct, NV.	63,200	63,200	-	7	Property of Pavones, Valdebernardo, Alcorcón, Plaza De Castilla
CaixaBank	17,000	16,660	340	74	Mercedes Formica, Ronda de Segovia and José M. Perdis properties
Bilbao Bizkaia Kutxa	24,695	23,348	898	1	Property Bentaberri
Total	126,911	123,224	2,238	110	

ING's mortgage loan has reporting obligation commitments with respect to the Group's individual and consolidated financial statements, such as the Loan to Value. At 31 December 2017, the Group complies with the financial ratios established in this agreement, and the directors consider that they will also be complied with at the end of 2018 and in the coming years.

Accrued unpaid interest relating to mortgage loans at 31 December 2017 amounted to 110 thousand euros, and the final average interest rate on these mortgage loans in 2017 was 1.32%.

Loan repayment dates

Details of the Group's loan repayment dates at 31 December 2017 are as follows:

	Thousands of euros		
	Mortgage Loan	Syndicated Loan	Total
2018	2,238	-	2,238
2019	2,238	-	2,238
2020	2,238	-	2,238
2021	2,238	-	2,238
2022	80,738	350,000	430,738
More than 5 years	35,772	-	35,772
	125,462	350,000	475,462

The balances of bank borrowings only reflect the amount drawn down.

At 31 December 2017 and 2016, the Group did not have any borrowings in currencies other than the euro.

The finance cost in 2017 for interest on syndicated loans, mortgage loans and financial instruments amounted to 6,090 thousand euros and was included in the accompanying 2017 consolidated income statement.

Details of debt arrangement expenses were recognised reducing the balance of "Bank borrowings" at 31 December 2017. In 2017, the Group recognised 4,371 thousand euros under "Finance costs" of the consolidated income statement for 2017 in respect of debt.

Of the total amount, 2,280 thousand euros related to arrangement fees and commissions recognised in respect of cancellation of the loans.

In 2017, the contractual conditions for the payment of the outstanding loans and all other contractual terms and conditions had been met.

Derivatives

The interest rate derivatives entered into by the Company and in force on 31 December 2017, with their fair values at that date, are as follows (in thousands of euros):

2017

company	Thousands of euros					
	Maturity	Interest rate	Notional	Fair value ex credit risk	Liabilities	Income statement Expense/(Income)
ING	30/09/2020	0.30%	37,240	418	414	(18)
HSBC France	14/12/2022	0.14%	56,000	(42)	(52)	(42)
MedioBanca	14/12/2022	0.14%	112,000	(108)	(128)	(107)
Goldman Sachs	14/12/2022	0.14%	56,000	(45)	(55)	(45)
Citibank Europe	14/12/2022	0.14%	56,000	(49)	(59)	(50)
			317,240	174	120	(262)

The fair values of interest rate derivatives are determined by the Group using a discounted cash flow analysis based on the rates implied on the yield curve of the euro according to market conditions at the measurement date.

These financial instruments are classified as level 2 according to the calculation hierarchy under IFRS 7.

As at 31 December 2017, the Group was a party to interest rate swap derivatives having a fair value of 418 thousand euros in respect of which the Group has opted for cash flow hedging accounting as permitted by IAS 39 Financial Instruments: Recognition and Measurement. The Group has adequately designated the hedging relationships in which these derivatives are instruments hedging the borrowing used by the Group, neutralising changes in the cash flows for interest payments by setting a variable rate to be paid thereon. These hedging relationships are, cumulatively, highly effective prospectively and retrospectively, starting at their designation date. The rest of derivatives have not been designated as accounting hedges.

At 31 December 2017, the Group recognised in equity a total of 336 thousand euros (489 thousand euros in 2016) in respect of the change in fair value of the derivatives satisfying these requirements, while recognising under "Change in fair value of financial instruments" of the consolidated income statement 262 thousand euros as a result of derivative financial instruments that do not satisfy the hedging requirements. In addition, in 2017 finance costs were incurred and contracts were settled for an amount of 219 thousand euros.

As a result of the Parent's application of 22 September 2016 to come within the special tax statutory scheme for SOCIMIs (Spanish real estate investment trusts) under the Ley 11/2009 (REITs Act), effective from 1 January 2016 onwards, the Company has recognised in equity the fair values of derivatives having no tax effect.

The Group has made an adjustment to its valuation techniques in order to calculate fair value of its derivatives. The Company includes a bilateral credit risk adjustment in order to reflect both its own and counterparty risk in the fair value of the derivatives. The Company applied the discounted cash flow method considering a discount rate affected by the inherent risk of these financial instruments.

To determine the fair value of derivatives, the Group used valuation techniques widely accepted in the market, based on the total expected exposure (which includes current and potential exposure), adjusted by the probability of default and the potential loss given default in the event of breach of the contract. DVA (Debt Value Adjustment) or CVA (Credit Value Adjustment) was thus estimated.

The current and expected future exposure of the derivatives are estimated on the basis of simulating movement scenarios for a range of market variables, such as yield curves, exchange rates and volatilities under market conditions at the measurement date.

In addition, to adjust credit risk account was taken of the Group's net exposure to each counterparty where the financial derivatives engaged with that counterparty come under a financial transaction master agreement that allows netting. For counterparties with available credit information, credit spreads are obtained from Credit Default Swaps (CDS) quoted in the market and/or their ratings. Where credit information is unavailable, the Group uses

comparable entities as a reference. The Group has engaged the services of Chatham Financial Europe Ltd to measure the fair value of derivatives.

At 31 December 2017, the effect on consolidated liabilities, equity and pre-tax profit of the change of 50 basis points in the estimated credit risk rate was as follows:

2017

Scenario	Thousands of euros		
	Liabilities	Equity	Consolidated profit before tax
Credit risk increase of 0.5%	(7,214)	-	(7,214)
Credit risk decrease of 0.5%	7,433	-	7,433

A reconciliation is set out below of the carrying amount of liabilities arising from financing activities in 2017, with separate treatment of changes that generate cash flows and changes that do not:

	Thousands of euros						
	01.01.2017	Addition due to business combinations	Cash flows	Change in fair value - Income statement	Change in fair value - Equity	Arrangement expense allocation	31.12.2017
Syndicated loan	249,713	-	10,100	-	-	(1,341)	348,372
Mortgage loans	110,831	75,947	(62,102)	-	-	36	124,712
Derivatives	940	-	(405)	(262)	153	(306)	120
Total liabilities from financing activities	361,484	75,947	37,493	(262)	153	(4,271)	473,204

15. Other current and non-current liabilities

The detail of these headings at 31 December 2017 and 2016 is as follows:

	Thousands of euros	
	2017	2016
<i>Non-current</i>		
Other financial liabilities	355,565	-
Provisions	320	1,410
Guarantees and deposits received	15,002	7,248
<i>Current</i>		
Provisions	1,019	1
Total	371,906	8,659

Other financial liabilities - Non-current

As mentioned in Note 3, the Parent must, at the election of Acciona Real Estate, S.L., carry out a capital reduction if the Parent's securities are not listed on the stock exchange before 21 September 2022. The redemption of shares will only concern those subscribed for by Acciona Real Estate, S.L. in 2017, and the amount of the capital reduction will be determined on the basis of the Group's EPRA NAV at the date. Payment for the share redemption would be made, at the Parent's election, in cash or by means of returning the net assets received in the context of the contribution made by Acciona Real Estate, S.L. in 2017, more (or less) in cash, the difference with respect to the Group's EPRA NAV at the amortization date.

Under prevailing accounting rules and standards, the Group has recognised a non-current liability arising from the commitment referred to in the foregoing paragraph. Under IAS 32, the liability was initially recognised at the present value of the estimated net value of the Group's assets, and was updated at 31 December 2017 based on the change in fair value.

The expense for change in fair value accrued in 2017 amounted to 5,804 thousand euros and was recorded under the "Change in fair value of financial instruments" caption in the accompanying consolidated income statement for 2017.

To calculate fair value, the Group estimated current EPRA NAV based on the Group's equity and added by unrealised gains on projects and concession agreements marked to market. The assumptions used to calculate the fair value of Group assets is set out in Note 7.

The Directors of the Parent believe it is highly probable the Group will list its shares on the stock exchange before 21 September 2022, and Acciona Real Estate S.L.'s option to redeem its shares will lapse, such that the liability will immediately become equity.

16. Trade and other payables

The breakdown of "Trade and other payables" at 31 December 2017 and 2016 is as follows:

	Thousands of euros	
	2017	2016
Trade and other payables:		
Payables to suppliers	811	1,576
Trade payables to related parties (Note 20.2)	2,357	2,745
Other payables	567	627
Personnel remuneration payable	591	1,008
Current tax liabilities (Note 17)	523	107
Other accounts payables to public authorities (Note 17)	243	317
Total	5,092	6,380

The Parent's directors consider that the carrying amount of trade payables approximates their fair value.

Information on the average payment period to suppliers. Final provision two of Law 31/2014, of 3 December

Below follows the disclosures required in additional provision three of Law 15/2010 of 5 July (amended by final provision two of Law 31/2014, of 3 December) prepared in accordance with ICAC resolution of 29 January 2016 on information to be disclosed in the notes to consolidated financial statements on the average payment period in commercial transactions.

	2017	2016
	Days	
Average period of payment to suppliers	15	17
Ratio of transactions paid	17	16
Ratio of transactions pending payment	1	22
Thousands of euros		
Total payments made	17,929	1,449
Total payments outstanding	2,542	4,773

The figures shown in the foregoing table in relation to payments to suppliers relate to suppliers that because of their nature are trade creditors for the supply of goods and services and, therefore, they include the figures relating to "Trade and other payables" under "Current liabilities" in the accompanying consolidated statement of financial position.

"Average period of payment to suppliers" is understood to be the time of payment or delay in payment of the trade payables. This "Average period for payment to suppliers" is calculated by multiplying the paid operations ratio by the total amount of payments made plus the pending payment operations ratio by the total amount of pending payments, and by dividing the sum of these amounts by the total amount of the payments made and the payments pending.

The ratio of transactions settled is calculated as the quotient whose numerator is the result of the sum of the products of multiplying the amounts paid by the number of days of payment (the number of calendar days between the end of the maximum payment period and the date of effective payment of the transaction) and whose denominator is the total amount of the payments made.

Also, the ratio of transactions not yet settled is calculated as the quotient whose numerator is the result of the sum of the products of multiplying the amount of the transactions not yet settled by the number of days in which payment has not been made (the number of calendar days between the end of the maximum payment period and the reporting date) and whose denominator is the total amount of the outstanding payments.

The maximum payment period applicable to the Company in 2016 under Law 3/2004, of 29 December, on combating late payment in commercial transactions, and pursuant to the transitional provisions contained in Law 15/2010, of 5 July, was 60 days until the publication of Law 11/2013, of 26 July, and 30 days since publication of the aforementioned law (unless the conditions mentioned in this law are met, in which case the maximum payment period may be increased to 60 days).

17. Public authorities and tax matters

The detail of the balances with the tax authorities at 31 December 2017 and 2016 was as follows:

	Thousands of euros	
	2017	2016
Receivables:		
Non-current-		
Deferred tax assets	11,083	296
	11,083	296
Payables:		
Non-current-		
Deferred tax liabilities	105,953	60,649
Current-		
VAT payable	111	187
IRPF payable	61	67
Social security payable	54	63
Current tax liabilities	523	107
Other taxes payable	17	-
	106,719	61,073

17.1 Reconciliation of accounting profit/(loss) to taxable income

At 31 December 2017 and 2016, the taxable profit/(tax loss) was calculated on the basis of the accounting profit/(loss) for the year, plus the effect of the change in the fair value of investment property and the temporary differences as a result of the existing restrictions.

The reconciliation of accounting profit/(loss), taxable profit/(tax loss) for corporate income tax purposes and the tax receivable or payable in this regard at 31 December 2017 and 2016 is as follows (in thousands of euros):

	Thousands of euros	
	2017	2016
Accounting profit before tax	70,482	25,022
Permanent differences:		
- Capital increase costs	(2,115)	-
- Change in value of investment property	(65,209)	(23,953)
- Other	(268)	-
Temporary differences		
- Deferred tax for reinvesting extraordinary gains, Art. 21 Law 43/1995	680	-
Tax base general taxation rate	2,104	952
Tax base accounting REITs	1,466	117
REIT system payment (0%)	-	-
General system payment (25%)	526	241
Total payment	526	241
Withholdings and payments on account	(3)	(134)
Income tax payable	523	107

Capital increase costs are deemed to be permanent differences since the applicable tax rate is 0%.

17.2 Reconciliation of accounting profit/(loss) and income tax expense

	Thousands of euros	
	2017	2016
Accounting profit/(loss) before tax	70,482	25,022
Permanent differences:		
- Capital increase costs	(2,115)	-
- Change in value of investment property	(65,209)	(23,953)
- Other	(268)	-
REIT system accounting profit/(loss)	1,466	117
General system accounting profit/(loss)	2,104	952
REIT system net payment (0%)	-	-
General system net payment (25%)	526	(238)
Adjustment due to sale of assets (reversal of liability due to RD)	(81)	(3)
Other adjustments	(149)	-
Income tax benefit/(expense)	(296)	(241)
Current tax	(552)	238
Deferred tax	256	3

17.3 Recognised deferred tax assets

The movement in this heading in the consolidated statement of financial position in 2017, broken down by the most important line items, was as follows:

	Thousands of euros				
	31.12.2016	Business combinations (Note 3)	Additions	Disposals	31.12.17
Deferred tax assets:					
Tax loss carryforwards	-	10,706	3,701	-	10,706
Other	296	-	82	(1)	377
	296	10,706	3,783	(1)	11,083

The changes in deferred tax assets in 2017 relate to the inclusion of tax assets from Compañía Urbanizadora del Coto S.L. (see Note 3).

These deferred tax assets have been recognised in the consolidated statement of financial position at 31 December 2017 as the Group's directors consider that, based on the best estimates of future results for the Group, including certain tax planning measures, it is likely that these assets will be recovered.

17.4 Deferred tax liabilities

Deferred tax liabilities were recognised at 31 December 2017 and 2016, mainly arising from the business combinations described in Note 3, and they originated from the differences existing between the accounting values and the tax values of the assets received from these transactions.

The variation in deferred tax liabilities in 2017 and 2016 is as follows:

	Thousands of euros
Initial balance business integrations	60,652
Derecognitions due to sales of assets	(3)
Total deferred tax liabilities at 31 December 2016	60,649
Addition due to business combinations (Note 3)	45,560
Deferred tax for reinvesting extraordinary gains, Art. 21 Law 43/1995	(175)
Derecognitions due to sale of assets	(81)
Total deferred tax liabilities at 31 December 2017	105,953

17.4 Years open for review and tax audits

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 2017, the Parent and its subsidiaries had 2013 to 2016 open for review for corporate income tax and 2014 to 2017 open for review for the other taxes applicable to them. The Parent's directors consider that the returns for the aforementioned taxes have been filed correctly and, therefore, even in the event of discrepancies in the interpretation of current tax legislation in relation to the tax treatment afforded to transactions, such liabilities as might arise would not have a material effect on the consolidated financial statements. Also, Law 34/2015, of 21 September, partially amending General Taxation Law 58/2003, of 17 December, establishes the right of the tax authorities to initiate a review and investigation procedure of the tax losses offset or carried forward or tax credits taken or carried forward, which will become statute barred after ten years from the day on which the regulatory period ends established for filing the tax return or self-assessment relating to the year or the tax period in which the right to offset the tax loss or to apply the tax credits arose.

18. Information requirements arising from REIT status under Law 11/2009, amended by Law 16/2012

Information requirements derived from the REIT status of the Parent and its subsidiaries are included in the related notes to the individual financial statements.

19. Revenue and expenses

19.1. Ordinary income

The distribution of revenue in 2017 and 2016 was as follows:

	Thousands of euros	
	2017	2016
Rent revenues	52,439	9,035
Income from provision of services	504	551
Total revenue	52,943	9,586

a) Geographical segment reporting

The breakdown of rent revenue by asset type and geographic market in 2017 and 2016 was as follows:

2017

Autonomous Communities	Thousands of euros	%
Madrid	31,645	60.3%
Basque Country	3,985	7.6%
Catalonia	2,511	4.8%
Valencia	2,150	4.1%
Balearic Islands	2,129	4.1%
Navarre	1,996	3.8%
Castilla La Mancha	1,866	3.6%
Other	6,157	11.7%
Total	52,439	100%

2016

Autonomous Communities	Thousands of euros	%
Madrid	5,660	62.6%
Basque Country	1,067	11.8%
Catalonia	175	1.9%
Valencia	417	4.6%
Balearic Islands	500	5.5%
Navarre	487	5.4%
Castilla La Mancha	467	5.2%
Other	261	2.9%
Total	9,035	100%

19.2 Personnel expenses

The breakdown of personnel expenses in 2017 and 2016 was as follows:

	Thousands of euros	
	2017	2016
Wages, salaries and similar	(2,568)	(1,871)
Other employee welfare costs and taxes	(646)	(129)
Total personal expenses	(3,214)	(2,000)

19.3 Other operating expenses

Details of this income statement heading in 2017 and 2016 were as follows:

	Thousands of euros	
	2017	2016
Non-recoverable expenses of the leased properties	13,675	2,393
Overheads		
Independent professional services	8,440	1,753
Office Rental	216	28
Taxes other than income tax	1,933	416
Other expenses	459	78
Impairment of trade receivables (Note 11)	300	65
Total other operating expenses	25.023	4,733

"Independent professional services" includes mainly the annual expense accrued for the advisory, planning and strategic management services provided by Merlin Properties SOCIMI, S.A. (see Note 20.1).

19.4 Finance expenses

The detail of the balance of this caption in the 2017 and 2016 consolidated income statements is as follows:

	Thousands of euros	
	2017	2016
Interest on loans and other	(11,338)	(1,141)
Finance costs	(11,338)	(1,141)

"Interest on loans and others" includes amortisation of the borrowing arrangement fees of 4,371 thousand euros incurred in 2017, using the effective interest method (see Note 14). Of this amount, 2,280 thousand euros related to contractual fees for cancellation of loans, as disclosed in Note 14.

19.5 Contribution to consolidated profit (loss)

The contribution of each Group company included in the scope of consolidation to results for 2017 was as follows:

Company	Thousands of euros	
	2017	2016
Full consolidation:		
Testa Residencial, SOCIMI, S.A.	61,792	24,827
Testa Alquileres Urbanos, S.L.U. (*)	(186)	(46)
Compañía Urbanizadora del Coto, S.L.	8,054	-
Valgrand 6, S.A.U.	526	-
Total	70,186	24,781

(*) Called Metrovacesa Alquileres Urbanos S.L.U. in 2016

20. Related party balances and transactions

20.1 Related party transactions

Details of transactions with related parties in 2017 and 2016 were as follows:

2017

	Thousands of euros			
	Other operating expenses	Finance expenses	Rent Revenue	Income from provision of services
Merlin Properties SOCIMI, S.A.	9,317		-	-
Banco Bilbao Vizcaya Argentaria, S.A.	-	1,162	-	120
Banco Santander, S.A.	-	4,937	161	384
TOTAL	9,317	6,099	161	504

2016

	Thousands of euros		
	Other operating expenses	Financial expenses	Income from provision of services
Merlin Properties SOCIMI, S.A.	1,813	-	-
Banco Bilbao Vizcaya Argentaria, S.A.	-	121	169
Banco Santander, S.A.	-	630	549
TOTAL	1,813	751	718

In fiscal year 2016, the Parent entered into a management services agreement with Merlin Properties SOCIMI, S.A. to provide advisory, planning and strategic services for businesses, assets and liabilities, in exchange for annual remuneration of 7.7 million euros plus value-added tax (updatable once a year to 1.5%). The agreement lasts 30 years and, in the event of early termination by the Parent or, as a result of certain situations, Merlin Properties SOCIMI, S.A. will be entitled to receive consideration equivalent to the current value of the remuneration of the management agreement for all the years in which such agreement is effective.

On 3 January 2018, the Parent notified Merlin Properties SOCIMI, S.A. of termination of the service agreement with effect from 19 January 2018 (see Note 26).

20.2 Related parties balances

The Group performs all its operations with related parties at market values. Additionally, the transfer prices are adequately supported, this is why the Parent Company's Directors consider that there are no significant risks from this aspect that could give rise to significant liabilities in the future. The detail of the balances with related parties at 31 December 2017 and 2016 is as follows:

31 December 2017

	Thousands of euros				
	Current accounts and other payables to Group companies and associates	Payables to suppliers	Bank borrowings	Other financial liabilities (Notes 3 and 15)	Cash and cash equivalents
Merlin Properties SOCIMI, S.A.	-	2,357	-	-	-
Acciona Real Estate, S.L. (Note 3)	5,400	-	-	355,565	-
Banco Bilbao Vizcaya Argentaria, S.A.	-	-	-	-	25
Banco Santander, S.A.	-	-	56,016	-	55,405
TOTAL	5,400	2,357	56,016	355,565	55,430

31 December 2016

	Thousands of euros			
	Current accounts and other payables to Group companies and associates	Payables to suppliers	Bank borrowings	Cash and cash equivalents
Merlin Properties SOCIMI, S.A.	203	2,745	-	-
Banco Bilbao Vizcaya Argentaria, S.A.	-	-	51,371	889
Banco Popular, S.A.	-	-	-	13
Banco Santander, S.A.	-	-	221,268	25,005
TOTAL	203	2,745	272,639	25,907

20.3 Remuneration of directors and senior management

Remuneration paid in 2017 and 2016 to members of the Board of Directors and senior management of Testa Residencial, SOCIMI, S.A., by item, was as follows (in thousands of euros):

31 December 2017

	Salaries	Attendance fees	Other items	Pension plans	Insurance premiums (1)	Termination benefits	Share-based payments	Remuneration of individuals representing the Company (2)
Board of Directors and Senior management	738	-	-	-	7	-	-	-

31 December 2016

	Salaries	Attendance fees	Other items	Pension plans	Insurance premiums (1)	Termination benefits	Share-based payments	Remuneration of individuals representing the Company (2)
Board of Directors and Senior management	178	-	-	-	2	-	-	-

(1) Includes the amount paid for the civil liability insurance premium for damages caused by acts or omissions by directors, totalling 19 thousand euros.

(2) Includes the remuneration paid to individuals representing the Company on the Board of Directors of other entities.

At 31 December 2017 and 2016, the Parent had not granted any advances or loans to Board members or senior management.

At the date of authorising these consolidated financial statements for issue, the Parent's directors were represented by 9 men and 1 woman (at 31 December 2016, they were represented by 10 men).

20.4 Information regarding conflicts of interest involving directors

In the year 2017 the members of the Board of Directors of Testa Residencial SOCIMI, S.A. have not communicated to the other members of the Board any situation of conflict, direct or indirect, that they or persons related to them, as defined in the Law on Corporations, may have with the interest of the Parent Company.

21. Other disclosures

21.1 Employees

The average number of employees at the Group in 2017, by professional category, is as follows:

	Number of employees	
	2017	2016
Executive directors	1	1
Senior Management	4	4
Other employees	75	45
Total	80	50

The breakdown of the Group, by gender, at 31 December 2017 and 2016, was as follows:

	31.12.2017		31.12.2016	
	Female	Male	Female	Male
Executive directors	-	1	-	1
Senior Management	1	3	1	3
Other employees	41	34	30	15
Total	42	38	31	19

In 2017 and 2016, no Group employee had a degree of disability equal to or greater than 33%.

22. Auditors' fees

Fees for audit services for the different companies in the Testa Residencial, SOCIMI, S.A. and Subsidiaries Group, provided by the main auditor Deloitte, S.L. and companies related thereto and by other auditors, were as follows:

Description	Thousands of euros	
	2017	2016
Audit services	165,000	75,000
Other audit related services:		
Other assurance services	27,000	-
Total audit and related services	192,000	75,000
Other services	-	-
Tax advisory services	-	-
Total other services	-	-
Total	192,000	75,000

23. Environmental disclosures

Given the Group's business, it has no environmental liabilities, expenses, assets, provisions or contingencies that could have a significant effect on its equity, financial position and the results of its operations.

Therefore, no specific disclosures relating to environmental issues are included in these notes to the consolidated financial statements.

24. Information on financial risk management

Financial risk factors

The Group's activities expose it to various types of financial risk: market risk, credit risk, liquidity risk and cash flow interest rate risk. The Group's overall risk management programme focuses on the uncertainty of financial markets and aims to minimise the adverse effects of such risks on the financial profitability of the Group.

Risk management is undertaken by the Group's senior management in accordance with the policies approved by the Board of Directors. Senior management identifies, evaluates and mitigates financial risks in close collaboration with the Group's operating units. The Board of Directors issues the written global risk management policies and the policies for specific areas, such as those for covering market risk, interest rate risk and liquidity risk, and for investing cash surpluses.

Market risk

In light of current conditions in the property sector, the Group has established specific measures that it plans to adopt to minimise the impact of these factors on its financial position.

The application of these measures is dependent on the outcome of the sensitivity analyses that the Company performs periodically. These analyses take the following factors into consideration:

- The economic environment in which the Group performs its activity: The design of various economic scenarios with different key variables that can affect the Group (e.g. interest rates, share prices, occupancy rates of investment property, etc.). The identification of variables that are interconnected and their degree of connection.

- Time frame within which the assessment is made: The time frame for the analysis and the potential deviations shall be taken into account.

Credit risk

Credit risk is defined as the risk of financial loss to which the Group is exposed if a customer or counterparty defaults on its contractual obligations.

As a general rule, the Group places cash and cash equivalents with financial institutions with high credit ratings.

The Group has policies in place to limit customer credit risk and it manages its exposure to credit recovery risk as part of its normal activities through, among others, guarantees and securities.

The Group has formal procedures in place to detect impairment of trade receivables. By means of these procedures and individual analyses by business areas, delays in payment can be detected and methods for estimating the impairment loss can be established.

Below are the estimated maturities of the Group's financial assets on the consolidated statement of financial position at 31 December 2017 and 2016. The attached tables break down the maturities of the financial assets at 31 December 2017 and 2016:

2017

	Thousands of euros				
	Less than 3 months	More than 3 and less than 6 months	More than 6 months and less than 1 year	Over 1 year	Total
Guarantees and deposits	-	-	-	5,074	5,074
Trade and other receivables	1,432	-	-	-	1,432
Other current financial assets	-	-	3	-	3
Cash and cash equivalents	71,158	-	-	-	71,158
Total	72,590	-	3	5,074	77,667

2016

	Thousands of euros				
	Less than 3 months	More than 3 and less than 6 months	More than 6 months and less than 1 year	Over 1 year	Total
Loans to third parties	-	-	-	-	-
Guarantees and deposits	-	-	-	3,814	3,814
Trade and other receivables	2,452	-	-	2,452	2,452
Other current financial assets	-	24	-	-	24
Cash and cash equivalents	28,801	-	-	-	28,801
Total	31,253	24	-	6,266	35,091

Cash and cash equivalents

The Group has cash and cash equivalents amounting to 71,158 thousand euros, which represent its maximum exposure to the risks of these assets.

Cash and cash equivalents are deposited with banks and financial institutions.

Liquidity risk

Liquidity risk is defined as the risk that the Group will encounter in meeting obligations associated with financial liabilities that are settled by delivering cash or other financial assets.

The Group applies a prudent liquidity risk management policy, based on having sufficient liquidity to meet its obligations when they fall due, in both normal and stressed conditions, without incurring unacceptable losses or placing the Group's reputation at risk.

Itemised below is the Group's exposure to liquidity risk at 31 December 2017 and 2016. The tables break down financial liabilities by remaining contractual term to maturity.

2017

	Thousands of euros				
	Less than 1 month	1 to 3 months	3 months to 1 year	Over 1 year	Total
Financial liabilities to banks	301	1,000	1,238	470,665	473,204
Other non-current liabilities – security and deposits	-	-	-	15,002	15,002
Other non-current liabilities	-	-	-	355,565	355,565
Trade and other payables (excluding public authorities)	4,326	-	-	-	4,326
Total	113,190	1,000	1,238	841,232	956,660

2016

	Thousands of euros				
	Less than 1 month	1 to 3 months	3 months to 1 year	Over 1 year	Total
Financial liabilities to banks	10,735	1,000	898	348,851	361,484
Other non-current liabilities – security and deposits	-	-	-	7,248	7,248
Trade and other payables (excluding public authorities)	5,956	-	-	-	5,956
Total	16,691	1,000	898	356,099	374,688

Solvency risk

At 31 December 2017, the Group's net bank borrowings came to 401,926 thousand euros as shown in the table below:

	Thousands of euros
Gross bank borrowings:	
Syndicated loan	348,181
Mortgage loans	124,602
Accrued interest	301
Cash and cash equivalents	(71,158)
Net bank borrowings	401,926

Foreign currency risk

The Group is not exposed to exchange rate fluctuations as all its transactions are carried out in its functional currency.

Tax risk

As mentioned in Note 1, the Parent will adhere to the special tax regime for REITs. Pursuant to Article 6 of Law 11/2009 of 26 October 2009, amended by Law 16/2012 of 27 December, companies that have opted for the special tax regime are required to distribute profit for the year to the shareholders in the form of dividends, once all obligations under commercial law have been met. The distribution must be approved within six months of each year-end and paid in the month following the date of the distribution resolution.

In the opinion of the directors of the Parent, at 31 December 2017 the Parent was compliant with the requirements under the SOCIMI (Spanish REIT) statutory scheme, except the requirement relating to listing its shares on the stock exchange, the deadline for which is 22 September 2018.

At its meeting of 30 November 2017, the Board of the Parent greenlighted the start of the process for listing the Parent Company's shares on Spain's "continuous market" in the coming months. For this reason, having regard to the support from shareholders, the directors believe that the listing requirement will be satisfied before the deadline, and are confident that the Group will remain within the SOCIMI scheme.

25. Third-party guarantees and other contingent liabilities

At 31 December 2017 and 2016, the Group had provided guarantees to third parties for an amount of 280 thousand euros and 265 thousand euros, respectively. Likewise, the only significant contingent liability was described in Note 20.1.

26. Events after the reporting period

Termination of management service agreement with Merlin Properties SOCIMI, S.A.

According to the decision taken in the Parent's Board of Directors' meeting of 22 December 2016, and once the term has elapsed and the conditions have been met as established in the contract among the Parent and Merlin Properties SOCIMI, S.A., in conformity with the provisions of clause 9.3 of the said contract, the Parent notified Merlin Properties SOCIMI, S.A. the dismissal of the contract effective 19 January 2018.

After confirming the accounting treatment for this termination with the Regulator, the impact of the dismissal will imply that the Group will register an expense of 108,563 thousand euros (which includes the corresponding portion of non-refundable VAT) in its consolidated financial statements for the year 2018, and a liability with Merlin Properties SOCIMI, S.A. for the same amount. Such liability may be settled in cash or shares of the Parent at its discretion.

In this connection, on 26 March 2018, the General Shareholders' Meeting of Testa Residencial SOCIMI, S.A. has approved a capital increase for compensation amounting to 89,721 thousand euros, through the issuance of 640,693,342 new shares of 0.01 euros of par value each, with an issue premium of 0,130037800013383 euros per

share issued (83,314 miles of euros). This capital increase has been fully subscribed by Merlin Properties SOCIMI, S.A. The remaining amount due that amounted to 18,840 thousand euros and corresponded to VAT has been settled in cash.

Long-term management incentive plan and exit bonus

On 26 March 2018, the General Shareholders' Meeting has approved the proposal for the listing and admission to trading of the shares of the Parent in the Spanish Stock Exchange. In this context, the Board of Directors, on the same date, has approved a long-term incentive plan for certain members of management. This plan will have a five year term and will be vested upon compliance with certain financial ratios associated with the value of the shares once admitted to trading. The maximum amount that the participants would receive under the plan would approximate to 1.8 million euros per year. The plan is to be settled in cash and shares in an equal proportion.

Additionally, the Board of Directors has also approved, in the same day, a shared-based payment, share-settled, plan for key management and other employees in the case of an initial public offering of shares. The number of shares to be received by key management members is linked to the completion of a period of service and the prices of the shares at the admission date. The number of shares for the other employees is fixed and is only linked to the completion of a period of service.

The Group will account for both plans in accordance with applicable accounting regulations.

Acquisition of new housing portfolio

On 23 March 2018, the Group has entered into a sale-purchase agreement with a third-party for the acquisition of 1,458 apartments for an approximate amount of 228 million euros. According with the terms of the contract, it is subject to certain conditions precedent, common for this type of transactions, which are expected to be met in the following months. This acquisition will be financed by means of a drawdown under the syndicated loan contracted in December 2017

27. Explanation added for translation to English

These consolidated financial statements are presented on the basis of the regulatory financial reporting framework applicable to the Group in Spain (see Note 2-1). Certain accounting practices applied by the Group that conform with that regulatory framework may not conform with other generally accepted accounting principles and rules.

Appendix I

Subsidiaries as at 31 December 2017

Company	Registered offices / activity	Equity interest	Thousands of euros								Consolidation method	Auditor
			Share capital	Profit/(loss)		Other Equity	Total Equity	Dividends received	Carrying amount			
				Operating	Net				Cost	Impairment		
Compañía Urbanizadora del Coto, S.L.	The acquisition and development of property for subsequent rental / Paseo de la Castellana 257, Madrid	99.66%	15,315	19,005	18,386	192,356	226,057	-	290,040	-	Full consolidation	Deloitte, S.L.
Testa Alquileres Urbanos S.L.U.	The acquisition and development of property for subsequent rental / Paseo de la Castellana 257, Madrid	100%	55,087	1,541	1,155	7,625	63,867	-	132,137	-	Full consolidation	Deloitte, S.L.
Valgrand 6, S.A.U.	The acquisition and development of property for subsequent rental / Paseo de la Castellana 257, Madrid	100%	10,013	248	580	411	11,004	-	12,266	(1,201)	Full consolidation	N/A

Translation of a report originally issued in Spanish. In the event of a discrepancy, the Spanish-language version prevails.

TESTA RESIDENCIAL SOCIMI, S.A. and Subsidiaries

Consolidated Directors' Report for
the year ended 31 December 2017

1. ORGANISATIONAL STRUCTURE AND FUNCTIONING

Strategy

The group Testa Residencial SOCIMI, S.A. (hereinafter the "Testa Group" or the "Group") is a group whose main objective is to generate sustainable shareholder return through the acquisition, focused management and selective rotation of residential real estate assets in moderate risk segments.

Composition

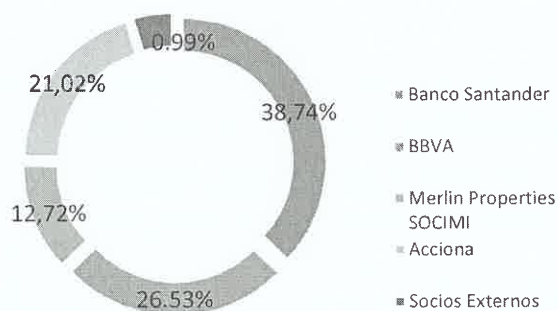
The description of the internal organisational structure may be summarised as follows:

- Board of Directors: comprising 10 directors.
- Audit Committee (AC)

The members of the Board of Directors and their categories are stated below:

- Mr. Ignacio Moreno Martínez (non-executive Chairman) Independent.
- Mr. Miguel Oñate Rino (Executive Director).
- D. Fernando Rodríguez-Avial Llardent. Proprietary.
- Mr. Isabel Antunez Cid. Proprietary.
- Mr. Carlos Manzano Cuesta. Proprietary.
- Mr. Jaime Rodríguez Andrade. Proprietary.
- Mr. Cesáreo Rey-Baltar Oramas. Proprietary.
- Mr. José María Xercavins Lluch. Report
- Mr. Antonio Hernández Mancha. Independent.
- Mr. Javier Alarcó Canosa. Independent.
- Mr. Lucas Osorio Iturmendi (non-director Secretary)

Capital structure at 31 December 2017



2. HIGHLIGHTS

ASSET CONTRIBUTION/ACQUISITION

The main contributions and purchases of assets in 2017 and 2016 were the following:

- In September 2016, the business combination of the residential real estate businesses of Metrovacesa (valued at 460 million euros) and Testa Residencial (valued at 186 million euros) was commercially formalised.
- In March 2017, investment property worth 659,723 thousand euros was added as a result of a non-monetary capital increase with the shareholder financial institutions.
- In September 2017, the Group included investment property relating mainly to homes located in Madrid totalling 413,601 thousand euros, as a result of the business combination with Acciona Real Estate S.L.
- In September and December 2017, the Group's Parent acquired homes in Madrid from third parties totalling 45,217 and 4,140 thousand euros, respectively.

The economic and operational effects of the contributions made in 2017 under the agreements between the parties have had economic effects as of April and October 2017

REFINANCING

- In December 2017, the Parent signed a syndicated loan not secured by a mortgage guarantee in the amount of 800 million euros, of which only 350 million euros had been drawn down at 31 December 2017. This loan was earmarked to repay the Parent's (Testa Residencial SOCIMI, S.A.) former syndicated loan, amounting to 250 million euros, set to mature in May 2018, and to repay the mortgage-secured syndicated loan and associated hedges taken out by the subsidiary Compañía Urbanizadora del Coto S.L. in the amount of 77 and 2 million euros, respectively.

KEY DATA OF PORTFOLIO

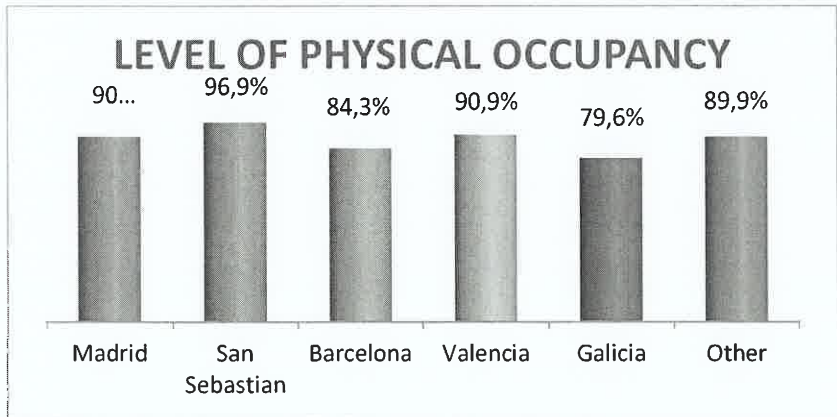
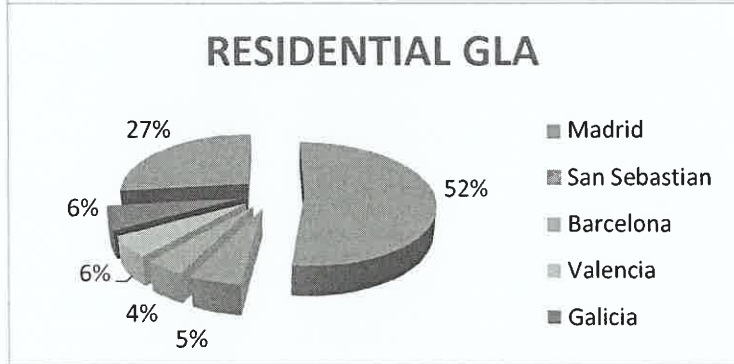
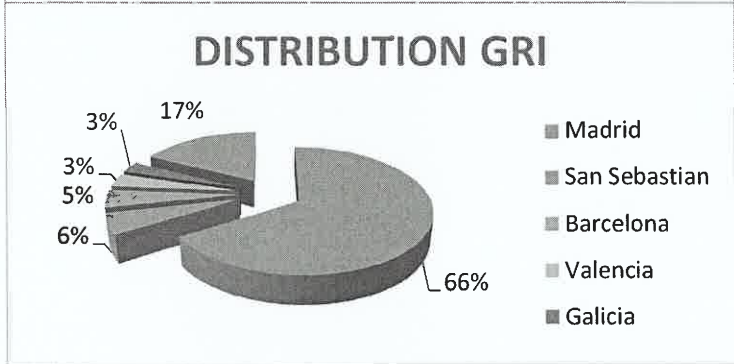
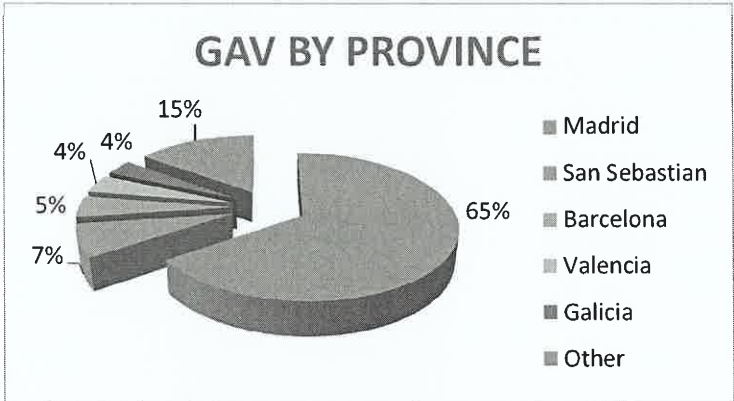
	<u>31/12/2017</u>	<u>31/12/2016</u>
Gross asset value ⁽¹⁾ (thousands of €)	2,275,521	1,078,608
2017 gross rent (thousands of €) ⁽²⁾	72,367	34,301
Gross yield (€ thousand) ⁽³⁾	3.2%	3.2%
Number of apartments (units)	9,244	4,677
Gross rent (€/m ² /month) ⁽⁴⁾	7.5	6.6
Gross rent (€/apartment/month) ⁽⁵⁾	679	618
Total residential G.L.A. (m ²)	837,739	439,765
Occupancy rate of residential portfolio	90%	92%

⁽¹⁾ According to appraisal carried out by Savills at 31 December 2017 and 2016

⁽²⁾ Calculated as gross rent at December 2017 and 2016 multiplied by 12

⁽³⁾ Calculated as gross rent divided by gross value of assets in operation

⁽⁴⁾ Calculated as gross residential rent at 31 December divided by leased building area.



KEY CONSOLIDATED FINANCIAL FIGURES (IFRS)

KEY CONSOLIDATED FINANCIAL FIGURES

(IFRS) (thousands of €)	31/12/2017	31/12/2016
Total income	53,084	9,589
Rental income	52,439	9,035
Net Rent	38,764	6,642
EBITDA	25,147	2,922
Net profit for the year	70,186	24,781
	31/12/2017	31/12/2016
Gross borrowings	473,204	361,484
Net debt	402,046	332,683
Gross asset value (GAV)	2,275,521	1,078,608
Net debt/Gross asset value (GAV)	17.7%	30.8%
Basic earnings per share (€)	0.0076	0.0053
Diluted earnings per share (€)	0.0076	0.0053

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

The separate income statement for the period ended 31 December 2017 and 2016 is shown below.

(Thousands of euros)	31/12/2017	31/12/2016
Revenue	52,943	9,586
Rental income	52,439	9,035
Rendered services	504	551
Other operating income	141	3
Other operating income	141	3
Total operating income	53,084	9,589
Asset operation expenses not passed on to tenants	(13,675)	(2,393)
Personnel Expenses	(3,214)	(2,000)
General expenses	(11,048)	(2,274)
Total operating expenses	(27,937)	(6,667)
EBITDA	25,147	2,922
Depreciation	(3,145)	(810)
Impairment loss allowances	(300)	(66)
Gains/(losses) from asset disposals	286	163
EBIT	21,988	2,209
Net financial result	(16,715)	(1,140)
Net gains of investment properties	65,209	23,953
PROFIT/(LOSS) BEFORE TAX	70,482	25,022
Income taxes	(296)	(241)
PROFIT/(LOSS) FOR THE PERIOD	70,186	24,781
Attributable to shareholders of the Parent	70,146	24,781
Attributable to non-controlling interests	40	-
Basic earnings per share (€)	0.0076	0.0053
Diluted earnings per share (€)	0.0076	0.0053

COMPARISON OF INFORMATION

In September 2016, the reverse merger took place between Testa Residencial SOCIMI, S.A. and the residential business of Metrovacesa S.A., whereby the latter was the acquiring entity. As a result, the consolidated income statement for 2016 includes only the period from the date of the combination of the two businesses, three months and 15 days, since the residential business of Metrovacesa did not have separate financial statements, as they were integrated into the financial statements of Metrovacesa, S.A.

Notes to the income statement

Gross rent corresponds to the rent on leases signed with tenants. Net rent does not include re-invoicing of tenants for common expenses, which are shown net under "Asset operation expenses not passed on to tenants".

The performance of Gross Rent in 2017 is positive, mainly as a result of the performance of the average euro price/m², which increased from €6.59 to 7.5/m². The performance of average rent for 2017 and of the occupancy rate is shown below:

	RENTAL INCOME €/M2				
	31/12/2016	31/03/2017	30/06/2017	30/09/2017	31/12/2017
MADRID	8.07	8.26	8.39	9.00	9.19
MÁLAGA	0.00	8.05	7.99	8.17	8.39
ARAGÓN	0.00	8.16	8.20	8.16	8.66
OVIEDO	0.00	4.81	4.94	5.08	5.15
PALMA DE MALLORCA	4.71	5.10	5.21	5.35	5.46
LAS PALMAS DE GRAN CANARIA	0.00	4.74	4.86	5.03	5.28
TOLEDO	3.62	3.72	3.81	4.07	4.29
VALLADOLID	4.36	4.35	4.55	4.60	4.66
BARCELONA	6.11	8.87	9.01	8.66	8.98
VALENCIA	4.53	4.70	4.73	4.88	5.06
GALICIA	0.00	4.24	4.25	4.34	4.40
PAMPLONA	4.81	4.90	4.94	4.98	5.01
SAN SEBASTIÁN	7.09	7.13	7.16	7.16	7.20
TOTAL RESIDENTIAL	6.59	6.66	6.75	7.35	7.50

Occupancy in the last six months of 2017 is positive, increasing from 88% to 90%.

General expenses include expenses from the provision of advisory, planning and strategic management services with Merlin Properties SOCIMI, S.A in exchange for an annual economic consideration of 7.7 million euros plus value-added tax. On 3 January 2018, the Parent notified Merlin Properties SOCIMI, S.A. of its withdrawal from the management agreement effective 19 January 2018.

The net financial results include the extraordinary amortisation of the debt arrangement expenses amounting to 2,280 thousand euros, which correspond to the formalisation expenses charged for the cancellation of the loans cancelled due to the refinancing carried out in December 2017.

Investment property is stated at fair value. This value is determined by reference to the appraisals carried out by independent experts.

On 22 September 2016, the General Meeting resolved that Testa Residencial Socimi, S.A. would adhere to the tax regime for Spanish listed real estate investment trusts (SOCIMIs) beginning with the fiscal year starting on 1 January 2016.

As a result, accumulated tax expense at 31 December 2017 and 2016 comes mainly from companies not subject in the period to the SOCIMI tax regime and from gains from asset disposals.

In 2017, the Testa Group generated revenue of 52,943 thousand euros, EBITDA of 25,147 thousand euros and net consolidated profit of 70,186 thousand euros mainly from operating income and net gains on investment property.

Gross operating margins and EBITDA, as well as FFO1 and AFFOR for the years ended 31 December 2017 and 2016 are shown below:

(Thousands of euros)	31/12/2017	31/12/2016
EBITDA	25,147	2,922
Income from services rendered and other	(645)	(554)
Non-recurring adjustments ⁽¹⁾	9,317	1,812
Adjusted EBITDA	33,819	4,180
	%	%
	64.5%	46.3%
Interest paid/received	(11,619)	(1,140)
Income tax paid	(114)	(133)
FFO1	22,086	2,907
Investments in improvements ⁽²⁾	(3,339)	(1,000)
AFFO	18,747	1,907

(1) Corresponds to service agreement of Merlin Properties, Socimi, S.A. cancelled on 19 January 2018.

(2) Corresponds to improvements in assets. Does not include acquisition costs of assets.

CONSOLIDATED BALANCE SHEET

ASSETS	31/12/2017	31/12/2016	EQUITY AND LIABILITIES	31/12/2017	31/12/2016
NON-CURRENT ASSETS	2,283,486	1,079,412	EQUITY	1,394,524	674,385
Intangible assets	156,442	159,410	Share capital	125,863	46,766
Property, plant and equipment	70	-	Issue premium	1,332,879	411,032
Investment property	2,106,079	912,304	Reserves	(134,800)	192,295
Non-current financial assets	9,812	7,401	Consolidated profit for the year	70,146	24,781
Deferred tax assets	11,083	296	Valuation adjustments	(336)	(489)
			Non-controlling interests	772	-
			NON-CURRENT LIABILITIES	947,505	418,158
			Long-term provisions	320	1,410
			Non-current bank borrowings	470,665	348,851
			Other non-current financial liabilities	370,567	7,248
			Deferred tax liabilities	105,953	60,649
CURRENT ASSETS	72,593	32,146	CURRENT LIABILITIES	14,050	19,014
			Short-term provisions	1,019	-
Trade and other receivables	1,432	2,452	Current bank borrowings	2,539	12,633
Other current financial assets	3	227	Current payables to Group companies	5,400	-
Other current assets	-	666	Trade and other payables	5,092	6,381
Cash and cash equivalents.	71,158	28,801	Other current liabilities	-	-
TOTAL ASSETS	2,356,079	1,111,557	TOTAL EQUITY AND LIABILITIES	2,356,079	1,111,557

Notes to the consolidated balance sheet

The main contributions and purchases of assets in 2017 were the following:

- In March 2017, investment property worth 659,723 thousand euros was added as a result of a non-monetary capital increase with the shareholder financial institutions.
- In September 2017, the Group included investment property relating mainly to homes located in Madrid totalling 413,601 thousand euros, as a result of the business combination with Acciona Real Estate S.L.
- In September and December 2017, the Group's Parent acquired homes in Madrid from third parties totalling 45,217 and 4,140 thousand euros, respectively.

The effect of the above transactions and the main effects of the changes in the balance sheet compared to 31 December 2017 are as follows:

- Increase in equity in the amount of 998.8 million euros.
- Increase in investment property in the amount of 1,122.7 million euros.

- As a result of the incorporation of the real estate assets of Acciona Real Estate, S.L., "bank borrowings" and "cash and cash equivalents" were also contributed in the approximate amount of 77.9 and 39.7 million euros, respectively, which is the main reason for the increase in financial debt and cash during the period.
- The shareholder agreement signed with Acciona Real Estate, S.L. stipulates that if the Group has not listed its shares in the stock exchange by 21 September 2022, Acciona Real Estate S.L. would be entitled to make a demand to the Group, within six months following this date, for the redemption of the shares subscribed in the contribution of September 2017. In exchange, Acciona Real Estate, S.L. would receive an amount equal to the percentage of its shares of the Group's EPRA NAV at the redemption date. The obligation would be settled, at the discretion of the Parent, either in cash or via delivery of the assets received.

This right of Acciona Real Estate, S.L. represents for the Group a potential repurchase obligation of the shares issued in the capital increase underwritten by Acciona Real Estate, S.L. Consequently, and in accordance with IAS 32, the company has recognised a non-current liability at fair value. This liability is recognised under "Other non-current financial liabilities" of the balance sheet, in the amount of 355,565 thousand euros.

The Directors of the Parent consider it highly probable that the Group will list its shares in the stock exchange prior to 21 September 2022. Therefore, the option to redeem the shares of Acciona Real Estate, S.L. will expire, and the liability will immediately become equity.

Following the asset contributions mentioned above, the composition of the Parent's share capital at 31 December 2017 is as follows:

Name/Company name	Shares	holding
SANTANDER GROUP	4,876,467,976	38.74%
BBVA GROUP	3,381,367,429	26.87%
MERLIN PROPERTIES, SOCIMI, S.A.	1,601,315,578	12.72%
ACCIONA REAL ESTATE S.A.U.	2,645,404,051	21.02%
NON-CONTROLLING INTERESTS	81,771,881	0.65%
TOTAL TESTA RESIDENCIAL SHARES	12,586,326,915	100.00%

Following capitalisation due to cancellation of the service agreement of Merlin Properties Socimi, S.A., the shareholder structure of the Parent will be as follows:

Name/Company name	Shares	holding
SANTANDER GROUP	4,876,467,976	36.87%
BBVA GROUP	3,381,367,429	25.56%
MERLIN PROPERTIES, SOCIMI, S.A.	2,242,008,920	16.95%
ACCIONA REAL ESTATE S.A.U.	2,645,404,051	20.00%
NON-CONTROLLING INTERESTS	81,771,881	0.62%
TOTAL TESTA RESIDENCIAL SHARES	13,227,020,257	100.00%

The fair value of the Testa Group's property asset portfolio amounts to 2,275,333 thousand euros and corresponds to appraisals obtained by Savills at 31 December 2017. Unrealised gains not recognised in the consolidated balance sheet at 31 December 2017 amount to 8,361 thousand euros.

GEOGRAPHICAL BREAKDOWN OF PREMIUM AND CORE MARKETS

The main indicators in the distribution of the 10 core markets in which the Group operates are as follows:

Geographical areas	Total Portfolio				Residential portfolio			
	GAV (millions of €)	GAV (%)	Gross rent (mill. €) ⁽¹⁾	Gross Yield (%) ⁽²⁾	Number of Apartments	GAV (€/m ²) ⁽³⁾	Passing rent (€/m ² /month) ⁽³⁾⁽⁴⁾	Occupancy (%) ⁽⁵⁾
Premium and Core Markets								
Madrid ^{(6)(*)}	1,450	63.7	44.0	3.0	4,431	3,520	9.6	89.0
San Sebastian ^(**)	165	7.2	4.0	2.4	510	3,482	7.2	97.0
Barcelona ^(*)	94	4.1	2.9	3.1	319	3,553	10.3	90.0
Las Palmas de Gran Canaria ^(*)	67	2.9	2.5	3.8	455	1,468	5.3	96.0
Palma de Mallorca ^(*)	62	2.7	2.4	3.9	273	1,616	5.5	96.0
Valencia ^(**)	56	2.5	1.5	2.6	225	2,161	5.1	94.0
Toledo ^(**)	54	2.4	2.1	3.9	449	1,203	4.3	91.0
Pamplona ^(*)	46	2.0	2.1	4.5	401	1,271	5.0	96.0
Valladolid ^(**)	42	1.9	1.6	3.7	448	1,297	4.7	86.0
Oviedo ^(**)	35	1.5	0.9	2.7	217	1,727	5.1	75.0
Top 10 markets	2,071	91.0	64.0	3.1	7,728	2,839	7.9	91.0
Other locations⁽⁷⁾	84	3.7	2.6	3.0	499	1,816	5.4	87.0
Total premium and core markets	2,155	94.7	66.6	3.1	8,227	2,777	7.8	90.0
Non-core assets	121	5.3	5.7	4.7	1,017	1,042	5.4	82.0
Total portfolio	2,275	100.0	72.2	3.2	9,244	2,539	7.5	90.0

(*) Premium market; (**) Core market

(1) Gross rent at 31 December 2017 multiplied by 12.

(2) Gross rent at 31 December 2017 divided by GAV.

(3) GAV divided by building area at 31 December 2017. The building area includes the useful area of the apartments plus the percentage of common areas (stairs, entrance, corridors, etc.) but does not include other common areas attached to the buildings.

(4) Gross rent divided by building area at 31 December 2017. The building area includes the useful area of the apartments plus the percentage of common areas (stairs, entrance, corridors, etc.) but does not include other common areas attached to the buildings.

(5) Leased building area divided by total building at 31 December 2017. The building area includes the useful area of the apartments plus the percentage of common areas (stairs, entrance, corridors, etc.) but does not include other common areas attached to the buildings.

(6) Referring to the Madrid Autonomous Region.

(7) Includes Alicante, A Coruña, Vigo and Málaga.

Geographical areas	Residential portfolio							
	L-f-I Rent				L-f-I Occupancy			
	30/06/2017	31/12/2017	30/09/2017	31/12/2017	30/06/2017	31/12/2017	30/09/2017	31/12/2017
Premium and Core Markets								
Madrid ^{(6)(*)}	8.7	9.1	9.3	9.6	87.9%	88.7%	89.2%	89.3%
San Sebastian ^(**)	7.2	7.2	7.2	7.2	98.6%	96.9%	96.6%	96.9%
Barcelona ^(*)	9.7	10.2	9.9	10.3	89.4%	90.3%	92.6%	90.3%
Las Palmas de Gran Canaria ^(*)	4.9	5.3	5.0	5.3	94.6%	96.3%	92.7%	96.3%
Palma de Mallorca ^(*)	5.2	5.5	5.4	5.5	91.4%	95.8%	95.4%	95.8%
Valencia ^(**)	4.7	5.1	4.9	5.1	90.3%	93.9%	88.3%	93.9%
Toledo ^(**)	3.8	4.3	4.1	4.3	91.7%	90.5%	87.3%	90.5%
Pamplona ^(*)	4.9	5.0	5.0	5.0	95.0%	96.0%	95.3%	96.0%
Valladolid ^(**)	4.6	4.7	4.6	4.7	80.1%	85.9%	81.5%	85.9%
Oviedo ^(**)	4.9	5.2	5.1	5.2	77.5%	75.5%	73.7%	75.5%
Top 10 markets	7.0	7.4	7.7	7.9	89.5%	90.5%	89.7%	90.6%
Other locations⁽⁷⁾	5.1	5.4	5.3	5.4	82.2%	87.2%	83.0%	87.2%
Total premium and core markets	6.9	7.2	7.6	7.8	89.0%	90.3%	89.3%	90.4%
Non-core assets	5.1	5.1	5.3	5.4	79.3%	80.5%	82.8%	82.3%
Total portfolio	6.7	7.1	7.3	7.5	88.0%	89.3%	88.6%	89.5%

(*) Premium market; (**) Core market

(6) Referring to the Madrid Autonomous Region.

(7) Includes Alicante, A Coruña, Vigo and Málaga.

3. DIVIDEND POLICY

The Group's dividend policy takes into account sustainable levels of distribution, and reflects the Group's forecast for the earning of recurring profit. The Group does not intend to create reserves that cannot be distributed to the shareholders, except as legally required.

Under the Spanish real estate investment trust (SOCIMI) regime, the Group will be obligated to distribute profit obtained in the year, after complying with any relevant requirement in the Spanish Limited Liability Company Law, in the form of dividends to shareholders. A decision on such distribution must occur within the six months following each year-end, as follows. (i) at least 50% of the profit from the transfer of properties and shares or stakes in qualified subsidiaries, provided the remaining profit is reinvested in other real estate assets within three years following the transfer date or, otherwise, 100% of the profit must be distributed as dividends following elapse of said period; (ii) 100% of the profit obtained from receipt of dividends paid by qualified subsidiaries; (iii) at least 80% of other profit. If the resolution on distribution of dividends is not adopted within the legally required period, the Group will lose its status as a Spanish real estate investment trust (SOCIMI) with respect to the year of such dividends.

The Group's dividend policy mandates distribution of at least 80% of the cash flow from operations, less payment of interest and less payment of ordinary expenses of asset maintenance.

4. RISKS AND UNCERTAINTIES

Financial risk management policies in the rental real estate sector are determined mainly by analysis of investment projects, management of property occupancy rates and the situation in the financial markets:

Market risk

In light of current conditions in the property sector, the Group has established specific measures that it plans to adopt to minimise the impact of these factors on its financial position.

The application of these measures is dependent on the outcome of the sensitivity analyses that the Company performs periodically. These analyses take the following factors into consideration:

- The economic environment in which the Group performs its activity: The design of various economic scenarios with different key variables that can affect the Group (e.g. interest rates, share prices, occupancy rates of investment property, etc.). The identification of variables that are interconnected and their degree of connection.
- Time frame within which the assessment is made: The time frame for the analysis and the potential deviations shall be taken into account.

Credit risk

Credit risk is defined as the risk of financial loss to which the Group is exposed if a customer or counterparty defaults on its contractual obligations.

As a general rule, the Group places cash and cash equivalents with financial institutions with high credit ratings.

The Group has policies in place to limit customer credit risk and it manages its exposure to credit recovery risk as part of its normal activities through, among others, guarantees and securities.

The Group has formal procedures in place to detect impairment of trade receivables. By means of these procedures and individual analyses by business areas, delays in payment can be detected and methods for estimating the impairment loss can be established.

Cash and cash equivalents

The Group has cash and cash equivalents totalling 71,158 thousand euros, which represents its maximum exposure to the risk associated with these assets.

Cash and cash equivalents are deposited with banks and financial institutions.

Liquidity risk

Liquidity risk is defined as the risk that the Group will encounter in meeting obligations associated with financial liabilities that are settled by delivering cash or other financial assets.

The Group applies a prudent liquidity risk management policy, based on having sufficient liquidity to meet its obligations when they fall due, in both normal and stressed conditions, without incurring unacceptable losses or placing the Group's reputation at risk.

Foreign currency risk

The Group is not exposed to exchange rate fluctuations as all its transactions are carried out in its functional currency.

Tax risk

The Parent adhered to the special tax regime for REITs. Pursuant to Article 6 of Law 11/2009 of 26 October 2009, amended by Law 16/2012 of 27 December, companies that have opted for the special tax regime are required to distribute profit for the year to the shareholders in the form of dividends, once all obligations under commercial law have been met. The distribution must be approved within six months of each year-end and paid in the month following the date of the distribution resolution.

As established by Transitional Provision One of Real Estate Investment Trust Law 11/2009, of 26 October, amended by Law 16/2012, of 27 December, the Company may opt to apply the special tax regime under the terms and conditions established in Article 8 of Law 11/2009, of 26 October, even if it does not meet the requirements therein, provided that such requirements are met within two years after the date of the option to apply that regime.

At 31 December 2017, the Parent does not meet the requirement of its shares being listed in the stock exchange, the time limit for which is 22 September 2018. The Board of Directors, in its meeting of 30 November 2017, approved the initiation of the process for listing the Parent Company's shares in the continuous market in the coming months. For this reason, and considering the support of the shareholders, the Directors of the Parent consider that the listing requirement, along with the other requirements for applying the special tax regime, will be met pursuant to applicable laws, and that the Parent Company will remain subject to the REIT tax regime.

5. TREASURY SHARES

The Group held no treasury shares at 31 December 2017 and 2016.

6. OUTLOOK/R&D/OTHER

For 2018, the Testa Group expects to maintain the same excellent occupancy rate and rent levels.

The Group also expects to continue to acquire assets that fit within its investment strategy and, at 31 December 2017, had a cash position of 71 million euros and an undrawn amount of 450 million euros of the new syndicated loan.

The Group considers that it complies with the maximum payment period with respect to the combating of late payments. The average period for payment to suppliers is approximately 15 days.

The Group did not undertake any research and development activity in 2017.

Average headcount

The average headcount of the Group in 2018 was 80, of which 47% are male and 53% are female.

Corporate responsibility

Given the nature of the Group's activity, it does not have a significant impact on the environment.

7. SIGNIFICANT EVENTS AFTER THE REPORTING PERIOD

Cancellation of service agreement with Merlin Properties, SOCIMI, S.A.

In accordance with the decision adopted by the Board of Directors of the Company on 22 December 2016, and following elapse of the terms and fulfilment of the conditions established in this regard in the service agreement entered into with Merlin Properties SOCIMI, S.A., the Company, in conformity with clause 9.3, has notified Merlin Properties, SOCIMI, S.A. of its withdrawal of the aforementioned agreement effective 19 January 2018.

The impact of this withdrawal means that the Company will record an expense of 108,563 thousand euros (which includes the portion corresponding to non-recoverable VAT) in its financial statements for 2018 as compensation for cancellation of the contract and, initially, a liability of the same amount for Merlin Properties SOCIMI, S.A. However, this liability may be settled in cash or through the delivery of shares of Testa Residencial SOCIMI, S.A., at the Company's discretion.

On 26 March 2018, the General Meeting of Testa Residencial SOCIMI, S.A., approved a capital increase via a conversion of debt into equity in the amount of 89,721 thousand euro, through the issue of 640,693,342 new shares of 0.01 euros in nominal value each (6,407 thousand euros), plus a share premium of €0.130037800013383 per share issued (83,314 thousand euros). The capital increase was fully subscribed by Merlin Properties SOCIMI, S.A. The remaining amount, relating to Value-Added Tax in the amount of 18,842 thousand euros, was settled in cash.

Long-term executive incentive plan and exit bonus

On 26 March 2018, the Board of Directors of the Company resolved to call a General Meeting, the agenda of which includes a proposal for admission to trading of Company shares in the stock exchanges of Madrid, Barcelona, Bilbao and Valencia. The Board of Directors has approved a long-term incentive plan for certain executives. The plan will have a duration of five years and accrual will be linked to the achievement of certain financial indicators related to the price of Company shares following admission to trading. The maximum amount that would be received by plan beneficiaries is approximately 1.8 million euros a year. The plan will be payable half in cash and half in shares.

In addition, the Board of Directors has approved an incentives plan payable in Company shares by the majority shareholders to key executives and other employees in the event of an initial public offering. The number of shares to be delivered to key executives will be linked to a length of service criterion and to the share price on the admission date. The number of shares for other employees is fixed and will be linked only to the length of service criterion.

Acquisition of portfolio of housing units

On 23 March 2018, the Company signed an agreement with a third party for the purchase of 1,458 housing units for an approximate amount of 228 million euros. Under its own terms, the agreement's effectiveness is subject to the fulfilment of certain conditions precedent that are standard in such transactions. The conditions are expected to be fulfilled in the coming months. The acquisition will be funded through a partial drawdown of the syndicated loan signed in December 2017.

8. ALTERNATIVE PERFORMANCE MEASURES

As indicated in Note 2 to the consolidated financial statements, the Group draws up its consolidated financial statements in accordance with the International Financial Reporting Standards adopted by the European Union (EU-IFRS). In addition to the accounting information under IFRS -EU, the Group deems it appropriate to present a range of Alternative Performance Measures (APMs) to facilitate assessment of its performance. Users should use these APMs to complement - but not replace - the financial information presented in accordance with the presentation bases for the consolidated financial statements.

In view of the particular features of its business, the Group explains its activity and performance on the basis of the following: Passing Rent (residential and other) and Average Residential Passing Rent by m2 and apartment,

Gross Annualised Rents, Performance of Like-for-Like Residential Passing Rent, Net Rent and Net Rent Margin, EBITDA, Adjusted EBITDA and Adjusted EBITDA Margin, FFO1 and FFO1 per share, AFFO and AFFO per share, Net Debt, Gross Asset Value, Gross Yield, Loan to Value, EPRA NAV, Adjusted EPRA NAV and Adjusted EPRA NAV per share as key indicators considered important for the Group and the sector in which it operates. The Group uses these measurements when planning its strategy, preparing budgets, reporting to its shareholders and reviewing the Group's performance.

The Group's management considers that these measures are commonly used among its peers in the industry. It considers measures based on EBITDA to be useful as they eliminate potential differences in operating income between the periods and companies being compared, due mainly to factors such as amortisation and depreciation, historic costs, the age of the assets, capital structures and tax regimes.

Details of the definitions, use, calculation and reconciliation of these APMs with the Group's consolidated financial statements are shown below:

Passing Rent (residential and other) and Average Residential Passing Rent per m² and apartment

The Group defines Passing Rent as the rent at which the Group's assets are leased on the last day of the period. To separate residential rent and the rent of commercial premises, parking, offices and others, the Group distinguishes between Residential Passing Rent and Other Passing Rent for these items. Average Residential Passing Rent is Residential Passing Rent divided by the number of leased square meters occupied or the number of apartments occupied. These APMs are considered useful and relevant because they represent the most current measurement possible of rent contracted and payable to the Group by its tenants.

Given the contractual nature of these APMs, they cannot be reconciled with the consolidated financial statements, but they are calculated as follows:

	euros	
	2017	2016
Residential Passing Rent	5,625,569	2,654,248
Other Passing Rent	405,000	194,990
Total Passing Rent	6,030,569	2,849,238
Residential square metres leased (m ²)	750,139	404,543
Average Residential Passing Rent (€/m²)	7.50	6.59
Number of apartments occupied (units)	8,280	4,308
Average Residential Passing Rent (€/apartment/month)	679	616

Annualised Gross Rent

The Group defines Annualised Gross Rent as the Total Passing Rent multiplied by 12. The Group uses this APM (Alternative Performance Measure) as a measurement to show expected rental income a year ahead of time taking into account the current leasing situation.

This APM, thus, emerges from direct multiplication, which means that Annualised Gross Rent at 31 December 2017 and 2016:

	Thousands of euros	
	2017	2016
Total Passing Rent	6,031	2,858
Annualised Gross Rent	72,372	34,296

Like-for-Like Performance of Average Residential Passing Rent

The Group defines Like-for-Like Average Residential Passing Rent as the percent difference between the Average Residential Passing Rent at the start and the end of a period, assuming a constant scope of leased assets during the period.

This measure is relevant for the Group because it can measure rental performance without distorting the comparison by taking into account any asset acquisitions during the period.

This APM is calculated as follows and, by its nature, cannot be reconciled with the Group's financial statements:

	Euros
	2017
(A) Average Residential Passing Rent at the end of the period for assets held from the start of the period	7.09
(B) Average Residential Passing Rent at the start of the period for assets held at the time.	6.59
Like-for-Like Performance of Average Residential Passing Rent ((A/B) -1)	7.7%

Net Rent and Net Rent Margin

The Group defines Net Rent as income from leases less non-recoverable expenses on leased properties, both as shown in the Group's consolidated financial statements. The Net Rent Margin is Net Rent divided by lease income.

These indicators are useful to the Group because they provide an initial measure of the performance and profitability of leased assets. They are reconciled and calculated based on the Group's consolidated financial statements as follows:

	Thousands of euros	
	2017	2016
Rent revenues (Note 19.1)	52,439	9,035
(-) Non-recoverable expenses on leased properties (Note 19.3)	(13,675)	(2,393)
Net Rent	38,764	6,642
Net Rent Margin	73.9%	73.5%

EBITDA, Adjusted EBITDA and Adjusted EBITDA Margin

The Group defines EBITDA as Net Rent less personnel expenses and general expenses. The Group defines Adjusted EBITDA as EBITDA less expenses considered exceptional in the period. For 2017 and 2016, these exceptional expenses arise from the service agreement with Merlin Properties SOCIMI, S.A. The Adjusted EBITDA Margin is defined and calculated as Adjusted EBITDA divided by Net Rent.

The Group and the industry uses EBITDA, Adjusted EBITDA and Adjusted EBITDA Margin as an objective and comparable performance measure for assessing its payment and cash flow-generation capacity.

Calculation and reconciliation of these indicators with the Group's consolidated financial statements are as follows:

	Thousands of euros	
	2017	2016
Net Rent	38,764	6,642
(-) Personnel expenses (Note 19.2)	(3,214)	(2,000)
(-) General expenses (Note 19.3)		
Professional Services	(8,440)	(1,753)
Office rent	(216)	(28)
Taxes other than income tax	(1,933)	(416)
Other	(459)	(78=
EBITDA	24,502	2,367
(+) Annual expense of service agreement	9,317	1,813
Adjusted EBITDA	33,819	4,180
Adjusted EBITDA Margin	64.5%	46.26%

FFO1 and FFO1 per share

The Group defines FFO1 as funds from transactions that are calculated as Adjusted EBITDA plus interest income, less interest payments and corporate income tax payments. Such income and expense are as presented in the Group's consolidated statement of cash flows. FFO1 per share is FFO1 divided by the number of shares of the Parent at the current date.

FFO1, total and per share, is a widely used key measure of liquidity in the sector where the Group operates.

It is calculated and reconciled as follows:

	Thousands of euros	
	2017	2016
Adjusted EBITDA	33,819	4,180
(-) Interest paid	(11,784)	(1,141)
(+) Interest received	165	1
(-) Corporate income tax paid	(114)	(133)
FFO1	22,086	2,907
Closing number of shares	12,586,326,743	4,676,593,732
FFO1 per share	0.0018	0.0006

AFFO and AFFO per share

The Group defines AFFO as the funds from alternative transactions calculated as FFO1 less capitalisations from improvements to investment property, excluding acquisition costs, the latter being taken from the notes to the Group's consolidated financial statements. AFFO per share is AFFO divided by the number of shares of the Parent at the current date.

Similarly to FFO1, AFFO is used because it provides a measure of liquidity generated by transactions, this time discounting the investments made by the Group to improve its assets.

	Thousands of euros	
	2017	2016
FFO1	22,086	2,907
(-) Capitalisations from improvements to investment property (excluding acquisition costs)	(3,339)	-
AFFO	18,747	2,907
Closing number of shares	12,586,326,743	4,676,593,732
AFFO per share	0.0015	0.0006

Net debt

The Group defines Net Debt as borrowings with credit institutions, bonds and other financial debts, including accrued interest payable, less cash and cash equivalents, as these are presented in the Group's consolidated statement of financial position.

This measure offers an objective view of the Group's net financial debt.

The reconciliation of this APM with the consolidated financial statements is as follows:

	Thousands of euros	
	2017	2016
(+) Non-current bank borrowings (Note 14)	473,224	348,462
(+) Current bank borrowings (Note 14)	2,238	11,998
(-) Arrangement expenses (Note 14)	(2,679)	(551)
(+) Debt interest (Note 14)	301	635
(+) Derivatives (Note 14)	120	940
(-) Cash and cash equivalents	(71,158)	(28,801)
Net debt	402,046	332,683

Gross Asset Value

The Group defines Gross Asset Value (GAV) as the gross value of its investment property and concession projects at the date measured by an independent expert appraiser.

GAV is a widely used benchmark for measuring the total value of the Group's assets.

GAV is not reconciled with the consolidated financial statements. Rather, it differs from the latter with respect to the accounting treatment of concession projects.

GAV at 31 December 2017 amounted to 2,275,521 thousand euros, whereas at 31 December 2016 it was 1,078,608 thousand euros.

Gross Yield

The Group defines Gross Yield as the Annualised Gross Rent divided by GAV.

Gross Yield is a measure that represents the gross profitability of the Group's assets.

It is calculated on the basis of previously defined APMs, as follows:

	2017	2016
Annualised Gross Rent	72,372	34,296
GAV	2,275,521	1,078,608
Gross Yield	3.18%	3.18%

Loan to Value

The Group defines Loan to Value (LTV) as Net Debt to GAV.

LTV is used as a measurement in the analysis and comparison of the Group's indebtedness and leveraging.

Consistent with its definition of LTV, it is not reconciled but rather calculated using two previously reconciled APMs, as shown below:

	Thousands of euros	
	2017	2016
Net financial debt	402,046	332,683
GAV	2,275,521	1,078,608
Loan to Value	17.7%	30.8%

EPRA NAV, Adjusted EPRA NAV and Adjusted EPRA NAV per share

The Group defines EPRA NAV as the equity attributable to the Parent plus unrealised gains on concession projects, the fair value of financial derivatives and deferred tax liabilities less deferred tax assets. Adjusted EPRA NAV aims to illustrate what the Group's EPRA NAV would be once the two corporate actions expected for 2018 become effective: payment of VAT from cancellation of service agreement with Merlin Properties SOCIMI, S.A. and conversion to equity of liability with Acciona pursuant to contractual clauses of corporate action that gave rise to the business combination described in Note 3 to the Group's consolidated financial statements. Therefore, the Adjusted EPRA NAV is calculated as EPRA NAV plus the effect the two transactions would have in equity. Adjusted EPRA NAV per share is merely the Adjusted EPRA NAV divided by the number of Parent Company shares at the current date.

The Group does not intend to use Adjusted EPRA NAV, as it has been defined, on a continuous basis in the future. Rather, it has been used in 2017 to accommodate adjustments deemed to be isolated, one-off events in the Group's business.

EPRA NAV is a widely used indicator to measure equity in the sector where the Group operates.

These indicators are reconciled and calculated as follows:

	Thousands of euros	
	2017	2016
Equity attributable to the Parent	1,393,752	674,385
(+) Unrealised gains on concession projects (Note 6)	8,361	3,444
(+) Fair value of financial derivatives (Note 14)	120	940
(+) Deferred tax liabilities	105,953	60,649
(-) Deferred tax assets	(11,083)	(296)
EPRA NAV	1,497,103	739,122
(-) VAT payment on cancellation of service agreement (Note 26)	(18,840)	
(+) Commitment with Acciona (Note 15)	355,565	-
Adjusted EPRA NAV	1,833,828	739,122
Adjusted number of shares	13,227,020,257	4,676,593,732
Adjusted EPRA NAV per share	0.1386	0.15840