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Annual Report on Directors' Compensation

MERLIN
PROPERTIES

Board of Directors

March 2017

ANNUAL REPORT ON COMPENSATION
FOR DIRECTORS OF MERLIN PROPERTIES, S.A.

A. COMPANY COMPENSATION POLICY FOR THE CURRENT YEAR (2017)

A.1 Explain the Company's compensation policy. This section will include information on:

- **General foundations and principles of the compensation policy.**
- **Most significant changes to the compensation policy with respect to the policy applied last year, as well as any changes made during the year to the terms for exercise of options already granted.**
- **Criteria used to establish the company's compensation policy.**
- **Relative importance of variable compensation items with respect to fixed components and criteria followed to determine the different components of the directors' compensation package (compensation mix).**

Explain the compensation policy

A.1.1 General foundations and principles of the compensation policy

The compensation policy of Merlin Properties SOCIMI, S.A. ("**Merlin**" or the "**Company**") for the members of the Board of Directors seeks to attract, retain and ensure the commitment of the best professionals and in this way achieve the Company's long-term objectives, while incorporating the necessary safeguards to avoid excessive risk taking and rewarding poor results.

It also takes into account the economic environment, the Company's results, the group's strategy, legal requirements, corporate governance recommendations and best market practices.

With that in mind, the Compensation Policy is based on the following principles and criteria:

- transparency of information on the compensation of the members of the Board of Directors;
- consistency with the business strategy, objectives, values and long-term interests of Merlin;
- focus on boosting the profitability and sustainability of the Company in the long term;
- acknowledgment of compensation for directors for the office of director in the strict sense, limited to non-executive directors (independent, nominee or other non-executive directors);
- compensation for executive directors solely for the performance of executive functions, and not for the tasks inherent in the office of director;
- receipt of variable compensation solely by executive directors, subject to the achievement of objectives that are linked to the interests of the shareholders, with certain specific conditions for its receipt, aligned with

prudent risk management and a medium- and long-term outlook, which drives the directors' performance in strategic terms, in addition to the achievement of short-term results; and

- inclusion of elements capable of attracting and retaining the best professionals.

A.1.2 Criteria used to establish the company's compensation policy

The Compensation Policy differentiates between non-executive directors (independent, nominee or other non-executive directors) and directors who perform executive functions at the Company.

1. The compensation of non-executive directors must (i) be transparent as regards information on directors' compensation; and (ii) provide an incentive to reward their dedication, qualifications and responsibilities, without compromising the independence of independent directors.

   This compensation will be comprised of a fixed annual allowance for the office of director and, as applicable, an additional fixed annual allowance for membership of Board committees, the amount of which will depend on the type of committee and office held thereon.

2. The compensation of directors who perform executive functions is allocated according to the terms of their contracts. In this connection, the Compensation Policy takes into account market trends and seeks to attract, retain and ensure the commitment of the best professionals. Executive directors do not receive any compensation for the office of director; they are remunerated for their executive functions and, unlike non-executive directors, they do have a variable compensation system. This system (i) constitutes a balanced relationship with value creation for shareholders; (ii) seeks to align the interests of the executive directors with the interests of the Company's shareholders through the establishment of specific objectives; and (iii) is designed to provide a medium- and long-term outlook in order to drive directors' performance in strategic terms, as well as the achievement of short-term results.

   The compensation structure for executive directors is made up of the following elements:

   - Annual fixed compensation.
   - Short-term cash incentive system (the "**STIP for Executive Directors**").
   - Long-term incentive system, payable in cash and in Company shares (the "**LTIP for Executive Directors**").
   - Severance for removal.
   - Life and health insurance benefits.
   - Exceptionally, in 2017, 2018 and 2019 executive directors will be entitled to the allocation of shares following the modification of the 2016 long-term incentive plan (the "**Past Incentives**").

A.1.3 Most significant changes to the compensation policy with respect to the policy applied last year, as well as any changes made during the year to the terms for exercise of options already granted

The Board of Directors of Merlin, at the proposal of the Appointments and Compensation Committee ("**ACC**") plans to propose a new Compensation Policy to the Shareholders' Meeting which shall be valid from the year of its approval by the Shareholders' Meeting (2017) and for the next three years (2018, 2019 and 2020).

In addition to the modification of the compensation system for non-executive directors on the terms indicated in section A.3.1, the most significant changes to this new policy with respect to the policy existing in 2016 are with respect to compensation for executive directors.

The most relevant aspects of the Compensation Policy for executive directors submitted to the Shareholders' Meeting for approval are as follows:

1. Fixed compensation: the fixed compensation amounts to be paid to executive directors have been modified.
2. Annual variable compensation: a new short-term cash incentive system is proposed (the "**STIP for Executive Directors**") which contemplates, among other matters, the deferral of payment of 50% of the incentive for a period of two years. This information is explained in section A.4 of this Report.
3. Long-term variable compensation: the previous system ("Management Stock Plan" or "MSP") is replaced with a system of long-term incentives payable in cash and in Merlin shares (the "**LTIP for Executive Directors**").
4. Introduction of upper limits or caps on the individual compensation of each executive director, calculated with respect to their fixed compensation, and applicable to both types of variable compensation.
5. Introduction of clauses for clawback of annual and long-term variable compensation: in line with corporate governance recommendations and best practices, the Company has included clauses in its Compensation Policy for the clawback of up to 100% of the variable compensation paid in certain scenarios, as described in section A.13 of this Report.
6. Severance for removal: the terms relating to severance for removal have been modified on the terms described in section A.6 of this Report.
7. With a view to ensuring that the Management Stock Plan in force during 2016 is aligned with the mid- and long-term objectives of the Company, the Board of Directors and executive team have agreed to modify the requirements for entitlement to the allocation of two-thirds of the shares which, in accordance with the MSP, must be allocated in 2017, since entitlement thereto was triggered in 2016. These shares will be awarded in 2017, 2018 and 2019 in the manner described in section C.1.2. In turn, it is planned to submit a proposal to the Shareholders' Meeting to modify the calendar for delivery of the shares deriving from the MSP.

A.1.4 Relative importance of variable compensation items with respect to fixed components and criteria followed to determine the different components of the directors' compensation package (compensation mix).

As previously mentioned, there is no variable compensation system for non-executive directors.

Directors who perform executive functions have a fully flexible variable compensation system that means that they may not receive any amount whatsoever for this item. The percentage of variable compensation may be significant if the degree of achievement of targets is high. If executive directors meet their targets, they may receive a target amount of the STIP for Executive Directors and a cap will be established for outstanding achievement of targets, linked to the fixed compensation at all times, in the amounts indicated in the compensation policy to be voted on by the Shareholders' Meeting together with this Report.

With respect to the LTIP for Executive Directors, the specific plan submitted to the Shareholders' Meeting for the period 2017-2019, both inclusive, will include a maximum amount linked to the Fixed Compensation for each year of duration of the LTIP (the calculation of which will exclude the deferred portion of the Management Stock Plan in force in 2016 described in section C.1.2 of this Report).

A.2 Information on the preparatory work and decision-making process followed to determine the compensation policy and role performed, as the case may be, by the compensation committee and other control bodies in the configuration of the compensation policy. This information will include, as the case may be, the mandate given to the compensation committee, its composition and the identity of any external advisers whose services were used to define the compensation policy. It will also indicate the category of any directors who participated in defining the compensation policy

Explain the process for determination of the compensation policy

At the date of this Report, the members of the Appointments and Compensation Committee (ACC) are Mr. Donald Johnston (Chairman), Mr. Fernando Ortiz Vaamonde, Ms. Pilar Cavero Mestre and Mr. Javier García-Carranza Benjumea, all of whom are independent non-executive directors, save for Mr. Javier García-Carranza Benjumea, who is a nominee non-executive director.

In accordance with article 45 of the Bylaws of Merlin and article 41 of the Board Regulations, the powers of the Appointments and Compensation Committee relating to the compensation policy of the members of the Board of Directors of the Company are as follows:

a) to propose to the Board of Directors the compensation policy for directors and general managers or those who perform senior management functions and report directly to the Board, the executive committees or the managing directors, as well as the individual compensation of the executive directors and the other terms of their contracts, ensuring the observance thereof;

b) to analyze, prepare and review the compensation programs on a regular basis, considering their suitability and returns, and proposing their modification or update;

c) to monitor observance of the compensation policy established by the Company; and

d) to assist the Board of Directors in preparing the report on the directors' compensation policy and submit to the Board of Directors any other reports on compensation provided for in the Bylaws.

The Board of Directors of the Company, in accordance with article 34 of the Bylaws and article 4 of the Board Regulations, has the power to approve the compensation policy for directors (for its approval by the Shareholders' Meeting) and senior executives, at the proposal of the Appointments and Compensation Committee.

The ACC has received advice from Willis Towers Watson on the definition of the components of the directors' compensation policy.

A.3 Indicate the amount and nature of the fixed components, with a breakdown, as applicable, of the compensation for performance of senior management functions by executive directors, of additional compensation for chairmanship or membership of any Board committees, of any fees for attending Board and committee meetings or other fixed compensation as director, as well as an estimate of the annual fixed compensation to which they give rise. List any other benefits not paid in cash and the fundamental parameters pursuant to which they are granted

Explain the fixed components of the compensation

A.3.1 Fixed compensation of non-executive directors (independent, nominee or other non-executive directors)

The compensation structure for non-executive directors (independent, nominee or other non-executive directors) is set out in article 38 of the Bylaws of Merlin (in the wording proposed to the Shareholders' Meeting to which the Compensation Policy has been submitted for approval). Having regard to this bylaw article, the amounts to be received by each category of director are as follows:

(i) Fixed annual allowance for the office of director: €100,000 gross per year.

If a director is appointed, removed or tenders his or her resignation during the year, the amount will be prorated according to the time that the director sat on the Board of Directors.

(ii) Fixed annual allowance for membership of Board committees:

a) €15,000 gross per year to each director sitting on the Audit and Control Committee.

b) €10,000 gross per year to each director sitting on the Appointments and Compensation Committee.

c) €5,000 gross per year to the chairpersons of each committee.

If a director is appointed or removed as a committee member during the year, the amount will be prorated according to the time that he or she sat on the committee in question.

The establishment of the maximum annual amount that Merlin may pay to the entire group of non-executive directors (independent, nominee or other non-executive directors), for the office of director, in the amount of one million, six hundred and sixty thousand euros (€1,660,000) gross per year, will be submitted to the Shareholders' Meeting of April 25, 2017 and will remain in force until the Shareholders' Meeting resolves to change it.

Executive directors will not receive this compensation under any circumstances.

A.3.2 Fixed compensation of executive directors

In accordance with the compensation policy submitted to the next Shareholders' Meeting, the annual fixed compensation for each of the executive directors in 2017 would be one million euros (€1,000,000.00) gross. This compensation is deemed to refer to a complete year. Accordingly, if the executive director vacates his or her office on a date other than the start or the end of the year, he or she will receive the amounts actually earned, in proportion to the time worked in that year.

A.4 Explain the amount, nature and principal characteristics of the variable components of the compensation systems. In particular:

- **List each of the compensation plans of which the directors are beneficiaries, their scope, date of approval, date of implementation, period of validity and main characteristics. In the case of share option plans and other financial instruments, the general characteristics of the plan will include information on the conditions for exercise of such options or financial instruments for each plan.**

- **Indicate any compensation in the form of profit-sharing or bonuses, and the reason for its award.**

- **Explain the fundamental parameters and the basis for any system of annual bonuses.**

- **Indicate the types of director (executive directors, nominee non-executive directors, independent non-executive directors or other non-executive directors) who are beneficiaries of compensation systems or plans that include variable compensation.**

- **Explain the basis of these variable compensation systems or plans, the chosen performance evaluation criteria, as well as the components and assessment methods for determining whether or not such evaluation criteria have been met and an estimate of the absolute amount of variable compensation arising from the compensation plan in force, depending on the degree of achievement of the assumptions or targets taken as a reference.**

- **As applicable, information will be given on any payment deferral periods established and/or any periods of retention of shares or other financial instruments.**

Explain the variable components of the compensation systems
Variable compensation is only applicable to the executive directors and is made up of the following elements: **1. Short-term cash incentive plan (STIP for Executive Directors)** The STIP for Executive Directors forms part and is paid out of the overall amount allocated annually by the Company to the payment of the variable compensation of all of its personnel. The maximum amount that the Company may allocate annually for the variable compensation of the entire workforce of the Company and its subsidiaries (the "**Short-Term Incentive Plan**" or "**Bonus Pool**") is the positive difference between Total Overheads and Operating Expenses. In this respect: (i) "Total Overheads": the maximum annual amount of the total general expenses of the Company and its subsidiaries, taking as a reference the higher of the following two amounts: (i) 6% of the gross income recorded in the 2017 consolidated financial statements of the Company; and (ii) 0.6% of the net asset value of the Company contained in the consolidated financial statements,

calculated in accordance with the standards of the Asociación Europea de Inmobiliarias Cotizadas - European Public Real Estate Association ("**EPRA NAV**") at December 31, 2017; these percentages will be reduced to 5.75% and 0.575%, respectively, in 2018 and 2019, and to 5.5% and 0.55% from 2020 onwards.

(ii) "Operating Expenses": the amount of the annual operating expenses of the Company and of its subsidiaries (including, in all cases, the fixed compensation of executive and non-executive personnel, the fixed compensation of executive directors, directors' compensation for the office of director or for membership of committees, audit expenses, expenses for tax, legal and labor advice, expenses for the appraisal and valuation of the real estate portfolio, leases, administrative fees, management and organizational expenses, costs and expenses associated with uncompleted transactions for the acquisition and/or sale of assets, and all other general expenses).

The Company pays the STIP for executive and non-executive personnel out of this amount. Once the above amounts have been deducted, the Board of Directors will decide on the STIP for Executive Directors, following a report by the ACC.

Prior to the Board meeting at which the Company's financial statements are prepared, the ACC will analyze the proposed amount and distribution of the STIP for Executive Directors jointly with that of the STIP for Executive Personnel and with the amounts of the other variables taken as a basis for such calculations.

In analyzing the suitability of the proposed amount and distribution of the STIP for Executive Directors, the ACC will assess the degree of achievement of the following targets:

- The forecast distribution of dividends, announced to the market by the executive team during the first quarter of 2017.
- The forecast funds for operations ("FFO") announced to the market by the executive team during the first quarter of 2017.
- The Company's strategic objectives; HR management; risk management; quality of management and the fostering of corporate social responsibility.

Additionally, with a view to establishing the individual STIP of each executive director, the ACC will assess the contribution made by each director to the abovementioned targets.

Once the Board of Directors, at the proposal of the ACC, has approved the proposed STIP for Executive Directors, the entitlement to this compensation item and its payment shall be governed by the following rules:

(i) Each executive director will be entitled to receive 50% of the STIP corresponding to him or her (the "**Upfront STIP**") on the date that the STIP (and its distribution) is approved by the Board of Directors (the "**STIP Approval Date**").

(ii) As regards the remaining 50% of the STIP corresponding to him or her (the "**Deferred STIP**"): entitlement to 25% will arise on the STIP Approval Date; entitlement to 12.5% will arise on the first anniversary of the STIP Approval Date and entitlement to the remaining 12.5% will arise on the second anniversary of the STIP Approval Date.

The STIP to which executive directors are entitled in a given year will be paid on the following dates:

(i) With respect to the Upfront STIP, jointly with the amount of the Fixed

Compensation paid in the calendar month following that of the STIP Approval Date (2018).

(ii) With respect to the Deferred STIP, on the business day following the date of the second anniversary of the STIP Approval Date (2020).

The Policy provides that, in certain cases of termination of the relationship between the executive director and the Company, the maturity and payment of the STIP for Executive Directors in force at that date will be brought forward, while in other cases the entitlement to vested amounts not received will be forfeited.

2. Long-term incentive system, payable in cash and in Company shares (LTIP for Executive Directors)

The LTIP is a variable compensation plan under which the executive directors and the members of the executive and management team from time to time, as decided by the Board of Directors, subject to a report by the Appointments and Compensation Committee and at the proposal of the executive directors, may be entitled to receive, once a predetermined period of time has elapsed and provided that set targets are met (i) a certain number of Company shares and (ii) a certain amount in cash.

The LTIP will be structured by means of one or more plans or cycles (each of them, individually, a "Plan" or a "Cycle"), the terms of which will be detailed in the Compensation Policy which, following a report by the ACC and approval by the Board of Directors, will be submitted to the Shareholders' Meeting for approval.

Specifically, for the period 2017-2019, following a report by the ACC and approval by the Board of Directors, it is envisaged that a specific multiyear incentive plan will be approved, the general terms of which are described below. The shares allocated to this multiyear incentive plan and the legally required aspects of the plan will be submitted to the Shareholders' Meeting for approval.

The incentive that may derive from the LTIP for Executive Directors, the cycle of which commences in 2017, is divided into two independent parts:

(i) Share Price LTIP: the amount will depend on the increase in the Company's share price in the period 2017-2019, and will be triggered if the shareholder return rate as a result of the increase in share value exceeds the thresholds detailed in the Plan. It will be settled by means of payment of a certain amount in cash. If the Share Price LTIP exceeds certain thresholds, it will be applied as a supplement to the NAV LTIP, within the maximum limits established for the Cycle.

The manner of calculating the incentive and the amount to be paid in cash may be consulted in the Compensation Policy to be submitted to a vote at the next Shareholders' Meeting.

(ii) NAV LTIP: the amount will depend on the increase in the EPRA NAV per share plus the dividends distributed by the Company in the period 2017-2019, and will be settled by a combination of the delivery of shares and an amount in cash.

In this connection, in order to trigger entitlement to the NAV LTIP, the EPRA NAV shareholder return rate must exceed the threshold detailed in the plan. Once this threshold has been exceeded, the amount of the incentive corresponding to the NAV LTIP will be equal to multiplying the percentage assigned to the Beneficiaries by the EPRA NAV shareholder return.

The manner of calculating the incentive and the resulting number of shares may be consulted in the Compensation Policy to be submitted to a vote at the next Shareholders' Meeting.

In all cases, the sum of the incentives deriving from the NAV LTIP and the Share Price LTIP may not exceed, per year, the upper limit (cap) determined in the Plan.

Entitlement to and payment of the LTIP for Executive Directors will be governed by the following rules:

(i) Share Price LTIP: 100% of this incentive is quantified and vested on the date of preparation of the 2019 financial statements and is paid in case in the time period indicated in the Plan as from the date of its vesting, which must be as close as reasonably possible to said date.

(ii) NAV LTIP: The amount of this incentive is quantified on the date of preparation of the 2019 financial statements but entitlement to 50% thereof will be triggered, with the applicable limits, on the first and second anniversaries of the date of its quantification, provided that the conditions detailed in the plan are met. The NAV LTIP will be paid with the limits and time periods indicated in the Plan.

The Policy provides that, in certain cases of termination of the relationship between the executive director and the Company, the maturity and payment of the cycles of the LTIP for Executive Directors in force at that date will be brought forward or the vested amounts not received will be forfeited.

3. Past Incentives

As referred to in Section A.1.3 of this Report, the Board of Directors and executive team have agreed to modify the requirements for entitlement to the allocation of two-thirds of the shares which, in accordance with the MSP, must be allocated in 2017. These shares will be allocated in 2017, 2018 and 2019 on the terms described in section C.1.2. In turn, it is planned to submit a proposal to the Shareholders' Meeting to modify the calendar for delivery of the shares deriving from the MSP.

A.5 Explain the main characteristics of the long-term savings plans, including retirement and any other survival benefit, financed in whole or in part by the company, whether funded internally or externally, with an estimate of their amount or equivalent annual cost, indicating the type of plan, whether it is a defined contribution or defined benefit plan, the terms for vesting of the economic rights in favor of the directors and its compatibility with any other severance for early termination or termination of the contractual relationship between the company and the director. Indicate the contributions made on the director's behalf to defined-contribution pension plans, or any increase in the director's vested rights in the case of contributions to defined-benefit plans

Explain the long-term savings systems
None

A.6 Indicate any severance agreed or paid in the event of termination of functions as director

Explain the severance
As part of the new policy to be submitted to the 2017 Shareholders' Meeting and subject to the approval thereof, the Company and the executive directors have agreed on a novation of their contracts in order to propose that severance in the event of termination of their relationship with the Company does not exceed, under any circumstances, an amount equal to the result of multiplying by two the fixed compensation received and the STIP for Executive Directors allocated in the twelve (12) months prior to the termination. The policy provides that severance will not be paid when the termination is due to a decision by the Company deriving from (a) a serious breach or infringement of the legal duties and obligations incumbent on them, or (b) any act or omission that causes serious damage to the Company, provided, in both cases, that the existence of such ground is declared by a competent court. The policy provides that severance may be paid in the event of the resignation of the executive director deriving from a substantial adverse modification of his or her conditions or functions. The severance is limited to an amount equal to one year of the fixed compensation received and the STIP for Executive Directors allocated in the twelve (12) months prior to the termination, where the termination is due to the resignation of the executive director as a result of a change of control at the Company.

A.7 Indicate the conditions that must be respected in the contracts of those exercising senior management functions as executive directors. Among other aspects, information will be provided on term, the limits on severance amounts, minimum-stay clauses, advance notice periods, as well as payment in lieu of such advance notice period, and any other clauses relating to hiring bonuses, as well as severance or indemnification for early termination or termination of the contractual relationship between the company and the executive director. Include, among others, noncompete, exclusivity, minimum-stay or loyalty, and post-contractual noncompete clauses or agreements

Explain the terms of the executive director contracts
The main terms of the contracts with executive directors are as follows: ▪ Term: the contracts with executive directors are for an indefinite term. ▪ Advance notice period: it is established that both parties must respect, in general and save for specific exceptions, an advance notice period of four (4) months. ▪ Failure by the Company to observe the advance notice requirement, save for the specific exceptions, will give rise to the obligation to pay indemnification in an amount equal to the advance notice period not observed. If the director fails to observe the advance notice requirements, such amount will be deducted from the settlement of amounts in his or her favor. ▪ Severance for removal: described in section A.6 above. ▪ Noncompete undertaking: Executive directors assume a 6-month noncompete

undertaking from the date of termination of their contractual relationship. The consideration for this obligation is equal to 500,000 euros, which will be paid to the director in monthly installments where the termination is to due to their resignation and such resignation does not give rise to any severance in their favor and it will be deemed absorbed (and therefore no additional payment will be payable) by the amount of severance for removal received in cases where the termination led to payment of severance to the director.

A.8 Explain any supplementary compensation earned by directors as consideration for services provided other that those inherent in their office

Explain the supplementary compensation
None in 2017.

A.9 Indicate any compensation in the form of advances, loans and guarantees granted, stating the interest rate, their essential characteristics and any amounts repaid, together with the obligations assumed on their behalf under guarantees

Explain the advances, loans and guarantees granted.
None in 2017.

A.10 Explain the main characteristics of compensation in kind

Explain the compensation in kind
The executive directors are beneficiaries of (i) an insurance policy against death or permanent incapacity to any degree, the beneficiary of which will be the executive director and/or the persons he or she designates in the event of death, as well as (ii) medical insurance, with global healthcare coverage and with a top-tier insurer, which will include as beneficiary the executive director and his or her spouse and dependent children. The sum of the premiums of both policies will amount to a maximum of €14,000 per year, which amount will be reviewed on an annual basis, in line with the habitual current parameters for this type of insurance, and will be mandatorily attributed to the executive director as compensation in kind.

A.11 Indicate the compensation earned by the director by virtue of the payments made by the listed company to a third-party entity at which the director provides his or her services, where the purpose of such payments is to remunerate the director's services at the company

Explain the compensation earned by the director by virtue of the payments made by the listed company to a third-party entity at which the director provides his or her services

None in 2017.

A.12 Any compensation item other than those listed above, regardless of its nature or the group entity making payment, especially when it may be considered a related-party transaction or when its issuance would detract from a true and fair view of the total compensation received by the director.

Explain the other compensation items
The directors form part, as insureds, of the civil liability policy for directors and executives arranged by Merlin, on the normal market terms and conditions.

A.13 Explain the steps adopted by the company in relation to the compensation system in order to reduce exposure to excessive risks and to bring it into line with the long-term objectives, values and interests of the company, to include, as the case may be, a reference to: measures envisaged to ensure the compensation policy takes into account the long-term results of the company, measures to ensure an adequate balance between the fixed and variable components of the compensation, measures adopted in relation to categories of personnel whose professional activities have a material impact on the company's risk profile, clawback formulas or clauses in order to seek the return of variable compensation components based on results when such components have been paid having regard to inaccurate data, which is subsequently shown to be patently inaccurate, and measures envisaged to prevent conflicts of interest.

Explain the measures adopted to reduce risks

The compensation systems for members of the Board of Directors do not include measurement elements that reward excessive risk-taking by the Company, since they are limited to fixed allowances for the office of director and for membership of committees.

In relation to the compensation system for executive directors, it is aligned with the long-term interests of the Company and does not encourage excessive risk-taking. As described in section A.4, the STIP amounts are linked annually to the gross income received by the Company and its subsidiaries and the net asset value, deducting the annual operating expenses of the Company and its subsidiaries. In turn, the trigger of the vesting of the LTIP will be subject, in a significant percentage, to the total shareholder return obtained during the measurement period corresponding to each Cycle of the Plan.

Accordingly, the compensation system for executive directors is linked to the Company's performance and compensation levels may not be raised if there is no correlation with the Company's results.

Moreover, the design of the compensation structure for directors of Merlin incorporates the following risk adjustments:

- The variable compensation components are sufficiently flexible to ensure that, in a scenario in which the targets linked to the variable compensation are not met, the executive directors receive only the fixed compensation.

- The STIP and LTIP form part of a multiyear system, since any compensation resulting from these plans is deferred by at least two years. In addition, executive directors must remain at the Company in order to receive such amounts in full, save in extraordinary cases.
- The LTIP links the compensation of executive directors to shareholder interests in that (i) part of the LTIP is conditional upon the performance of the share price and (ii) the incentive is paid in Company shares.

Lastly, the Directors' Compensation Policy includes a clawback clause whereby Merlin can require executive directors, in the two years following payment of the incentive, to return up to 100% of the amounts or shares received under the STIP or LTIP if any of the following circumstances occur:

- a serious penalty is imposed on the Company by the National Securities Market Commission for facts related to the discharge of the functions of an executive director at the Company; or
- there is a material restatement of the Company's financial statements on grounds attributable to one or more executive directors and unless such restatement was motivated by a change in the applicable accounting standards.

In both cases the clawback clause will be triggered where the above circumstances refer in time to any of the years taken into consideration for the determination of the STIP or LTIP for Executive Directors.

B. COMPENSATION POLICY ENVISAGED FOR FUTURE YEARS

Revoked.

C. OVERALL SUMMARY OF HOW THE COMPENSATION POLICY WAS APPLIED IN THE YEAR CLOSED (2016)

C.1 Briefly explain the main characteristics of the structure and compensation items of the compensation policy applied during the year closed, which gives rise to the details of the individual compensation earned by each director and set out in section D of this report, as well as a summary of the decisions taken by the Board in order to apply such items

Explain the structure and compensation items of the compensation policy applied during the year

C.1.1 Compensation policy for the office of director

Independent directors received an amount of €60,000 both for their membership of the Board and, as applicable, for their participation in Board committees.

The attendance fees for Committee meetings in 2016 amounted to €1,000 gross for each meeting attended by the independent directors.

C.1.2 Compensation policy for executive directors

The fixed compensation of the executive directors in 2016 amounted to €600,000 (€300,000 for each executive director). The Company also paid the premiums corresponding to the medical and life insurance policies described in section A.10. The amount of the premiums amounted to €7,118.20 for Mr. Ismael Clemente and to €4,274.24 for Mr. Miguel Ollero.

With respect to the system of variable compensation earned in 2016, its application during the year is analyzed below:

1. **Annual variable compensation**

   The Company's Appointments and Compensation Committee, taking into account (i) the degree of achievement of the quantitative and qualitative targets set for 2016 and (ii) the budget or bonus pool, has determined the amount of the annual variable compensation:

   Annual Bonus: the 2016 Annual Bonus for executive directors determined by the ACC amounted to €925,000 for Mr. Ismael Clemente and to €900,000 for Mr. Miguel Ollero. These amounts will be paid 10 days after the preparation of the 2016 financial statements (March 9, 2017).

   Restricted Annual Bonus: this amounts to the same as the Annual Bonus, that is, €925,000 for Mr. Ismael Clemente and €900,000 for Mr. Miguel Ollero.

   The directors will be entitled to collect the Restricted Annual Bonus on the Payment Date, per the following calendar:

   - 25% on March 9, 2017 (10 days after the preparation of the 2016 financial statements).
   - A further 25% on the first, second and third anniversaries of March 9, 2017 (that is, in 2018, 2019 and 2020).

   These amounts will be paid in cash in 2022. In order to receive the Restricted Annual Bonus, the directors must remain at the Company on the payment date, save in certain cases of termination of the relationship between the executive director and the Company (good leaver scenarios), in which they may receive some or all of the Restricted annual Bonus,

2. **Management Stock Plan**

   In order for the executive directors to be entitled to the delivery of shares under the Share Plan, the Company must exceed the following thresholds:

   - The total annual shareholder return must be higher than 8%.
   - The sum of (i) the EPRA NAV of MERLIN at December 31, 2016 and (ii) the total dividend (or any other form of compensation or distribution to the shareholders) distributed in the year or any year prior to the offering and admission to trading of the Company's shares, must exceed the higher of the following amounts:
     - The initial EPRA NAV (where the initial EPRA NAV is considered the net funds obtained by the Company as a result of the offering and admission to trading of its shares).
     - The EPRA NAV at December 31 of the last year giving entitlement to payment of the MSP (prior to 2016, entitlement to payment of the MSP was not generated in any other year).

     This excess will be called the High Watermark Outperformance.

   Since the above thresholds were exceeded, the incentive deriving from the MSP has been calculated according to the percentages with respect to (i) the total annual shareholder return and (ii) the High Watermark Outperformance reported to the Shareholders' Meeting held on April 6, 2016.

The applicable incentive has been divided between the average share price in the thirty (30) trading sessions on the Madrid Stock Exchange prior to the tenth day after the date of preparation of the 2016 financial statements (the "Calculation Date"), giving rise to 2,250,000 shares to be allocated to the MSP of the executive directors. This amount is within the maximum authorized by the 2016 Shareholders' Meeting, which was 2,700,000 shares.

According to the terms of the MSP, these shares should be awarded (the "Shares Awarded") on the Calculation Date. The above notwithstanding, with a view to bringing the MSP into line with the mid- and long-term objectives of the Company, the Board of Directors and executive team have agreed to modify the terms of the MSP which, in relation to the executive directors, would stipulate the following:

- The Shares Awarded on the Calculation Date to the executive directors will be limited to 750,000, corresponding to one-third of the 2,250,000 shares resulting from the above calculation.
- The remaining 1,500,000 shares (the "Remaining Shares") will be awarded on the dates of preparation of the 2017 and 2018 financial statements (50% on each of these dates), provided that, at the close of such years, the Company had the solvency levels described in the Compensation Policy. This condition will apply independently in each year. Accordingly, nonfulfillment of the condition in one year will not affect the shares to which entitlement was recognized in another year.

This modification of the conditions of the MSP is conditional upon the new Compensation Policy being approved by the Shareholders' Meeting of the Company on April 25, 2017 and not revoked during the abovementioned allocation period.

In light of the modifications to the MSP, the Board of Directors, at the proposal of the ACC, has agreed to allocate 383,333 shares to Mr. Ismael Clemente and 366,667 shares to Mr. Miguel Ollero.

In accordance with the definitions of CNMV Circular 4/2013 (as amended by Circular 7/2015), the shares actually awarded 750,000 are included under section D.1.a) ii), "number of shares". The allocation of the Remaining Shares will depend on compliance with the solvency requirements in 2017 and 2018, and such shares may not be deemed to have vested.

On the other hand, the calendar for entitlement to all of the shares linked to the MSP (2,250,000 shares) remains unchanged. That is, executive directors will be entitled to 562,500 shares on the Calculation Date, with the remainder being deferred for the next three anniversaries, at a rate of 25% on each of them (the "Allocation Dates"). This notwithstanding, it is planned to submit a proposal to the Shareholders' Meeting of April 25, 2017 to modify the delivery date of the shares provided for in the initial terms of the MSP. In this regard, 562,000 shares would be delivered as soon as possible once the new Compensation Policy is approved by the Shareholders' Meeting. The remaining shares would be delivered at a rate of 25% on each of the Allocation Dates.

If the relationship between the executive director and the Company is terminated before the last payment date, the director may receive some or all of the undelivered shares derived from the MSP (good leaver scenarios) or may not receive any shares (bad leaver scenarios).There are also specific scenarios for early settlement of the MSP in the event of a change of control at the company.

All of the shares delivered will be subject to a restricted period ending in 2023.

This restricted period will not apply if, during same, (i) the employment or commercial relationship is terminated as a result of retirement, dismissal, death or total permanent incapacity; or (ii) a change of control occurs.

C.1.3 Severance

No directors were removed in 2016, meaning that no severance for dismissal was paid to directors.

D. DETAILS OF INDIVIDUAL COMPENSATION EARNED BY DIRECTORS IN THE YEAR CLOSED (2016)

Name	Type of director	2016 accrual period
Mr. Rodrigo Echenique Gordillo	Nominee	From 10/20/2016 through 12/31/2016
Mr. Ismael Clemente Orrego	Executive	From 01/01/2016 through 12/31/2016
Mr. Miguel Ollero Barrera	Executive	From 01/01/2016 through 12/31/2016
Mr. John Gómez-Hall	Independent	From 01/01/2016 through 12/31/2016
Mr. Alfredo Fernández Agras	Independent	From 01/01/2016 through 12/31/2016
Ms. Ana de Pro Gonzalo	Independent	From 01/01/2016 through 12/31/2016
Ms. Ana María García Fau	Independent	From 01/01/2016 through 12/31/2016
Ms. Francisca Ortega Hernández-Agero	Nominee	From 10/20/2016 through 12/31/2016
Mr. Javier Garcia-Carranza Benjumea	Nominee	From 10/20/2016 through 12/31/2016
Mr. Agustin Vidal-Aragon de Olives	Nominee	From 10/20/2016 through 12/31/2016
Ms. Pilar Cavero Mestre	Independent	From October 20, 2016 through 12/31/2016
Mr. Juan María Aguirre Gonzalo	Independent	From 10/20/2016 through 12/31/2016
Ms. María Luisa Jordá Castro	Independent	From 01/01/2016 through 12/31/2016
Mr. George Donald Johnston	Independent	From 01/01/2016 through 12/31/2016
Mr. Fernando Javier Ortiz	Independent	From 01/01/2016 through 12/31/2016
Mr. Hammad Waqar Sajjad Khan	Nominee	From 01/01/2016 through 08/03/2016

D.1 Complete the following tables on the individual compensation earned by each director during the year (including compensation for executive functions)

a) Compensation earned at the Company to which this report relates:

i. Compensation in cash (€ thousand)

Name	Salaries	Fixed compensation	Attendance fees	Short-term variable compensation	Long-term variable compensation	Committee compensation	Severance	Other items	Total fiscal year t	Total fiscal year t-1
Mr. Rodrigo Echenique Gordillo										
Mr. Ismael Clemente Orrego	300			1,850				5	2,155	
Mr. Miguel Ollero Barrera	300			1,800				3	2,103	
Mr. John Gómez-Hall		60							60	
Mr. Alfredo Fernández Agras		60				17			77	
Ms. Ana de Pro Gonzalo		60							60	
Ms. Ana María García Fau		60				11			71	
Ms. Francisca Ortega Hernández-Agero										
Mr. Javier Garcia-Carranza Benjumea										
Mr. Agustin Vidal-Aragon de Olives										
Ms. Pilar Cavero Mestre		12							12	
Mr. Juan María Aguirre Gonzalo		12				1			13	
Ms. María Luisa Jordá Castro		60				11			71	
Mr. George Donald Johnston		60				8			68	
Mr. Fernando Javier Ortiz		60				8			68	
Mr. Hammad Waqar Sajjad Khan										

ii. Share-based compensation systems

MR. ISMAEL CLEMENTE ORREGO
2016 MSP in shares

Implementation Date	Options held at the start of 2016				Options allocated during 2016			
	No. of options	Shares affected	Exercise price (€)	Exercise period	No. of options	Shares affected	Exercise price (€)	Exercise period
06/04/2014	0		0.00	-	0	0	0.00	-

Conditions: -

Shares delivered during 2016			Options exercised during 2016				Options vested and not exercised	Options held at the end of 2016			
No. of Shares	Price	Amount	Exercise price (€)	No. of options	Shares affected	Gross profit (€ thousand)	No. of options	No. of options	Shares affected	Exercise price (€)	Exercise period
383,333	10.6735	4,092	0.00	0	0	0	0	0	0	0.00	-

Entitlement to these shares and the delivery thereof is subject to the calendar described in section C.1. In this connection, if the new Compensation Policy is approved at the next Shareholders' Meeting, only 287,500 shares will be delivered in 2017. However, such shares will be subject to a restricted period ending in 2023.
The share price has been determined as the average share price in the thirty (30) trading sessions on the Madrid Stock Exchange prior to the tenth day after the date of preparation of the 2016 financial statements.

MR. MIGUEL OLLERO BARRERA
2016 MSP in shares

Implementation Date	Options held at the start of 2016	Options allocated during 2016

	No. of options	Shares affected	Exercise price (€)	Exercise period	No. of options	Shares affected	Exercise price (€)	Exercise period
06/04/2014	0	0	0.00	-	0	0	0.00	-
Conditions: -								

Shares delivered during 2016			Options exercised during 2016				Options vested and not exercised	Options held at the end of 2016			
No. of Shares	Price	Amount	Exercise price (€)	No. of options	Shares affected	Gross profit (€ thousand)	No. of options	No. of options	Shares affected	Exercise price (€)	Exercise period
366,667	10.6735	3,914	0.00	0	0	0	0	0	0	0.00	-
Entitlement to these shares and the delivery thereof is subject to the calendar described in section C.1. In this connection, if the new Compensation Policy is approved at the next Shareholders' Meeting, only 287,500 shares will be delivered in 2017. However, such shares will be subject to a restricted period ending in 2023. The share price has been determined as the average share price in the thirty (30) trading sessions on the Madrid Stock Exchange prior to the tenth day after the date of preparation of the 2016 financial statements.											

iii. Long-term savings systems

iv. Other benefits (€ thousand)

ISMAEL CLEMENTE		
Compensation in the form of advances, loans granted		
Interest rate of the transaction	Essential characteristics of the transaction	Amounts repaid

0.00		There is no compensation in the form of advances or loans granted	None
Life insurance premiums		**Guarantees provided by the Company for directors**	
2016 fiscal year:	**2015 fiscal year:**	**2016 fiscal year:**	**2015 fiscal year:**
2	0	No guarantees have been provided by the Company for directors in 2016	No guarantees have been provided by the Company for directors in 2015

<table>
<tr><th colspan="4">MIGUEL OLLERO</th></tr>
<tr><th colspan="4">Compensation in the form of advances, loans granted</th></tr>
<tr><th colspan="2">Interest rate of the transaction</th><th>Essential characteristics of the transaction</th><th>Amounts repaid</th></tr>
<tr><td colspan="2">0.00</td><td>There is no compensation in the form of advances or loans granted</td><td>None</td></tr>
<tr><th colspan="2">Life insurance premiums</th><th colspan="2">Guarantees provided by the Company for directors</th></tr>
<tr><th>2016 fiscal year:</th><th>2015 fiscal year:</th><th>2016 fiscal year:</th><th>2015 fiscal year:</th></tr>
<tr><td>2</td><td>0</td><td>No guarantees have been provided by the Company for directors in 2016</td><td>No guarantees have been provided by the Company for directors in 2015</td></tr>
</table>

b) Compensation earned by Company directors for membership of boards at other group companies:

MERLIN PROPERTIES

c) Summary of compensation (€ thousand):

	Compensation earned at the Company				Compensation earned at group companies:				Total		
Name	Compensation in cash	Number of shares granted	Profit from options exercised	Total fiscal year t Company	Compensation in cash	Number of shares granted	Profit from options exercised	Total fiscal year t Group	Total fiscal year t	Total fiscal year t-1	Contributions to savings systems
Mr. Rodrigo Echenique Gordillo											
Mr. Ismael Clemente Orrego	2,155	4,092		6,247					6,247	1,996	
Mr. Miguel Ollero Barrera	2,103	3,914		6,017					6,017	1,944	
Mr. John Gómez-Hall	60								60	18	
Mr. Alfredo Fernández Agras	77								77	67	
Ms. Ana de Pro Gonzalo	60								60	45	
Ms. Ana María García Fau	71								71	65	
Ms. Francisca Ortega Hernández-Agero											
Mr. Javier Garcia-Carranza Benjumea											
Mr. Agustin Vidal-Aragon de Olives											
Ms. Pilar Cavero Mestre	12								12		
Mr. Juan María Aguirre Gonzalo	13								13		
Ms. María Luisa Jordá Castro	71								71	65	
Mr. George Donald Johnston	68								68	62	
Mr. Fernando Javier Ortiz	68								68	63	
Mr. Hammad Waqar Sajjad Khan											

D.2 Report on the relationship between the compensation obtained by directors and the results or other performance measures of the company, explaining, as the case may be, how variations in the company's performance may have influenced the variation in directors' compensation.

This aspect has been addressed in section C.1.2 of this Report.

D.3 Report on the outcome of the consultative vote by the Shareholders' Meeting on the annual report on directors' compensation for the previous year, indicating the number of votes against cast, if any.

	Number	% of total
Votes cast	191,394,326	59.2497%

	Number	% of votes cast
Votes against	101,738,652	53.1566 %
Votes in favor	84,832,774	44.3235%
Abstentions	4,822,900	2.5199 %

E. OTHER INFORMATION OF INTEREST

If there are any material aspects relating to directors' compensation that have not been addressed elsewhere in this report and which are necessary to provide a more comprehensive and reasoned view of the compensation structure and practices of the company, provide a brief explanation.

Section D.1 a) i)

The "other items" column includes the cost of the health insurance policy with reimbursement of medical expenses described in section A.10.

50% of the amounts indicated in the "short-term variable compensation" column will not be received until 2022. In order to receive the full amount, the directors must remain at the Company on the payment date, save in certain cases of termination of the relationship between the executive director and the Company (good leaver scenarios), in which they may receive some or all of it.

Section D.1 a) iii)

In relation to the shares indicated in this section and that are not to be delivered in 2017, if the relationship between the executive director and the Company is terminated before the payment date, the director may receive some or all of the shares derived from the MSP (good leaver scenarios) or may not receive any shares (bad leaver scenarios). There are also specific scenarios of early settlement of the MSP in the event of a change of control at the Company.

* * *