

**Report on the activity of the Audit and Control Committee of
MERLIN Properties, SOCIMI, S.A.
during the fiscal year ended December 31, 2016**

February 2017

1. Introduction

The organization and powers of the Audit and Control Committee of MERLIN Properties SOCIMI, S.A. (the “**Committee**” and the “**Company**”) are regulated in article 40 of the Regulations of the Board of Directors and article 44 of the Bylaws, both of the Company. These articles establish, in brief, the following key features of the Committee:

1.1. Composition

The Committee:

- (i) is made up of non-executive directors in the number determined by the Board of Directors, between a minimum of three (3) and a maximum of five (5), all of whom must be non-executive directors and the majority of whom must be independent; its members shall be appointed:
 - (a) by the Board of Directors at the proposal of the Appointments and Compensation Committee; and
 - (b) taking into account their knowledge and experience of accounting, audit or risk management matters (having regard to this, in particular, in the election of its chairman);
- (ii) shall appoint from among its number:
 - (a) a chairman, who must be an independent director; the chairman must be replaced every four (4) years, and may be re-appointed once one (1) year has elapsed since his/her replacement; and
 - (b) a secretary and a deputy secretary, who need not be committee members of the Committee;
- (iii) currently has the following composition:

MEMBER	OFFICE	CATEGORY AS DIRECTOR
Ms. María Luisa Jordá Castro	Chairwoman	Independent
Ms. Ana María García Fau	Member	Independent
Mr. Juan María Aguirre Gonzalo	Member	Independent
Ms. Francisca Ortega Hernández-Agero	Member	Nominee

1.2. Operation

The Committee:

- (i) is called to meetings by its chairman, either at his/her own initiative, at the request of the chairman of the Board of Directors or that of any of the members of the Committee itself;
- (ii) shall meet at least quarterly in order to review the periodic financial information which, in accordance with the applicable legislation, the Board of Directors must submit to the stock exchange authorities, as well as the information that the Board of Directors must approve and include within its annual public documentation;
- (iii) shall be validly convened where the majority of its members are present in person or by proxy; and
- (iv) its resolutions shall be adopted by a majority of the members present in person or by proxy (the chairman's vote being the casting vote in the event of a tie).

1.3. Main tasks

The Committee has as its main tasks:

- (i) to report to the Shareholders' Meeting on questions raised in relation to the matters falling within its remit;
- (ii) to present to the Board of Directors the proposed selection, appointment, re-appointment and replacement of the external auditors and the conditions of their engagement;
- (iii) to obtain information on the audit plan and its implementation;
- (iv) to ensure the independence and effectiveness of the internal audit function;
- (v) to periodically review the internal control and risk management systems of the Company and, in particular, the correct design of the internal control and financial reporting ("ICFR") management system;
- (vi) to approve the internal audit plan for assessment of the ICFR, and any amendments thereof, and receive periodic information on the outcome

of its work, as well as the action plan to correct any deficiencies observed;

- (vii) to annually receive from the external auditors (a) a declaration of their independence, (b) information on the additional services of any kind provided and (c) the fees received from these entities by the external auditor, or by persons or entities related to the auditor, in accordance with the provisions of audit legislation;
- (viii) to supervise the process for preparation and presentation of the financial statements of the Company and the periodic financial information that, in accordance with the applicable legislation, the Company must provide to the markets;
- (ix) to issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion on the independence of the auditor or audit firms;
- (x) to appoint and supervise the services of external appraisers in relation to the valuation of the Company's assets; and
- (xi) report in advance to the Board of Directors on the creation or acquisition of holdings in special purpose vehicles or entities domiciled in countries or territories considered to be tax havens, the economic conditions and the accounting impact and, where applicable, the exchange ratio of structural or corporate modifications planned by the Company and transactions with related parties.

2. Activities pursued by the Committee

2.1 Meetings

In 2016, the Committee met twelve (12) times (in particular, on February 15, February 23, May 11, June 21, July 6, July 27, August 10 (on this occasion, within a board meeting), September 20, October 19, October 25, November 10 and December 12, all of 2016), all face-to-face meetings except for the meeting of October 19 which was held by written consent and without a meeting:

2.2 General activities

Generally speaking, at its meetings during fiscal year 2016 and in performing the functions entrusted to it, the Committee has:

- (i) reviewed and reported on the presentation of the separate and consolidated financial statements for the year ended December 31, 2015, as well as on the quarterly and half-yearly financial information required (during fiscal year 2016) of the Company, as a listed company, by the applicable legislation;
- (ii) reported on the external audit conducted in relation to the year ended December 31, 2015, as well as on the limited and preliminary reviews conducted by the external auditor in relation to the financial information for the first quarter and half year required of the Company during fiscal year 2016;
- (iii) taken note of the related-party transactions on a half-yearly basis;
- (iv) supervised the execution of the internal audit work within the context of the internal control systems;
- (v) has appointed and supervised the services of the external appraisers in relation to the valuation of the assets of the Company;
- (vi) reviewed and approved the ICFR Manual and the Accounting Policies Manual of the Group;
- (vii) taken note of and reported favorably on the corporate transactions performed with Testa Inmuebles en Renta, SOCIMI, S.A. and Metrovacesa, S.A.;
- (viii) reviewed and updated the:
 - (a) the Audit Statute;
 - (a) the Code of Ethics of the internal audit function; and
 - (b) the Audit Processes Manual;
- (ix) kept the Risk Map up to date; and
- (x) informed the Board of Directors of the work entrusted to the external auditor (Deloitte) during the year in progress.

2.3 Specific activities

As part of the specific functions entrusted to it, the Committee has pursued the following activities in 2016:

2.3.1 Internal audit tasks

The internal audit department is currently made up of two people.

Within its powers and among other aspects, the Committee:

- (i) ensures the independence and effectiveness of the function of that department, supervising, among other aspects, the annual work plan for it; and
- (ii) approves its budget and supervises its remuneration.

Accordingly, in fulfilling the responsibilities assigned to it, in 2016 the Committee:

- (i) has promoted the implementation of the Statute of Internal Audit Activity, the Code of Ethics of the Internal Audit Activity and the Manual of Internal Audit Processes;
- (ii) has conducted a review of the strategic plan for the internal audit and the progress of the anti-money laundering tasks;
- (iii) has reviewed and approved an annual work plan for 2016;
- (iv) at its meetings held on February 23, May 11, July 6, July 27, September 20, October 25, November 10 and December 12, all of 2016, the head of the internal audit function or, alternatively, a manager of the Company, appeared before the Committee and presented the developments and advances in its area of responsibility, paying special attention to the various degrees of progress of the work, models and processes being carried out in this respect (mainly the ICFR, preparation of key procedures, as well as the implementation of a crime prevention model and a risk management system).

2.3.2 Risk management

The Company has in place a corporate risk management model supervised by the Committee, which serves to identify potential events that may affect the organization, to manage its risks and to provide reasonable security for the achievement of its objectives.

The Committee (with the support of the Internal Audit Department) supervises the model, based on the application of the risk management methodology through the supervision of the identification and assessment of the risks (likelihood and impact) that affect the objectives of each of the areas. In implementing the plan, it assesses and concludes on the sufficiency and effectiveness of the controls put in place by the Company, issuing, where appropriate, recommendations.

The year 2016 saw the completion of the start-up phase of the Company' Internal Control Model, which began in early 2015. This phase allowed the Company to identify critical processes and draw up the policies, manuals and relevant procedures, which were approved in 2016 and include:

- (i) The ICFR Manual, as well as certain procedures which formed part of the Internal Control over Financial Reporting (ICFR) System, which includes:
 - (a) Property Acquisition;
 - (b) Property Finance;
 - (c) Invoices Issued and Invoices Received;
 - (d) Invoices Issued Collection and Invoices Received;
 - (e) Expense Reports;
 - (f) Asset Management;
 - (g) Procurement;
 - (h) Tax Return Filing; and
 - (i) NAV Calculation;
- (ii) a Manual on the Functions of the Crime Prevention System;
- (iii) an ethics channel;
- (iv) the Criminal Risk Map; and
- (v) a manual on the Criteria and Procedures for Reporting Relevant Information.

In 2016, in addition to adjusting the contents of the above-mentioned policies, manuals and procedures, the Committee, in conjunction with the head of the internal audit function, resumed the task undertaken by;

- (i) supplementing the ICFR Manual;
- (ii) supplementing and approving the Financial Risk Matrices;
- (iii) promoting and developing the manuals on:
 - (a) Prevention of Money Laundering and Financing of Terrorism, in conjunction with an independent expert (PwC) and a team from MERLIN;
 - (b) Risks Management Systems;
 - (c) Financial and Accounting Policy;
 - (d) Risk Control and Management;
 - (e) Corporate Risk Map;
 - (f) Classification of Information Security; and
 - (g) General Controls over Information Technologies.
- (iv) developing new public communication and power of attorney review procedures.

2.3.3 Financial information

With respect to the preparation and presentation of the mandatory financial information of the Company and its Group, the Committee has worked this year on the following items:

- (i) at the meeting of the Committee of February 23, 2016:
 - (a) following a presentation by the external auditor, the separate and consolidated financial statements of the Company were reviewed and reported on favorably;
 - (b) all of the related-party transactions performed in 2015 were analyzed and it was concluded that they were performed on reasonable arm's length terms and that they do not represent a significant amount that could compromise any of the parties;

- (ii) at the meeting of the Committee of May 11, 2016, the financial statements and directors' report for the first quarter close of 2016 were presented for the report thereof to the market and the Financial Plan of the Group;
- (iii) at the meeting of the Committee of September 20, 2016, the financial information on the earnings for the first half of 2016 was presented for the reporting thereof to the CNMV and the market;
- (iv) at the meeting of the Committee of October 19, 2016, the Committee reported favorably on the pro forma financial statements of the business combination of Merlin and Metrovacesa, for the period ended June 30, 2016, and the provisional liquidity statement for the distribution of an interim dividend;
- (v) at the meeting of the Committee of November 10, 2016, the financial statements for the third quarter of the Company and the Consolidated Group.

2.3.4 External auditors

In 2016 the external auditors of the Company (Deloitte) have appeared before the Committee at its meetings of (i) February 23, and (ii) September 20, both of 2016. The key aspects of the appearances were as follows:

- (i) At the meeting of February 23, 2016, the auditor:
 - (a) set out the following, among other points, within the framework of the work performed on the financial statements (i) the main audit risks; (ii) the main items on the consolidated balance sheet and income statement; (iii) revalued acquisition costs, the amounts of guarantee deposits and the embedded derivative; and (iv) the main increases in the balances of equity accounts, the conclusion reached being that the Company's audit report will contain no qualifications; and
 - (b) handed over its letter of independence in respect of the work performed during the year 2015.
- (ii) at the meeting of September 20, 2016, the auditor:

- (a) set out (i) the review undertaken of the financial statements at June 30, 2016; (ii) its conclusions with respect to situations of fraud; and (iii) generally, the presentation of an unqualified audit report on the Company;
 - (b) summarized the main aggregates in the balance sheet;
 - (c) described the review undertaken of equity accounts and current liabilities;
 - (d) explained that the main differences in the income statement with respect to previous figures derived from an increase in revenues owing to an increased level of activity, which has a direct impact on net revenues;
 - (e) set out its analysis of the main risks;
 - (f) made reference to compliance with the requirements of the SOCIMIs regime, the accounting treatment given to the stock plan for management personnel and bonuses, and referred briefly to the spin-off of Metrovacesa, S.A.; and
- (iii) At the meetings of July 27 and December 12, 2016, the work entrusted to Deloitte, other than audit work, was reported on.

2.3.5 Regulatory compliance

2.3.5.1 Criminal risk prevention (Corporate Defense)

In 2016, the Committee has supervised the monitoring and control of criminal risks, in the context of the preventive analysis of criminal risks that may affect the Company's Group and extend criminal liability to Merlin as a legal entity.

2.3.5.2 Ethics channel

The ethics channel acts as a mechanism that enables employees to confidentially report the potentially significant irregularities, in particular financial and accounting irregularities, that they detect at the company. The Appointments and Compensation Committee informs the Committee of any reports received, the status of their resolution and the conclusions reached. In 2016 and as of the date of publication of this report, no reports have been received through this channel.

2.3.5.3 Corporate transactions

With respect to corporate and structural modification transactions, the Committee has taken prior note and has reported on the transactions (and the related documentation) performed by the Company in the year which have concluded with the merger by absorption of Testa Inmuebles en Renta, SOCIMI, S.A. and the total spin-off of Metrovacesa, S.A. (in which the Company acted as a recipient).

3. Action plan for fiscal year 2017

The Committee's action plan for fiscal year 2017 will center on continuing with the functions and powers inherent in the Committee, as regulated in the Board Regulations, and mentioned in section 1 of this report.

Accordingly, and against the above backdrop, the Committee intends, as actions for 2017, to:

- (i) oversee the financial information preparation process;
- (ii) approve the Risk Map for 2017 and the anticipated updates based on risk priority;
- (iii) determine in greater detail the narratives and flowcharts of key processes most relevant to the preparation of financial information;
- (iv) monitor the work of supervision and review of controls being carried out as risk prevention measures;
- (v) monitor the application of the internal control over financial reporting (ICFR) system, receive periodic information on the outcome of its work and, where appropriate, prepare an action plan to correct the deficiencies observed, establishing greater controls to mitigate any type of risk;

- (vi) monitor the application of the Crime Prevention and Detection Model to receive periodic information on its application and prepare an action plan to correct the deficiencies observed, establishing greater controls for this kind of risk;
- (vii) carry out exhaustive and ad hoc monitoring:
 - (a) of the activity of the internal audit department;
 - (b) of the financial information of the Company and its group so that the information supplied to the market is as accurate and suitable as possible;
- (viii) maintain a smooth and ongoing dialogue with the external auditor, determining, as precisely as possible, the scope of its work, revising its conclusions, monitoring any other non-audit work, as well as any issues that may jeopardize its independence; and
- (ix) approve and monitor the annual work plan of the Internal Audit Department, including at least the following actions:
 - (a) monitoring the risks of Metrovacesa's integration into Merlin;
 - (b) analyzing the management carried out at occupied properties;
 - (c) auditing the management of certain specific material assets of different types and sector;
 - (d) preparing a process relating to: (i) the actions that are taken at unproductive land lots; (ii) contracts with suppliers; and (iii) hiring of external appraisers; and
 - (e) reviewing existing controls on asset managers.
- (x) follow up on the recommendations identified in control audits; and
- (xi) support Corporate Social Responsibility tasks.