Non-performing assets decreased in the year, and there was considerable rotation and an improvement in the composition of foreclosed assets.

Highlights

— In 2017, the Group adapted to ECB recommendations outlined in its Guidance to Banks on Non-Performing Loans, a process that notably included the approval of a Strategic Plan and Operating Plan specifically focusing on reducing non-performing assets; the results are visible in the excellent progress made in reducing non-performing assets, in line with the trend of the last few years, coupled with positive performance by real estate assets. In 2017, the Group reduced the volume of NPAs by c.€3,500 million (including €1,252 million in NPAs) in the carve-out for the new Solvia Desarrollos Inmobiliarios business line), exceeding the initial objectives.

— Real estate sales started contributing a positive net return (profit) from the second half of the year.

— Solvia continues to post solid performance, most notably in real estate asset sales.

Business overview

The Asset Transformation and Industrial and Real Estate Holdings Department horizontally manages non-performing and real estate exposures, as well as establishing and implementing the strategy for real estate investees, including Solvia.

With regard to non-performing and real estate exposures, the Department focuses on implementing the asset transformation strategy and on an integrated approach to the Group's real estate assets with a view to maximising their value.

Management priorities in 2017

In 2017 Banco Sabadell adapted to the recommendations contained in the ECB's Guidance to Banks on Non-Performing Loans, most of which were already part of the asset transformation strategy established in previous years and of the guiding principles for the Asset Transformation business unit, whose main goal is to improve the non-performing asset recovery and transformation processes with a view to maximising their value potential, either by optimising their management or divesting them, whichever is the best option.

Consequently, the Bank has approved ambitious goals to reduce non-performing assets in the next few years, and it has formally established two strategic priorities that govern the management of this kind of assets:

— Continuous reduction of non-performing assets (doubtful exposures and foreclosed real estate assets) until the balances are normalised.

— Focus on managing non-performing assets through the specialised services of the Asset Transformation and Industrial and Real Estate Holdings Department, which was one of the first banking workout units in Spain focusing specifically on managing assets of this kind.

The defined strategy is built on five pillars that have been identified as being critical in the process of managing non-performing assets (NPAs):

— Globality, understood as segmented management of all problematic and potentially problematic exposures: end-to-end vision of the process to transform problematic exposures, with special emphasis on timely management. Reducing the flow of assets being classified as non-performing and in default is vital to normalise non-performing assets.
— Specialisation and segmentation of responsibilities by processes and portfolios to underpin the management approach, so that each type of NPA is treated in the most adequate manner with a view to reducing them as far as possible.
— Maximisation of recovery and monetisation of NPAs, boosting efficiency of management processes in terms of time and cost.
— Multi-channels and transactional capacity: Banco de Sabadell has developed specific channels that afford it considerable transactional capacity to recover its exposure to NPAs.
— Alignment of the entire organisation in managing and controlling NPAs under the principle of three lines of defence, ensuring the independence of the Asset Transformation and Industrial and Real Estate Holdings Department from the rest of areas that took part in granting the non-performing exposures.

The following aspects provide fundamental support in the process of managing non-performing assets:

— Business intelligence and continuous process improvement, in order to develop and deepen capacities to segment and predict recovery actions, so as to systematise, continuously improve, corporatise and optimise processes throughout the recovery cycle.
— Financial capacity to ensure the proper present accounting coverage of the incurred and expected losses associated with these assets and the capacity to generate future revenues with which to cover potential impairments and solid capitalisation levels to cover potential unexpected losses from NPAs.
— Governance system based on three lines of defence, in which, after the first line of defence, featuring the specialised independent workout unit (Asset Transformation and Industrial and Real Estate Holdings Department), and the business units that approved the exposures, there is a second independent line of oversight, comprising the Risk Control and Compliance Departments, followed by a third line of defence, namely Internal Audit, which reviews the adequacy and quality of the entire process.

To implement this strategy, the Asset Transformation and Industrial and Real Estate Holdings Department is structured into various units, each focusing on one stage of the recovery process and the administration, management and transformation of NPAs, having considerable experience and expert knowledge of the various areas of the process. This organisational structure, which has changed over the years to adapt and better respond to the needs and priorities as driven by the established goals, and which has proven its worth, as evidenced by the steady continuous improvement in the reduction of the Group's doubtful and non-performing exposures in the last few years, comprises the areas listed below at 2017 year-end, each of which focuses on specific aspects of the process. The loan loss recovery and default management process involves the following areas:

The main mission of Delinquency Prevention and Management is to implement the policies and decisions on the transformation of non-performing exposures, fostering a mutual approach wherever this is the most suitable way to resolve the specific case, and paying special attention to the social exclusion risks in some of these situations.

Technical Recoveries manages external collection, bankruptcy and litigation, aimed at optimising the recovery of credit risk through external channels and/or litigation, when mutual negotiation is not sufficient or is not considered to be suitable.

The Corporate Loan Restructuring Department specialises in dealing with issues surrounding the recovery of corporate, property and developer exposures and focuses on loan restructuring, recovery and loss minimisation within that borrower category.

The Business Intelligence, Control and Asset Protection Scheme Department is a Group-wide servicing unit tasked with optimising and continually improving the Group's recovery processes and with overseeing the management of those processes. Its responsibilities include the development and exploitation of existing information on the Group's various NPAs to facilitate optimum financial decision-making with regard to the various transformation alternatives.

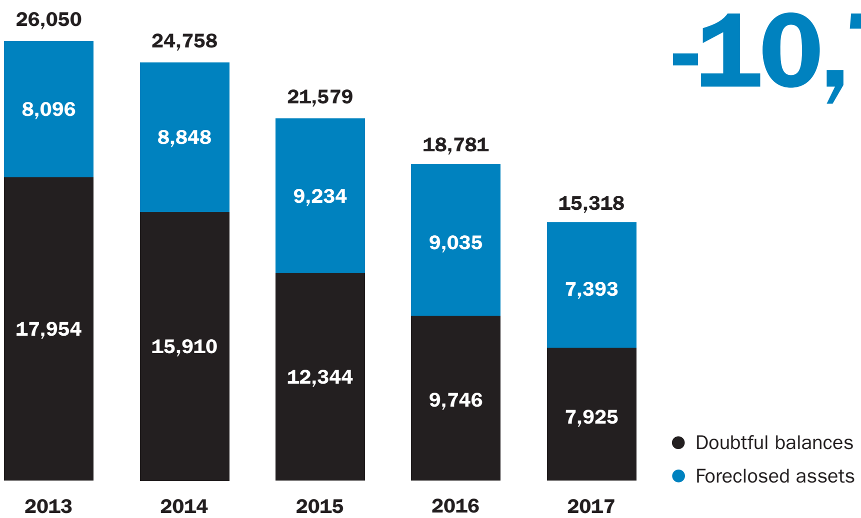
As for the management of Real Estate Exposure and of Real Estate Assets received as payment of debts, the Asset Transformation and Industrial and Real Estate Holdings Department uses the Sabadell Real Estate and Institutional Markets Department, which is in charge of horizontally managing the Group's real estate exposure and its transformation, with the clear goal of reducing doubtful exposures by optimising their value, improving the return on non-problematic exposures and the orderly growth of new investment, all under the focus of portfolio risk and return (G3 & G4). This department also manages the divestment of NPA portfolios through processes aimed at institutional and wholesale investors with perimeters chosen as a function of the needs and policies of the Sabadell Group and it analyses and reviews the strategies and models for managing NPAs in order to maximise the efficiency of recovery processes. Notable among the real estate subsidiaries is Banco Sabadell's real estate services provider: Solvia.

With regard to past due debt recovery actions in 2017, it is especially important to note that Banco Sabadell has continued to proactively manage mortgage defaults on customers' main residences, seeking solutions that avoid litigation and avoiding evictions in any event. Consequently, 2,592 dation in payment transactions amounting to €420 million were arranged, As a result of offering housing solutions to customers at risk of social exclusion who affected by mortgage litigation proceedings or dation in payment processes, the Bank has close to 7,500 low-rent homes, including those contributed to the Social Housing Fund and more than 850 homes with affordable rent.

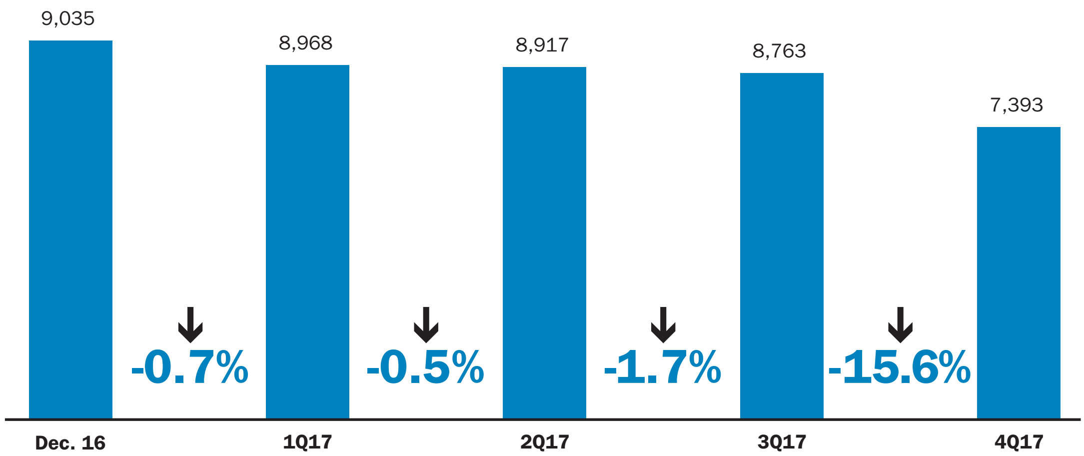
In 2017, assets totalling €2,751 million were transacted, with a positive contribution to the income statement, resulting in a net reduction in the total volume of problematic properties compared with the start of the period and intensifying the trend commenced in the previous year, with the prospect of ongoing positive performance in 2018. In this connection, professional asset sales (plots, land and unfinished non-residential product) increased for the second consecutive year. The year-on-year increase in the volume of professional assets sold was 16.4%, boosted by the notable rise in interest among foreign professional investors in this product type. The Group has continued to develop the institutional sales channel to maximise the divestment volume and price, as well as to enhance customers' experience.

Furthermore, in the fourth quarter, as a result of the increase in land development and proprietary development activity, embodied in the creation of Solvia Desarrollos Inmobiliarios, land and plots with specific potential and scope for appreciation were identified and transferred to this new subsidiary.

G3 NPLs and foreclosed assets



-10,732€M



G4 Variation in foreclosed assets(€M)

Key business data

Net profit in 2017 amounted to -€943.4 million, affected by the extraordinary provisions in the year (T11).

Net interest income amounted to -€52.1 million, less than the previous year due to the decline in the loan book that is in run-off mode.

Income from financial transactions was impacted by the sale of non-performing loans. Gross income amounted to €30.1 million, down 38.4% on the previous year.

Administrative expenses and depreciation and amortisation charges increased by 7.6% year-on-year to -€162.7 million as a result of the expansion of the servicer and increase in the portfolio of hotels managed by Hotel Investment Partnership.

Provisions and impairments amounted to -€1,215.8 million, due to the extraordinary impairments in the year. Disposals produced a net loss of -€14.1 million, i.e. an 85.4% improvement on the previous year. Real estate disposals in the last two quarters of the year produced €8.5 million and €5.1 million, respectively, in profit.

T11 Key figures — Asset Transformation

€M

	2016	2017	% 17/16
Net interest income	**(26)**	**(52)**	**98.8**
Equity-accounted affiliates and dividends	(1)	(1)	(49.9)
Fees and commissions (net)	(1)	2	—
Net income from financial transactions and exchange differences	(50)	(37)	(25.7)
Other operating income/expense	128	118	(7.6)
Gross income	**49**	**30**	**(38.4)**
Administrative expenses and depreciation and amortisation	(151)	(163)	7.6
Operating profit/(loss)	**(102)**	**(133)**	**29.5**
Provisions and impairments	(801)	(1,216)	51.9
Gain/(loss) on disposals	(96)	(14)	(85.4)
Gain/(loss) on derecognition of assets, etc.	—	41	—
Profit/(loss) before tax	**(903)**	**(1,307)**	**44.8**
Income tax	263	364	38.3
Profit/(loss) after tax	**(640)**	**(943)**	**47.5**
Minority interest	—	—	—
Profit/(loss) attributable to the group	**(640)**	**(943)**	**47.5**
Ratios (%)			
ROE (profit / average shareholders' equity)	—	—	—
Cost:income (general administrative expenses / gross income)	—	—	—
NPL ratio (%)	31.7%	32.2%	—
Coverage ratio (%)	54.2%	49.9%	—
Assets	**17,956**	**15,384**	**(14.3)**
Loans and advances to customers (net), excluding repos	6,663	3,865	(42.0)
Real estate exposure (net)	4,716	3,372	(28.5)
Liabilities	**15,886**	**13,728**	**(13.6)**
On-balance sheet customer funds	172	104	(39.7)
Intercompany funding	14,057	12,627	(10.2)
Assigned capital	**2,069**	**1,656**	**(20.0)**
Off-balance sheet customer funds	**15**	**27**	**83.0**
Other indicators			
Employees	825	1,018	23.4
Branches	—	—	—

Capital gains on asset disposals include mainly the sale of hotel management subsidiary HI Partners Holdco Value Added via Hotel Investment Partners.

Sound management of real estate assets continued and net lending fell by 42.0% year-on-year, while net real estate exposure declined by 28.5%.

The recovery in the Spanish real estate market has enabled Solvia to develop new businesses.

Solvia

Solvia, Banco Sabadell's real estate services provider, was very active in 2017. Solvia is one of the main real estate solution platforms, covering a broad range of services: from property development to asset management and sales. In addition, it provides loan management and settlement services for some customers.

Solvia continued to develop its business by diversifying its customer portfolio. This year new customer assets were added to the development portfolio, and new customers acquired to which advisory services were provided in selecting assets for development and in managing the marketing developments. Furthermore, Solvia provides real estate consultancy services for foreign funds acquiring portfolios in Spain.

In 2017 work was ongoing to develop the range of agent services (sale and rental) for individuals and companies. In this connection, Solvia has boosted the capacity of its team and, in particular, is in the process of expanding its own network of agents and consultants for companies, as well as raising its profile through the franchise network. At the end of 2017, it had 18 own offices and had signed contracts with 41 franchisees in the main Spanish cities. The company continued to invest in its marketing capability and in 2017 continued to lead the market in brand recognition.

In 2017, Solvia property sales amounted to €1,778 million and the loan recovery activity which Solvia executes for Sareb remained highly dynamic, generating €191 million in liquidity. Solvia managed and marketed 101 real estate developments in the year, starting with plots belonging to its customers, and sales of developments exceeded €83 million in the year.

BS Capital

BS Capital is the department that manages the Bank's industrial holdings. It focuses on taking up temporary holdings in companies, with the main goal of maximising the return on investment.

In 2017, it continued to actively manage its portfolio of investees, continuing with a divestment programme going back several years. New projects under way include notably fundraising for Aurica III, FCR in the amount of €160 million, exceeding the target amount of €150 million; this fund has made its first two investments. Another new project was the incorporation of Sinia Capital, the Mexican subsidiary of Sinia Renovables, through which seed capital and mezzanine debt investments were made in two wind power projects in Mexico; additionally, the Bank invested in more than 8 digital or technological startups through Sabadell Venture Capital, including the very first investment in venture debt, and the arrangement, management and sale of holdings from debt restructuring and capitalisation processes continued.