



INDEPENDENT
AUDITORS'
REPORT



CONSOLIDATED
STATEMENT OF
FINANCIAL POSITION



MEMORIA
CONSOLIDADA

CONSOLIDATED DIRECTORS' REPORT

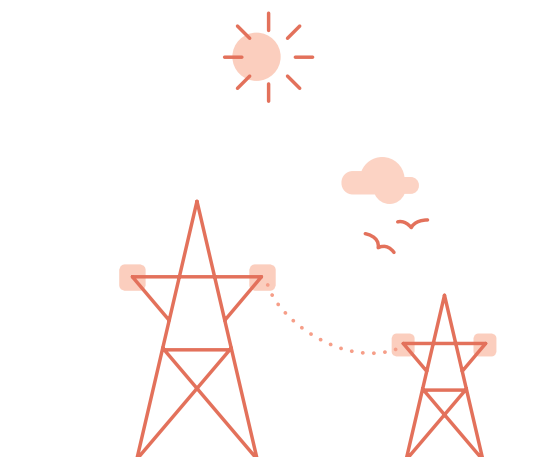
CONSOLIDATED
DIRECTORS'
REPORT





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1 Company position

1.1. ORGANISATIONAL STRUCTURE

Corporate bodies

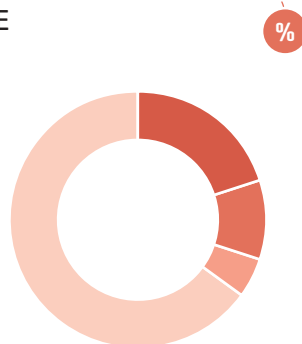
The board of directors and the shareholders are responsible for governing and managing the Red Eléctrica Group and its Parent, Red Eléctrica Corporación, S.A. [hereinafter REC].

The shareholders' general meeting is governed by the articles of association and the general meeting regulations, in accordance with the Spanish Companies Act. The ownership structure at the date of the 2016 shareholders' ordinary general meeting was as follows:

OWNERSHIP STRUCTURE

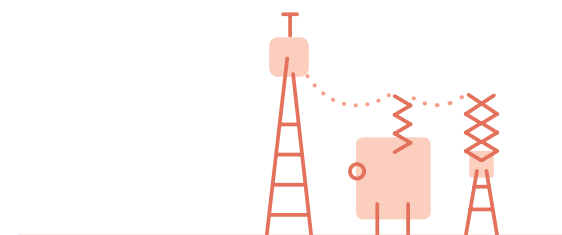
SEPI	20
Non-controlling investors	10
Spanish institutions	4
Foreign institutions	66

Information from 2016 General Shareholders Meeting.



The board of directors has formed two permanent committees: the Audit Committee and the Appointments and Remuneration Committee, which are regulated by the articles of association and the regulations of the board of directors, as well as by all applicable corporate governance legislation.

At 31 December 2016 the board of directors of Red Eléctrica Corporación, S.A. was made up of 11 members. At its meeting held on 29 November 2016, the board resolved to accept the resignation of Mr. Agustín Conde Bajén from the position of independent director of the company. At 31 December 2016, therefore, one independent director position on the board of directors and on the Appointments and Remuneration Committee was vacant.



The composition and powers of the board of directors and the various committees are as follows:

BOARD OF DIRECTORS



POWERS

- Approval of the general strategies and policies of both the Company and the Group.
- Group risk control.
- Effective supervision of the management team.
- Annual assessment of the quality and efficiency of the Board and functioning of its Committees.

AUDIT COMMITTEE



CHAIR:
Independent Director

POWERS RELATING TO:

- Supervision of the process to prepare the Company's financial and economic information.
- Supervision of internal control and risk management systems.
- External auditor independence.
- Compliance with legal provisions and internal regulations.
- Powers regarding shareholder relations.

APPOINTMENTS AND REMUNERATION COMMITTEE



CHAIR:
Independent Director

POWERS RELATING TO:

- Appointment and removal of directors.
- Board and senior management remuneration policy.
- Compliance with director duties.
- Management of the Board assessment process.
- Information, supervision and proposals in relation to corporate governance and responsibility.
- Preparation of the gender diversity report that is submitted to the Board for approval.





In view of the commitment undertaken by the company chairman at the general shareholders meeting held in April 2012, and considering international best practice in the field of corporate governance, at the extraordinary meeting held on 17 July 2015, called specifically for that purpose, the board of directors of Red Eléctrica submitted for the approval of the shareholders a proposal to segregate the positions of chairman of the board of directors and chief executive of the company, and to appoint Juan Lasala Bernad as executive director. The two motions were passed, with votes in favour from 99% of the shareholders, compared to the required quorum of 58%. At its meeting held on 28 July 2015, the board of directors appointed the new executive director as managing director of the company.

A transition period was established for the segregation of powers, which ended on the date of the shareholders' ordinary general meeting in 2016, resulting in full segregation of duties between the positions of chairman of the board and managing director. Since that meeting, the chairman of the board of directors has only had the responsibilities inherent in that position.

Until the shareholders' 2016 ordinary general meeting, the chairman continued to exercise executive powers, focusing his efforts on directing, supporting and overseeing the transfer of executive powers to the new managing director to enable an orderly and systematic transfer of those powers during the transition period.

Moreover, the position of coordinating independent director created in 2013 has been maintained, since the shareholders and proxy advisors consider that this position embodies an efficient corporate governance practice through the responsibilities attributed to it.

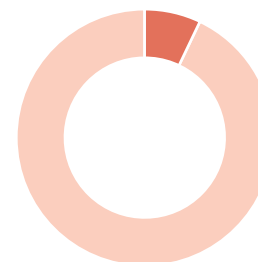
The Annual Corporate Governance Report, which is attached hereto, contains detailed information regarding the composition and operation of the governing bodies of the Parent.

Composition of the Red Eléctrica Group

The Red Eléctrica Group's principal activity is electricity transmission and system operation in Spain via Red Eléctrica de España S.A.U. [REE], which generates 92% of consolidated revenues and represents 92% of the Group's total assets (93% and 94%, respectively, in 2015). Other activities together account for the remaining 8% of revenues and 8% of total assets (7% and 6%, respectively, in 2015). The Group is present in six countries: Spain, Peru, Chile, the Netherlands, Luxembourg and France.

RED ELÉCTRICA CORPORACIÓN [REC]

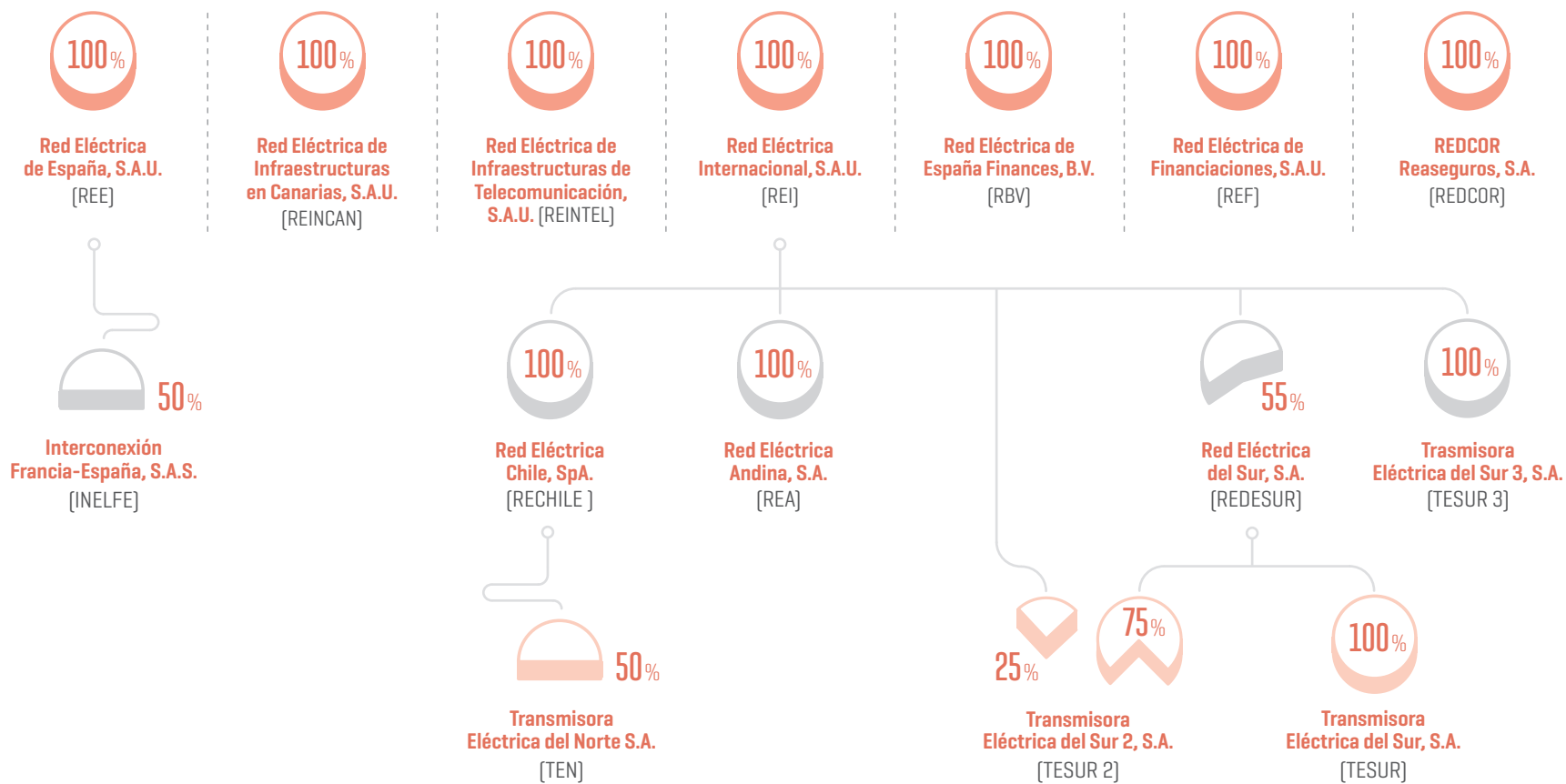
Red Eléctrica de España [REE]	92
Electricity activities in Spain <i>[Consolidated revenue]</i>	
Other activities	8
<i>[Consolidated revenue]</i>	
Red Eléctrica Internacional [REI] Electricity activities outside the Spanish system: in Perú via REDESUR, REA, TESUR, TESUR 2 y TESUR 3 and in Chile via RE Chile and TEN.	
REINTEL Telecommunication activities.	
BV and REF Financing activities.	
REDCOR Reinsurance of the risk of each Group Company.	



In 2016, there were changes in the consolidated Group, as described in [note 2g](#) to the consolidated annual accounts. At 31 December 2016, the composition of the Group was as follows (for more information on the activity of each company, see Appendix I to the notes to the consolidated annual accounts):



RED ELÉCTRICA CORPORACIÓN, S.A. [REC]





1.2. ACTIVITIES AND BUSINESS PERFORMANCE

The Group carries out the aforementioned activities in Spain and abroad, most notably electricity transmission in Spain, Peru and Chile, and rendering telecommunications services to third parties.

Role of transmission agent and system operator for the Spanish electricity system

The mission of Red Eléctrica de España, S.A.U. [hereinafter REE], as transmission agent and system operator for the Spanish electricity system, is that of ensuring that the Spanish electricity system functions correctly and guaranteeing the continuity and security of the electricity supply at all times. To this end, it oversees and coordinates the generation and transmission system and manages the development of the transmission network. The Company seeks to fulfil its mission while adhering to the principles of neutrality, transparency, independence and economic efficiency, so as to offer a secure, efficient and high quality electricity service to society as a whole.

The approval of the Plan for 2015-2020 has brought the certainty required to implement the Investment Plan.

2016 is the first year in which the remuneration for the transmission activity has been set pursuant to the new remuneration model approved in 2013.

Investments in the transmission network in 2016 totalled Euros 398.5 million and were basically to address technical restrictions, extend the network mesh, execute specific projects for international interconnections and inter-island underwater connections, and to ensure security of supply and network reliability.

During the year, 673.6 km of new lines and 61 new substation bays came into service, while transformation capacity was increased by 1,500 MVA, bringing the nationwide total up to 86,044 MVA.

The most significant initiatives in terms of development and renewal of the transmission network, by major works or axes, were as follows:

- > Asturias-Galicia Link: the purpose of this axis is to ensure security and quality of supply throughout the northern axis, connecting the north of Galicia and the west of Asturias to address forecast consumption in the region and facilitate evacuation of new generation energy. A large portion of this axis entered into service before 2011. In 2016, the Boimente-Pesoz line came into service.
- > Godelleta axis: aimed at resolving technical restrictions in Valencia. In 2016 further progress was made on construction and towards its entry into service.
- > Torremendo axis: aimed at enhancing the reliability of the transmission network in Alicante. In 2016 further progress was made on construction and towards its entry into service.
- > Sabinal axis: construction of the pertinent input and output points has increased the reliability of the electricity supply to Gran Canaria, reducing the concentration of electricity generation in the island's northern hub and relieving the Jinamar substation.



- > Aragón-Levante line: this line connects the Aragón, Fuendetodos, Muniesa, Mezquita and Morella substations, enabling new generation wind power to be evacuated and reinforcing the transmission network. In 2016, the Mezquita-Morella line came into service.

Actions to reinforce international and inter-island interconnections included the following:

- > Interconnections with France: in 2016 the preliminary works and studies for the planned new interconnections with France were ongoing. All of these facilities are expected to enter into service after 2020.
- > Inter-island interconnections: these include the Mallorca-Ibiza interconnection aimed at resolving Ibiza's isolation in terms of electricity, as well as enabling system cost savings and encouraging competition in energy generation on the islands. This new link reinforces the electrical integration of the Balearic Islands and the Spanish mainland and is essential to guarantee a reliable supply of energy to the archipelago.

The electrical connection takes the form of a dual high-voltage alternating-current link with a power of 100 MVA per circuit, a voltage of 132 kV, and a total length of 126 km. The second line of this link came into service in February 2016

- > Other inter-island connection projects are at the preliminary stages: Mallorca-Menorca, Ibiza-Formentera and Lanzarote-Fuerteventura.

The most notable events in 2016 were as follows:

- > Mainland energy demand closed the year at 249,923 GWh, up 0.6% on 2015. Corrected for the effect of working patterns and temperatures, demand attributable primarily to economic activity remained relatively level vis-à-vis 2015 and without growth, unlike in the previous year when growth of 1.7% was posted.
- > Maximum instantaneous power was recorded on Tuesday 6 September at 13:32 hours, at a rate of 40,489 MW. This is down 0.6% on the maximum for the prior year, and is 10.9% lower than the record of 45,450 MW posted on 17 December 2007. Peak demand in terms of time was also posted on 6 September [between 13:00 and 14:00 hours] at 40,144 MWh, 10.5% below the all-time high obtained in 2007.
- > Installed capacity on the mainland has fallen compared to the prior year, ending 2016 at 100,088 MW, which is 916 MW [0.9%] less than at December 2015. The most notable variations were seen in coal-fired production, where power slid 932 MW as a result of the closure of the Compostilla 2, Elcogás, Narcea 1, Puertollano and Soto de la Ribera 2 plants. The capacity of other technologies either did not vary or changed only insignificantly.
- > In 2016 the auctions for the rendering of the interruptibility service in 2017 were successfully conducted. Specifically, the country's electricity-intensive industry competed to be assigned the service in auctions that awarded 2,975 MW of interruptible resources for 2017.

> In 2016, renewable energy's percentage contribution to total energy generation in the electricity system climbed to 40.8% [36.9% in 2015]. In absolute terms, renewable generation is up 7.8% on the prior year, essentially due to the 27.6% increase in hydroelectric generation.

> Electricity exchanges through the mainland-Balearic Islands link resulted in a net balance of exports to the islands of 1,251 GWh [6.4% less than in 2015], covering 21.4% of their demand.

> At the 2016 year end, total annual demand for electricity in non-mainland systems had increased by 1% on the prior year. By systems, demand rose by 0.7% in the Balearic Islands, 1.3% in the Canary Islands and 2.6% in Ceuta, but declined by 2.4% in Melilla.

> International electricity exchanges resulted in a net import balance for the first time since 2003, totalling 7,667 GWh in 2016. Exports amounted to 14,178 GWh [15,089 GWh in 2015] and imports totalled 21,845 GWh [14,956 GWh in 2015].

Canary Islands infrastructure

Red Eléctrica Infraestructuras en Canarias, S.A.U. [REINCAN] is the Red Eléctrica Group company that develops pumped-storage hydroelectric power plants in the Canary Islands. These are geared towards security of supply, system security and the integration of unmanageable renewable energies, pursuant to article 5 of Law 17/2013.

In 2015 the Soria-Chira 200 MW hydroelectric pumping power plant project in Gran Canaria was transferred to the system operator, as stipulated in Order IET/728/2014 of 28 April 2014. Once REE had assumed ownership of the project in 2016, and pursuant to Law 17/2013, for the purposes of implementing a new energy model in Gran Canaria to improve security of supply, system security and the integration of renewable energies, a revised project was submitted in July 2016, which includes technical and environmental improvements.

The revised project was declared to be of strategic interest by the Regional Government of the Canary Islands in 2016 and has been submitted for consideration by the government. As such, it is estimated that construction may begin soon.

Telecommunications business

The Red Eléctrica Group's telecommunications business primarily operates in Spain, doing so through the subsidiary Red Eléctrica Infraestructuras de Telecomunicación, S.A.U. [REINTEL].

REINTEL is the Red Eléctrica Group company responsible for operating telecommunications networks and rendering telecommunications services to third parties.

REINTEL is a neutral provider of telecommunications infrastructure. Its principal activity is leasing dark fibre and associated infrastructure. REINTEL has a fibre optic network in excess of 33,000 km rolled out over the electricity transmission grid and the railway network, guaranteeing transparent access on equal terms to its customers and to sector players.



No significant events were recorded in 2016 that could influence the performance of the business. REINTEL has been awarded, for a period of 20 years, the rights to use and operate the fibre optic network not used for railway services, and the related infrastructure, owned by Adif-Alta Velocidad. This transaction was executed on 20 November 2014.

International business

The Red Eléctrica Group has conducted its international business through its subsidiary Red Eléctrica Internacional, S.A.U. [REI], which holds equity investments in the Peruvian companies Red Eléctrica Andina, S.AC. [REA], Transmisora Eléctrica del Sur, S.A. [TESUR], Transmisora Eléctrica del Sur 2, S.A. [TESUR 2], Transmisora Eléctrica del Sur 3, S.A. [TESUR 3], Red Eléctrica del Sur, S.A. [REDESUR], and also has companies in Chile, namely Red Eléctrica Chile, S.p.A. [RECH] and Transportadora Eléctrica del Norte, S.A. [TEN].

In 2016, the management excellence of REDESUR and TESUR [the companies that manage transmission infrastructure in Peru] and their commitment to stakeholder satisfaction allowed them to offer a transmission service with maximum availability, while supporting development in their operating environment.

For REDESUR, consolidation of the Integrated Management System [IMS] has allowed the company to continue delivering excellent operating standards, with a network availability factor of 99.86% in 2016, above the average for the last five years [99.8%].

TESUR, meanwhile, is currently at the initial stages of operating the concession for the 220 kV Tintaya-Socabaya transmission line, awarded in 2010 for a

period of 30 years following its entry into commercial service in mid-2014. The availability factor for TESUR's network was 99.85% in 2016.

REA renders maintenance services for the REDESUR and TESUR facilities. Furthermore, in 2016 REA completed all of the tasks required to implement the special projects undertaken by REDESUR, as well as carrying out the pending actions relating to TESUR facilities and rendering management services for TESUR 2 and TESUR 3 construction projects.

REA also carries out facilities maintenance and supervises works for other clients, consolidating its position in southern Peru as a leading provider of such services.

The new TESUR 2 and TESUR 3 projects, awarded in 2015, are currently under construction and at different stages of development.

TESUR 2 has been awarded the concession for the 115 km, 220 kV Azángaro-Juliaca-Puno line, and associated substations, in Peru. This project involves the design, construction, operation and maintenance of the line for 30 years and the expected investment is USD 70 million. The project is currently at the construction stage, now that all the pertinent administrative permits have been obtained.





TESUR 3 has been awarded the concession for the 129 km, 220 kV Montalvo-Los Héroes line, and associated substations, also in southern Peru. This project involves the design, construction, operation and maintenance of the line for 30 years and the expected investment is approximately USD 40 million. The project was awarded in December 2015 and is at the initial stages of the construction phase, the concession agreement having been signed in September 2016.

RECH was acquired by REI in November 2015. Its principal activity is the acquisition, holding, administration and management of any equity investments the Group may hold in Chile. REI holds 100% of this company's share capital, which amounts to US Dollars 110 million. In turn, RECH holds a 50% equity investment in Transmisora Eléctrica del Norte (TEN), while the other 50% is held by the Chilean company Engie Energía Chile, a subsidiary of the ENGIE Group.

Both of these companies are involved in the construction and commercial operation of the Mejillones-Cardones transmission line in Chile, which is being developed by TEN. The project forms part of Chile's backbone transmission system, comprising a 500kV line spanning a distance of 600 km, connecting the Central Interconnected System (SIC) and the Far North Interconnected System (SING).

At the 2016 year end, construction of these facilities was at an advanced stage, with a percentage of completion of 75%. In view of the timely progress being made on these works, commercial operation of the facilities is expected to commence in the last quarter of 2017, as scheduled.

In December 2016 the TEN financing agreements were finalised with nine local and international banks, for a total amount of US Dollars 856 million and with maturity dates in 2034 and 2042. This financing has received various accolades in financial circles:

- > The Project Finance International (PFI) Awards selected TEN as LatAm Power Deal of the Year.
- > IJGlobal Awards-Euromoney 2016 named the TEN financing Latin American Transmission Deal of the Year.

This acquisition has enabled the Red Eléctrica Group to start operating in Chile and consolidate its position in the border regions of northern Chile and southern Peru.



2 Business performance

2.1. KEY FINANCIAL INDICATORS

Revenue for 2016 amounted to Euros 1,932.3 million, down 0.3% on the prior year. This figure includes the remuneration for the transmission activity in Spain, which encompasses the facilities that came into service in 2015. It also comprises revenue of Euros 86 million from telecommunications services rendered, regulated revenue of Euros 56 million for system operation, and revenue from transmission activity conducted abroad, amounting to Euros 19.8 million.

EBITDA^[1] amounted to Euros 1,486.0 million, climbing 1.9% year-on-year.

With regard to operating expenses:

> The **cost of supplies and other operating expenses** fell 3.0% in 2016, a continued reflection of the Red Eléctrica Group's efforts throughout the year to achieve efficiency. Not taking into account the effect of including the implementation costs of new investment projects in Peru, pursuant to IFRIC 12 [expenses with a balancing entry for a similar amount in Group revenue], the cost of supplies and other operating expenses would have dropped by around 6% for the year as a whole.

> **Personnel expenses** were 3.9% higher than in the prior year. Slightly more than half the increase is due to the trend in salaries and wages, reflecting the larger workforce. The remainder is a result of the rise in employee benefits and similar expenses.

The headcount was 1,773 at 31 December 2016, while the average workforce was 1,765 employees, up 0.6% on 2015.

EBIT^[2] totalled Euros 1,003.3 million, up 1.4% year-on-year. The increase in this item is offset by the 3.0% rise in the depreciation and amortisation charge for non-current assets, in connection with facilities that came into service during the year.

The **net finance cost** amounted to Euros 151.3 million, compared to a net finance cost of Euros 159.3 million reported in the prior year. This improvement is essentially due a drop in interest as a result of lower borrowing costs.

Profit for the year totalled Euros 636.9 million, up 5.1% on the previous year. The effective tax rate was 24.9%, which is 2% lower than in the prior year, in view of the corporate income tax rate being reduced in Spain.

The Group's **investments** in 2016 amounted to Euros 643.1 million, a year-on-year rise of 43.6%. This amount includes the Euros 398.5 million earmarked for the transmission network in Spain, and Euros 199.8 million reflects the 50% equity investment in the Chilean company TEN. TEN invested a total of Euros 273 million in Chile throughout 2016.

[1] EBITDA is calculated as the sum of revenue, self-constructed assets and other operating income less personnel expenses, supplies and other operating expenses.

[2] EBIT is calculated as EBITDA plus any non-financial capital grants recognised and gains/losses or impairment on asset disposals, less depreciation and amortisation.



Dividends paid with a charge to profit for the year amounted to Euros 432.8 million, equal to 0.8025 Euros per share. This is an increase of 7% on the amount paid out in 2015, as considered in the Strategic Plan for 2014-2020.

At the end of 2016, 96% of the Group's financial debt is non-current. In terms of interest, 84% is fixed-rate and the remaining 16% is variable-rate.

In 2016, the average cost of the Group's financial debt was 2.94%, compared to 3.20% in the prior year. Average gross debt was Euros 5,462.1 million, compared with Euros 5,418.9 million in the previous year.

Finally, Red Eléctrica Group's **equity** amounted to Euros 2,920.5 million, rising 5.8% vis-à-vis the figure posted at the 2015 year end. This growth is primarily due to profit for the period.

FINANCIAL INDICATORS

(millions of Euros)

	2015	2016	Δ%
Revenue	1,938.9	1,932.3	-0.3%
EBITDA	1,458.4	1,486.0	1.9%
EBIT	989.0	1,003.3	1.4%
Net profit	606.0	636.9	5.1%
ROE (post-tax profit/Equity)	22.0%	21.8%	-0.9%
Cash flows from operating activities	1,326.1	1,007.1	-24.1%
Distribution of dividends	404.8	432.8	7.0%
Equity	2,760.6	2,920.5	5.8%
Gearing	64.0%	62.9%	-1.7%
Investments	447.8	643.1	43.6%
Total assets	10,597.9	10,550.4	-0.4%
Debt service coverage ratio (Net debt/EBITDA)	3.36	3.33	-0.8%

2.2. ENVIRONMENT AND PERSONNEL

2.2.1. Environment

The Group carries out its activities in accordance with strict environmental criteria incorporated into and enforced through the Group's environmental policy.

The commitment to the environment originates from Group management, which defines the environmental policy (reviewed and approved in October 2014) and implements measures to comply with environmental requirements by means of an Environmental Management System that is certified under ISO 14001 and EMAS regulations.



The involvement of all of the organisational units and the commitment of all of the Group's employees are essential to the implementation of this system. A specific environmental department, therefore, exists to provide technical support.

The main environmental challenges facing the Group are as follows:

- > Ensuring that facilities are compatible with the environment, selecting layouts and locations to minimise environmental impact. Application of preventative and corrective measures and strict environmental criteria in all stages of activity means that the potential impact on the environment is immaterial.
- > Ensuring the protection and conservation of biodiversity, to which end the Group has implemented a specific strategy covering the following areas of action: protection of fauna (particularly birdlife) and flora, fire prevention and development of conservation projects.
- > Contributing to the fight against climate change, which has led the Group to define its Climate Change Strategy [reviewed and approved in May 2014]. Various measures were implemented in 2016 aimed at energy savings and energy efficiency, primarily in relation to sustainable transport and reducing electricity consumption.

Ordinary expenses incurred by the Group in 2016 in relation to the protection and improvement of the environment amounted to Euros 19,804 thousand. In addition, investment in environmental actions totalled Euros 4,469 thousand in 2016.

2.2.2. Personnel

The roll-out of the Human Resources master plan, which commenced in 2014, continued in 2016. This plan is linked to the Group's Strategic Plan and defines initiatives and projects that promote its implementation at all levels of the Group.

To facilitate achievement of business objectives, against a backdrop of commitment and a favourable social climate, the master plan is based on four pillars: strategic business partners, management excellence, talent management and leadership in health and safety.

The effectiveness of the plan is monitored through human resources scorecards and regular climate and satisfaction surveys. The plan is reviewed and updated annually to include proposed improvements and suggestions.

Stable, high-quality employment

In 2016, following the organisational adjustments deriving from the segregation of duties between the chairman of the board of directors and the managing director, the organisational structure was remodelled so as to address the challenges of the Strategic Plan.

At the end of 2016, the Group's workforce comprised 1,773 professionals. The commitment to employment stability is reflected in the high percentage (almost 100%) of employees on permanent contracts and the fostering of internal promotions.



Variations in the average and year-end headcount in 2015 and 2016 were as follows:

	2015	2016	Δ%
Average headcount	1,755	1,765	0.6%
% men	77.9%	76.6%	-1.7%
% women	22.1%	23.4%	5.9%
Year-end headcount	1,763	1,773	0.6%

Diversity and integration

The Group promotes equal opportunities in all aspects of its people management, and implements programmes, internal procedures and initiatives to foster diversity and integration, addressing factors such as age, gender and disability.

Throughout 2016, initiatives aimed at increasing the representation of women in positions traditionally occupied by men were ongoing. At 31 December, 20% of managerial positions were held by women.

In 2016 implementation of the action plan to integrate disabled employees began. The Group benefits from the collaboration of the Fundación Adecco in this respect, as well as the full involvement of the Group's management team. At the 2016 year end, the Group's workforce included 13 disabled employees [10 men and 3 women].

The action plan associated with the Workforce Ageing Management Plan, approved in 2015, also got underway during the year.

Talent management

Roll-out of the Talent Management Model throughout 2016 has boosted learning and professional development amongst the Group's people in different aspects:

- > A development programme has been devised as part of the Leadership Model, aimed at qualified technical personnel who coordinate the work of the functional teams.
- > Red Eléctrica's Knowledge Management Model action plan has got underway and the governing body that will facilitate its implementation has been created.
- > The Bank of Potential programmes for technical personnel and department heads are still ongoing. These are the main sources when recruiting for managerial positions.

In 2016 work was undertaken to define the Corporate University, Red Eléctrica Campus. With its innovative methods, modern infrastructure and advanced technology, this will serve as the channel to roll out the strategy, values and culture of the Group.

All employees are assessed annually in terms of skills, commitment and contribution. In 2016, for the first time, the digital skills-related performance of all employees has been appraised.

Dialogue and transparency

The new miRED intranet was the main addition to internal channels, focusing on shared communication between all of the organisation's units and collaborative spaces to connect people and promote dialogue.



The action plans arising out of the climate survey conducted in 2015, which provided detailed feedback on key issues relating to human resources management, got underway in 2016.

At the tail-end of 2016, the Group launched its internal communications assessment survey to gauge the opinion of its employees across the board and hear their thoughts on management, initiatives and channels, so as to identify areas requiring improvement and meet workforce communication needs.

Health and safety

In 2016 a rules and regulations document was approved, which contains the main components of the management system, principles and general guidelines, details of those in charge of the model, the related regulations regarding company welfare management, and a communications plan for the Healthy Company Model. A manual providing specific information on all aspects of the Model was also published.

To raise awareness amongst employees with regard to occupational risk prevention, in 2016 the Group provided 5,850 hours of health and safety training to 1,165 members of its personnel. Specific training on electricity-related risk made up 410 of these hours.

Work-life balance

Developments in recent years in the work-life balance model have enabled REE to enhance its HR management strategy. The challenge lies in being able to assess, on a case-by-case basis, the dual demands placed on people [work-personal life] in order to manage the work-life balance more flexibly, based on a mutual commitment between the company and its people, with a view to enhancing wellbeing and quality of life.

3 Liquidity and capital

The Red Eléctrica Group's liquidity policy has been designed to ensure payment obligations are met, by diversifying how financing requirements are covered and when debt matures.

The Group's liquidity position is essentially based on robust cash flow generation, primarily through regulated activities. Coupled with appropriate management of collection and payment periods and current financial capacity through short- and long-term credit facilities, this allows the Group to prudently manage its liquidity risk.

The undrawn balance on credit facilities at 31 December 2016 amounts to Euros 2,002.5 million.

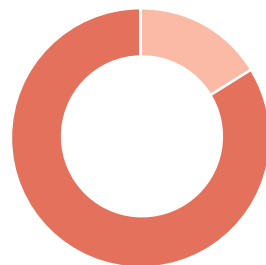
The average maturity of the debt drawn down at the end of the year is 5.7 years.



The Group's financial strategy has aimed to reflect the nature of its businesses, at all times adhering to legislation in force. The activities conducted by the Group are very capital-intensive, wherein investments mature over long periods. In addition, these assets are remunerated over long periods of time, meaning that financial debt is primarily long-term and fixed-rate.

STRUCTURE OF FINANCIAL DEBT: FIXED VS. VARIABLE

■ Fixed rate	84
■ Variable rate	16



The Group's capital structure policy ensures a financial structure that optimises the cost of capital through a sound financial position, which balances the generation of value for shareholders with competitive costs of financing. Capital is periodically monitored through the gearing ratio, which in 2016 stood at 62.9%, compared to 64% in 2015. This ratio is calculated as net financial debt divided by equity plus net financial debt.

To maintain and adjust the capital structure, the Company can adjust the amount of dividends payable to shareholders, reimburse capital or issue shares.

4 Risk management

The Group has implemented a Comprehensive Risk Management System, which aims to ensure that any risks that might affect its strategies and objectives are systematically identified, analysed, assessed, managed and controlled, according to uniform criteria and within the established risk levels, in order to facilitate compliance with the strategies and objectives of the Group. The Comprehensive Risk Management Policy was approved by the board of directors. This Comprehensive Risk Management System, the Policy and the General Procedure are based on the COSO II [Committee of Sponsoring Organizations of the Treadway Commission] Enterprise Risk Management Integrated Framework.

Amongst the main risks identified as regards the Group achieving its objectives are regulatory risk, inasmuch as the Group's principal business lines are subject to regulations, operational risk, primarily relating to electricity system servicing activities, financial risk and environmental risk.

The risk management policies are detailed in [note 15](#) to the accompanying consolidated annual accounts.



5 Average supplier payment period 'Reporting requirement', third additional provision of law 15/2010 of 5 July 2010

In accordance with the Spanish Accounting and Auditing Institute [ICAC] resolution of 29 January 2016 regarding the information that must be disclosed in the notes to annual accounts on average payment periods to suppliers in commercial transactions, the average supplier payment period in the case of Spanish Group companies was 46.2 days at the 2016 year end.

The disclosures required by this resolution are contained in [note 19](#) to the Group's consolidated annual accounts for 2016.

6 Significant events occurring after the reporting period

On 19 January 2017 the Group company Red Eléctrica Internacional acquired 45% of the shares in REDESUR, which until then were held by the infrastructure investment fund AC Capitales. The Group thereby increased its ownership of this Peruvian company to 100%.

The effective date of this acquisition is 1 January 2017.

7 Outlook

The Group will keep working towards achieving the objectives laid out in the Strategic Plan. To this end, it will continue in its role of Spanish TSO, while also reinforcing its efficiency criteria so as to adapt to the new, more stringent regulatory and remuneration environment, and placing greater emphasis on widening its business base as an alternative means of growth.

Implementation of the strategy, based on excellence, innovation and personal development, will allow the Group to maintain its current leadership in terms of the reliability and security of the electricity systems it operates and the excellent standards in other activities.

The Group will uphold its commitment to maximise value for its shareholders, offering an attractive return in the form of dividends and generating value through efficient management of its activities, analysing alternatives for expanding its business base, maintaining a robust capital structure and working to guarantee supply with a maximum level of quality.

The Group will, therefore, continue to seek the generation of long-term value, creating lasting, competitive advantages and improving our corporate reputation, whilst focusing on providing optimum service to society – the differentiating feature of the Group's management.



Outlook for regulated activities in Spain

Regulated activities primarily observe the following lines of action:

- > Market integration and the sustainability of the electricity system, which justify maintaining the level of investment in the transmission network in coming years, in accordance with the new remuneration framework. The investment plan will focus on bolstering the process of reinforcing the structure and mesh of the grid and developing interconnections, especially in non-mainland systems.
- > A goal of efficiency, enabling the Group to maintain its position as an international benchmark. Accordingly, the Company has reviewed its main operating processes, promoting a streamlined and flexible organisation that optimises the Company's returns and the efficiency of the mainland and non-mainland electricity systems.
- > Implementation of new regulated activities, such as storage of energy in the island systems as a tool to guarantee the security of the non-mainland and isolated electricity systems.

The Group will apply a financial policy adapted to the new remuneration model for the transmission activity, ensuring that financial debt is diversified and its liquidity position can comfortably cover upcoming maturities, aiming for the most flexible financial structure possible.

Outlook for telecommunication activities

The telecommunications activities carried out by REINTEL, as telecommunications infrastructure supplier, will focus on the backbone fibre network market, specifically the lease of dark fibre optic infrastructure associated with agents in the telecommunications sector. To this end, REINTEL will continue to implement its commercial plan and undertake the investments requested by customers, in order to generate greater revenues.

Furthermore, REINTEL will continue to make progress on interconnecting rail and electrical fibre networks with the aim of offering new solutions to its customers, such as new redundant sources and access points, whilst continuing to uphold the high standard of service quality offered to its customers.

Outlook for the international business

The Group will continue to focus its international business activity on strengthening its performance in countries where it has a presence, specifically Peru and Chile.

Moreover, as a way of expanding the business base, efforts will centre on executing projects or acquisitions that meet a number of geographical, strategic and financial criteria, so as to increase international presence.



Outlook for the infrastructure construction activity in the Canary Islands

REINCAN'S activity – the construction of energy storage facilities in the Canary Islands – will serve as a system operation tool, enabling greater integration of renewable energies while also enhancing security of supply in the non-mainland systems.

8 Research, development and innovation (R&D&i)

In 2016 a new Innovation Strategy was approved to leverage innovation as a driver for growth, cultural change and sustainability within the Red Eléctrica Group. This initiative aims to bring innovation to all corners of the business activity, focusing primarily on four key angles: digitalisation, people, sustainability and technology.

In the international arena, innovation activity undertaken as part of ENTSO-E projects is particularly noteworthy. ENTSO-E published the 'R&D Monitoring Report 2015' during the year, evaluating the stage of completion of its R&D+i plan based on an analysis of the results of more than 70 innovation projects in which European TSOs played a major role. The updated 'R&D Roadmap 2017-2026' was also published.

The collaboration with the European Technology & Innovation Platform (ETIP) for electricity networks is ongoing as part of the EU's SET Plan. Through REE, the Group sits on the steering committee as a representative of the European TSOs.

The MIGRATE project got underway in 2016 under the European Union's Horizon 2020 programme, in which REE is involved as a work package leader. The aim of this project is to heighten understanding of the performance of electricity systems operated with high penetrations of power electronics (generators, loads, HVDC links, FACTS, etc.). The BEST PATHS project (BEyond the State-of-the-art Technologies for re-Powering Ac corridors & multi-Terminal HVDC Systems) is also ongoing. This project is coordinated by REE and has 39 participating partners, including universities, technological centres, industry, electricity companies and European TSOs.

As regards projects implemented under domestic innovation programmes, work continues on AMCOS-Stability FACTS to design a prototype to improve the stability of frequency and voltage in small isolated systems.

Throughout 2016 work was ongoing on proprietary R&D+i projects such as ALMACENA, whereby an electrochemical storage system set up in Carmona (Seville) has enabled a more in-depth study of future applications of this new technology for the integration of renewable energies and improvements to system operation services. A comparative analysis has also been conducted vis-à-vis other electrochemical storage systems as part of a project with EPRI (Electric Power Research Institute, United States) to enhance the experience acquired through the ALMACENA project, in terms of its integration



into the electricity system, and as regards operation and maintenance. Furthermore, in 2016 the research conducted to support the PERFILA project drew to a close. This research used information from a panel of consumers equipped with smart meters, so as to improve the consumer profiles applied to customers whose consumption is not measured on an hourly basis.

A number of projects were completed in 2016, notably the monitoring of underground lines using distributed temperature sensors (DTS), the inspection of electricity lines via feedback from photogrammetric methods based on images obtained using aerial photography, a phasor-based monitoring and control system installed on the islands of Lanzarote and Fuerteventura, a study of overvoltage arising due to ferroresonance on high-voltage networks, the use of drones to gather geographical information and inspect electricity lines, a methodology to enable optimum management of the entire treatment cycle for vegetation in the line channel, an optical current sensor to identify shortfalls in the underground section of mixed lines, a new predictor of mainland and non-mainland demand, automation of the delineation of as-built substation plans, a methodology to assess the condition of foundation support structures, and a prototype to enable real-time monitoring of electric vehicle charge points in Palma de Mallorca.

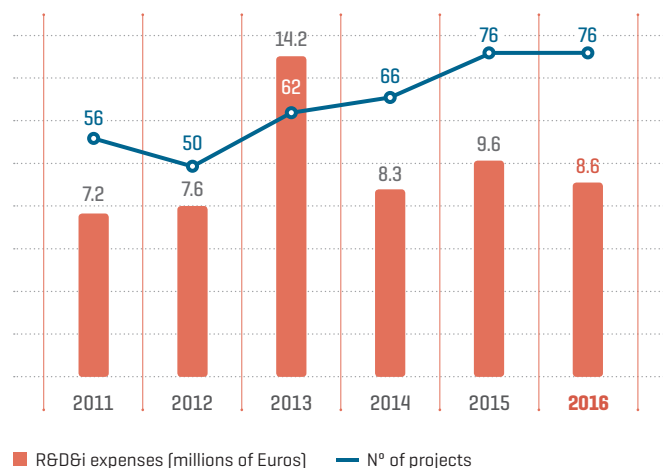
Projects geared towards environmental conservation include the development and validation of a ground-breaking technique, the first in the world, to recover underwater meadows formed by *Posidonia oceanica* – a highly-protected aquatic plant native to the Mediterranean – using laboratory-germinated seeds and bundles originating from natural fragmentation. This will mitigate the impact of laying undersea electricity cables in the Balearic Islands. In view of the positive results obtained from this project, Red Eléctrica will be planting *Posidonia oceanica* meadows as part of its 'REE Forest' programme.

Development of a sustainable and flexible modular transformer has also successfully drawn to a close, the most notable feature of this system being that it uses environmentally-friendly vegetable oil. Moreover, a methodology that enables the oil collection pits of high-voltage machines to be emptied, as well as in situ catalyst-based treatment to separate the oils and fats from the water, has also been devised.

The Electric Power Research Institute [EPRI] in the United States, an organisation that engages in research for the electricity sector and in which a number of companies worldwide are involved, has announced REE as the recipient of one of its 2016 PDU Transfer Technology Awards for its collaboration in the analyses of integration and the impact of energy storage on electricity systems and, more specifically, for its development of a model to maximise the integration of renewable energies into its non-mainland systems.

Overall, the Group worked on 76 innovation projects in 2016, at a total cost of Euros 8.6 million.

EXPENSES IN R&D&i



9 Own shares

In order to provide investors with adequate levels of liquidity the Company acquired 5,003,630 shares with a total par value of Euros 2.5 million and a cash value of Euros 93.9 million in 2016. A total of 4,786,046 shares were sold, with an overall par value of Euros 2.4 million and a cash value of Euros 90.9 million.

At 31 December 2016 the Company held 1,966,332 own shares, representing 0.36% of its share capital. These shares had an overall par value of Euros 983 thousand [see note 11 to the consolidated annual accounts] and a market value of Euros 35,247 thousand.

The Company has complied with the requirements of article 509 of the Spanish Companies Act, which provides that the par value of acquired shares listed on secondary markets, together with those already held by the Company and its subsidiaries, must not exceed 10% of the share capital. The Company's subsidiaries do not hold own shares or shares in the Company.

10 Other relevant information

10.1. STOCK MARKET PERFORMANCE AND SHAREHOLDER RETURNS

All of the shares in REC, the Group's listed company, are quoted on the four Spanish stock exchanges and are traded through the Spanish automated quotation system. REC also forms part of the IBEX 35 index, of which it represented 2.0% at the end of 2016.

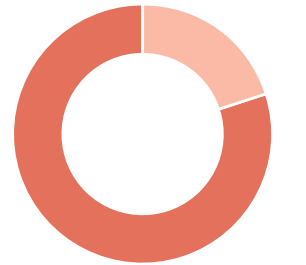
At 31 December 2016, the share capital of REC amounted to Euros 270.5 million and was represented by 541,080,000 shares with a par value of Euros 0.50 each, subscribed and fully paid. At the 2016 annual general meeting, the shareholders approved a 4-for-1 share split, reducing the par value of the Company's shares from Euros 2 to Euros 0.50 per share without modifying total share capital.



During the year REC's free float was 80%.

SHAREHOLDER STRUCTURE

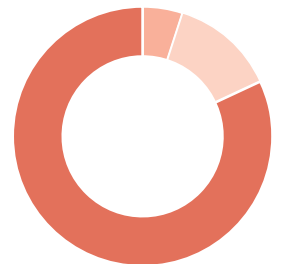
Free-float	80
Strategic investors	20



At the date of the last shareholders' meeting – 15 April 2016 – the free float comprised 432,864,000 shares, of which an estimated 13% is held by non-controlling shareholders, 5% by Spanish institutional investors and 82% by foreign institutional investors, primarily in the United Kingdom and the United States.

FREE-FLOAT DISTRIBUTION

Foreign institutions	82
Spanish institutions	5
Non-controlling investors	13



In terms of stock market performance, once again the United States top the rankings with double-digit improvement. The Dow Jones was the strongest of the principal US indices, closing the year with a rise of 13%, followed by S&P 500, up 10%, and Nasdaq, which climbed 8%.

Performance was more subdued in Europe, however. London's FTSE 100 displayed the most notable performance, rising 14%. The other European stock markets ended the year in positive figures (Paris +5%, Frankfurt +7%), except the Italian stock exchange which closed at a loss (down 10%), hindered by the weakness of its financial system, and the Spanish selective index, which slid 2%.

The listed price of REC's shares dropped 2% in 2016, despite its well-received 2014-2019 Strategic Plan presented in February, with challenging targets and competitive dividends as its main features.

The market capitalisation of the Company at the end of 2016 was Euros 9,730 million.

In total, 714.4 million shares were traded in 2016, which is 1.32 times the Company's share capital. In cash terms, Euros 13,432 million was traded, down 28% on the Euros 18,537 million traded in the prior year.

10.2. DIVIDEND POLICY

The dividends paid in 2016 amounted to Euros 432.8 million, 7% more than in 2015.

The board of directors has proposed a dividend of Euros 0.8587 per share with a charge to 2016 profit, pending approval by the shareholders at their general meeting, representing a year-on-year increase of 7%. This takes into account the new number of Company shares (541,080,000 shares as opposed to 135,270,000 shares previously).

Based on the projections and estimates contained in the Group's 2014-2019 Strategic Plan, the dividend could grow at a rate of approximately 7%. This increase is considered as the average annual rate for the period covered by the Strategic Plan, on the basis of the total dividend approved with a charge to 2014. This forecast is subject to fulfilment of the Plan.

The dividend will be paid in two instalments – an interim dividend in January and a supplementary dividend half way through the year following approval of the annual accounts by the shareholders at their general meeting.

10.3. CREDIT RATING

On 3 August 2016 the rating agency Standard & Poor's issued a new report on Red Eléctrica maintaining its rating and outlook. Following this announcement, the Company and its subsidiary, Red Eléctrica de España, S.A.U., maintain long-term ratings of 'A-' and short-term ratings of 'A-2' with a stable outlook.

On 27 May 2016 the rating agency Fitch Ratings upgraded the Company's long-term rating to 'A' from 'A-' with a stable outlook. Following this announcement, Red Eléctrica Corporación, S.A. and Red Eléctrica de España, S.A.U. maintain long-term ratings of 'A' and short-term ratings of 'F1', with a stable outlook.

10.4. EXCELLENCE AND CORPORATE RESPONSIBILITY

Corporate responsibility forms part of the Red Eléctrica Group's corporate culture. It is also a key tool for creating value when conducting its activities to fulfil its mission.

As a key line of action for the Group, the 2014-2019 Strategic Plan lays down a management process based on corporate responsibility best practice. In implementing this strategy, the Group acts in a responsible, ethical and committed manner vis-à-vis its stakeholders and society in general.

The Group's commitment to developing a sustainable future for energy is embodied in the principles and guidelines contained in its Corporate Responsibility Policy, and brought into effect through a multi-year plan that defines the medium-term initiatives framework for its corporate responsibility.

The Group forms part of the most reputable sustainability indices, demonstrating its commitment to sustainability, which in turn serves as a pivotal tool for addressing global challenges, and reflecting its bid for transparency in its reporting to third parties. The performance of the Group is subject to ongoing analysis and assessment. The Group's presence in the principal sustainability indices [Dow Jones Sustainability Indices, FTSE4Good,



Climate Disclosure Project, Euronext Vigeo, Ethibel, MSCI, Stoxx Global ESG Leaders Indices and ECPI) evidences its firm commitment to sustainable development.

Since 1999, the Company has applied the EFQM (European Foundation for Quality Management) Excellence Model, aiming for ongoing improvements to the Company's management and results. A certified system (quality, environment, occupational health and safety, corporate responsibility and energy efficiency) subject to annual audit has been in place since 2000, covering all of the Company's processes.

In 2016 the Group retained its European Seal of Excellence 500+, which was renewed in 2015, with a rating of 700 to 750 points, as awarded by Club Excelencia en Gestión (CEG), the official representative in Spain of the European Foundation for Quality Management. The 2016-2017 Excellence Plan was drawn up in 2016, containing 46 improvement initiatives arising from the report on the analysis of excellence conducted in 2015.

An analysis was carried out in 2016 of Red Eléctrica's existing alliances, linking these with the Strategic Plan and the stakeholders. After clearly defining the meaning of an alliance for Red Eléctrica, and having analysed and classified the existing alliances, this work serves as a starting point for identifying opportunities to create shared value with the stakeholders.

The excellence management system is in turn based on a process management approach. In this respect, risk management at process level was introduced in 2016, thereby extending the scope of the Company's risk management.

11 Annual Corporate Governance Report

The Annual Corporate Governance Report forms an integral part of the Directors' Report and can be viewed at the following address:

<http://www.cnmv.es/Portal/consultas/EE/InformacionGobCorp.aspx?nif=A-78003662>

The various sections of this consolidated director's report contain certain prospective information that reflects projections and estimates based on underlying assumptions, statements referring to plans, objectives and expectations associated with future transactions, investments, synergies, products and services, as well as statements concerning results or future dividends, or estimates calculated by the directors and based on assumptions that those directors consider reasonable.

While the Group considers the expectations reflected in those statements to be reasonable, investors and holders of shares in the Parent are advised that the information and statements containing future projections are subject to risks and uncertainties, many of which are difficult to foresee and generally beyond the Group's control. As a result of such risks, actual results and developments could differ substantially from those



expressed, implied or forecast in the information and statements containing future projections.

The affirmations and statements containing future projections do not provide any guarantee as to future results and have not been reviewed by auditors outside the Group or by other independent third parties. It is recommended that no decisions be made on the basis of the affirmations and statements containing future projections that refer exclusively to the information available at the date of this report. All of the affirmations and statements containing future projections that are reflected in this report are expressly subject to the warnings given. The affirmations and statements containing future projections included in this document are based on the information available at the date of this directors' report. Except as required by applicable legislation, the Group is not obligated to publicly update its statements or review the information containing future projections, even where new data is published or new events arise.

DECLARACIÓN DE RESPONSABILIDAD DEL INFORME FINANCIERO ANUAL


Los miembros del Consejo de Administración de RED ELECTRICA CORPORACIÓN, S.A. declaran, hasta donde alcanza su conocimiento, que las cuentas anuales individuales así como las consolidadas correspondientes al ejercicio 2016, formuladas en la sesión de 22 de febrero de 2017, han sido elaboradas con arreglo a los principios de contabilidad aplicables, ofrecen la imagen fiel del patrimonio, de la situación financiera y de los resultados de RED ELÉCTRICA CORPORACIÓN, S.A. y de las empresas comprendidas en la consolidación tomados en su conjunto, y que los informes de gestión individual y consolidado, incluyen un análisis fiel de la evolución y los resultados empresariales y de la posición de RED ELECTRICA CORPORACIÓN y de las empresas comprendidas en la consolidación tomadas en su conjunto, junto con la descripción de los principales riesgos e incertidumbres a que se enfrentan.

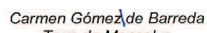
Madrid, 22 de febrero de 2017

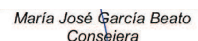

José Folgado Blanco
Presidente


Juan Lasala Bernad
Consejero Delegado


Mª Ángeles Amador Millán
Consejera


Fernando Fernández
Méndez de Andés
Consejero


Carmen Gómez de Barreda
Tous de Monsalve
Consejera


María José García Beato
Consejera


Socorro Fernández Larrea
Consejera


Antonio Gomez Ciria
Consejero


Santiago Lanzuela Martín
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José Luis Felto Higuera
Consejero


José Ángel Partearroyo
Martín
Consejero


Arsenio Fernández de Mesa y
Díaz del Río
Consejero