

Spain
RMBS
Special Report

Foreclosure Management and Loan Modifications in Spanish RMBS

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Related Research

- [Originator Support for Spanish Structured Finance Transactions \(November 2010\)](#)

Summary: Greater Transparency Still Required

The management of foreclosed properties owned by securitisation vehicles (SPVs or funds) is a recent phenomenon of the Spanish securitisation market. As of December 2010, for the 137 Fitch-rated RMBS transactions in Spain, a cumulative total of 3,393 properties had been assigned to SPVs. This figure is small when compared to the total number of legal cases for repossessions since 2008, which totalled 240,000, according to statistics from the Spanish judicial system (ie. *Consejo General del Poder Judicial*). While the data suggests low materiality, Fitch Ratings believes this is explained by originators supporting transactions.

Despite deterioration in performance and a challenging economic environment, on average, only 3.2% of securitised loans within each transaction have been subject to some form of loan modification to date, with margin reduction (2.3%) and maturity extension (0.9%) being the most significant modifications. Only 0.3% of modifications were granted to loans in arrears over 90 days. Fitch believes that this relatively small number can be explained by the fact that certain refinancing solutions are declared as prepayments, rather than loan modifications.

Key Findings and Credit Implications

- Fitch is surprised by the significant difference in the total number of repossessed properties across transactions which share similarities in terms of seasoning and performance. This appears to be dependent on the strategies of the fund management companies (Gestora) (see Figure 2).
- Fitch understands that various management strategies to deal with foreclosures are being implemented by the different Gestoras and sometimes by the same institution, depending on the originator.
- Fitch believes that the low number of properties assigned to some funds reflects the originators' strategies of repossessing the property by bidding for it at auction.
- Fitch acknowledges that the bidding practices of originators could be beneficial for the overall performance of the transaction, generating cash inflows and preventing lengthy sale processes. However, the agency is concerned that such practises could mask a transaction's real capacity to generate recoveries.
- In Fitch's view, reported loan modifications do not capture all refinance solutions made available to troubled borrowers. The agency is concerned about the lack of information and the sustainability of such practices in the medium term.
- The agency analyses each transaction to assess the materiality of the modifications granted. Fitch perceives borrowers that request an extension of 80 months on average to be of weak profile, and the agency will make conservative assumptions about the future performance of such loans.
- Fitch believes that both repossessions and loan modifications will increase in the near future, as expected interest rate increases generate additional distressed borrowers in a mortgage market dominated by floating-rate transactions.

Spanish RMBS Foreclosure Management Report As of Dec 2010

No. of RMBS transactions rated by Fitch	137
No. of properties assigned to the SPVs	3,393
No. of sold properties previously owned by SPVs	1,916
No. of properties currently owned by SPVs	1,477
Initial valuation of the properties assigned to the fund (Euro)	664, 973,801
Current valuation of the properties assigned to the SPV (Euro)	501,569,737

Source: Fitch, based on Gestoras' data reports.

Spanish Gestoras

- **AyT:** Ahorro y Titulización S.G.F.T, S.A.
- **EdT:** Europea de Titulización S.A., S.G.F.T.
- **GAT:** Gestión de Activos Titulizados S.G.F.T.S.A.
- **Gesticaixa:** Gesticaixa S.G.F.T. S.A.
- **IM:** Intermoney Titulización S.G.F.T.
- **Santander:** Santander de Titulización, S.G.F.T, S.A.
- **TDA:** Titulización de Activos, SGFT, S.A.

Background

During the 2001-2007 Spanish housing boom, the level of repossessions was relatively small. However, in the last three years, the number of judicial assignments has increased significantly, as has the number of deeds in lieu and swaps of debt for property. The stock of repossessed properties now in the hands of financial institutions and securitisation vehicles in Spain is trending upwards and has become an area of special attention for market analysts and investors.

Loan modifications are also a source of concern when analysing the performance of Spanish securitised transactions. Fitch is of the opinion that support is being granted by some originators in the form of loan modifications and/or refinancing solutions to troubled borrowers (see report “*Originator Support for Spanish Structured Finance Transactions*”, dated 16 November 2010). However, limitations in reporting in these specific areas make it difficult to assess the extent of such measures and as a result, the true arrears performance of Spanish securitised transactions.

The agency has gathered significant data from various Gestoras to better understand these trends and to assess the magnitude of repossessed properties and loan modifications within Spanish RMBS. Additionally, in this report, the agency will assess the management of the foreclosure process in general and consider credit implications for its rating analysis. Note that the majority of data illustrated within this report is not publicly available within the Gestoras’ websites; Fitch has requested quarterly updates of this data set, to enable it to maintain its credit views.

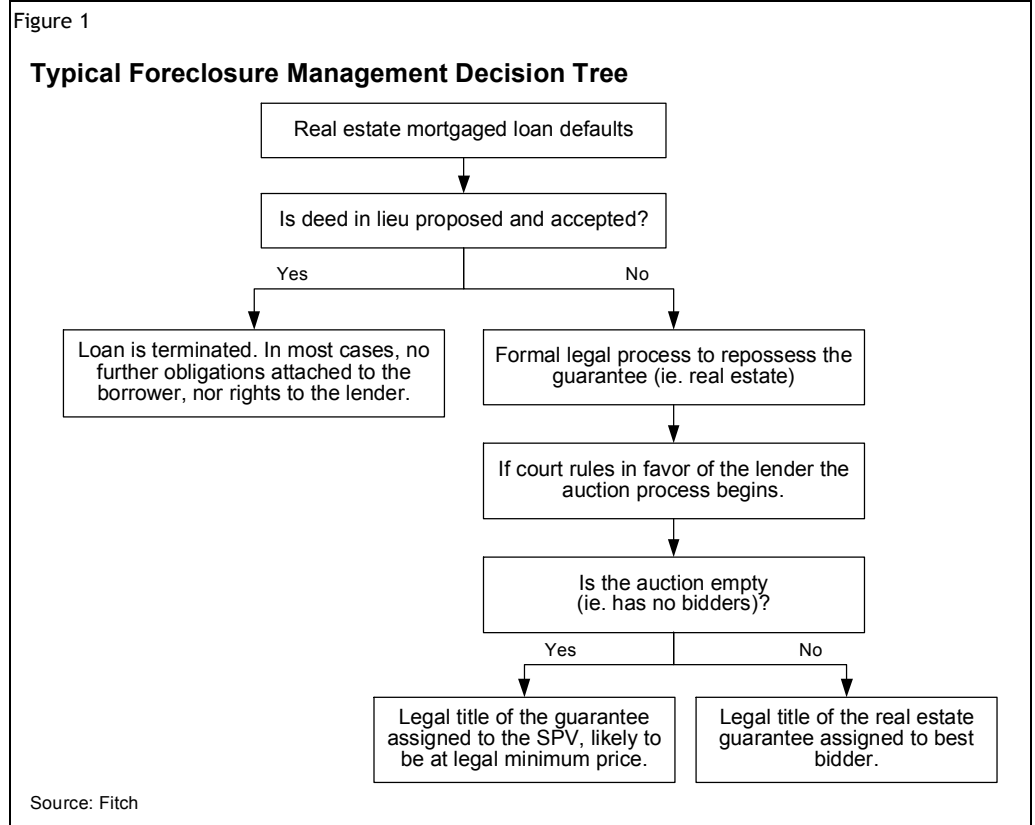
Foreclosure Management by SPVs

When a real estate mortgaged loan defaults and legal action is taken against the borrower, the most common measures used to deal with the foreclosure process are listed below.

- a. **Deeds in lieu or swap of debt for property:** the borrower hands ownership of the real estate asset to the lender in exchange of full termination under the loan obligation. These instances are not common in Spanish securitisations. Where such cases occur, Gestoras have the right to refuse any such proposal made by any borrower to the servicer.
- b. **Auction:** this involves the lender submitting a repossession case on such guarantee to the courts. When this is sanctioned in favour of the lender, the transfer price is determined through an auction process. The legal minimum price allowed is equivalent to 50% of the initial property valuation. While some auctions are conducted with multiple bidders and the auction price is determined by the bidding process, most auctions currently take place with no bidders other than the loan originator. If the auction has no bidders the legal title of the repossessed property will be transferred to the SPV and it then forms part of the asset pool of the securitisation transaction (as can be seen in some investor reports).

With regards to repossessed properties belonging to the SPVs, most originators make full or partial payment of the remaining loan balance to the SPV, thus claiming total ownership of the position, including the real estate guarantee. If the originator suggests a partial payment to the SPV, the respective Gestora has the right to refuse such proposal. On such occasions (i.e. originators making full or partial payment to the SPV), the SPV would recognise cash flows either as prepayments (ie when no default recognition has been implemented), or as a recovery (ie if the default has already been recognised).

When the auction results in the assignment of the property to the SPV and the sale proceeds of the repossessed property are not sufficient to clear the total outstanding balance of the loan, the SPV is entitled to a legal claim against the defaulted borrower for additional income or assets (as debt instruments in Spain are full recourse by law). However, Fitch does not take into account such future incomes in its Recovery Rate estimates.



Fitch believes that the small proportion of repossessed real estate assets within Spanish RMBS is partly explained by the active support that some securitisation transactions are receiving from their respective originators - in the form of bidding at auction for the property backing the loan

In Figure 2, Fitch sets out its main findings, identifying the key strategies associated with the main management companies.

Other than the general policies followed by different Gestoras, Fitch has gathered information on the number of properties repossessed by each fund. This information is useful when assessing future recovery rate expectations. It allows Fitch to determine each Gestora’s ability to deal with the stock of properties under its management (including from an operational perspective), and to determine if the losses experienced by SPVs are in line with Fitch’s base case expectations.

The inventory of 3,393, as of December 2010, must be recognised in a macro context, in which according to statistics from the Spanish judicial system, foreclosure proceedings for 240,000 properties backing defaulted mortgages loans have started in the last three years. Fitch believes this small proportion is partly explained by the active support that some securitisation transactions are receiving from their respective originators.

In determining the total amount of residential properties in Spain that is expected to find demand, one must add to the above figure of foreclosed assets the (currently unknown) number of properties acquired by financial institutions via deed in lieu and the approximately 1m empty newly built homes (according to Bank of Spain analysis).

Figure 2
Foreclosure Management in Spanish RMBS

	Gestora/management company						
	AyT	EdT	GAT	Gesticaixa	IM	Santander	TDA
Main policy	The property is assigned to the SPV if there are no bidders or if the bid by the originator does not cover the entire outstanding debt. Deed in lieu not permitted	Assignment of the property to the SPV, management of the property conducted by the collateral servicer/originator. EdT monitors / approves any action related to repossessed assets	Assignment of the property to the SPV. SPV tends to sell such property to a real estate firm integrated within the Group structure	Assignment of the property to the originator, which pays the auction price to the SPV (typically 50% of initial valuation when the auction has no bidders)	Depending on each originator. Some originators repossess the property and cancel repayment of the entire debt to the SPV	No information provided	The property is assigned to the SPV when no bidders come to the auction, or when the bid submitted by the originator is considered not sufficient. Deed in lieu allowed only in specific cases
Number of RMBS transactions rated by Fitch	40	35	12	6	10	8	26
Number of properties assigned to the SPV	16	1,047	1,988	0	0	No information provided	342
Number of sold properties previously owned by SPVs	2	45	1,869	0	0	No information provided	0
Number of properties currently owned by SPVs	14	1,002	119	0	0	No information provided	342
Initial valuation of the properties assigned to the fund (euro)	4,168,523	206,342,071	386,017,428	0	0	No information provided	68,445,780
Current valuation of the properties assigned to the SPV (euro)	3,096,674	152,229,974	298,122,771	0	0	No information provided	48,120,318

Source: Fitch, based on Gestoras' data reports. Data as of December 2010

Property Price Correction and Foreclosure Costs

Fitch has gathered together loan-by-loan data on repossessed properties sold by SPVs. The data is limited to just 1,597 units (provided by EdT, GAT and AyT). As such, the sample is not fully representative of the price correction which might be expected when properties are sold in the wider real estate market. The largest sample (from GAT), relates mainly to sales executed with firms integrated under the same risk group, which may not have been conducted on an arm's length basis.

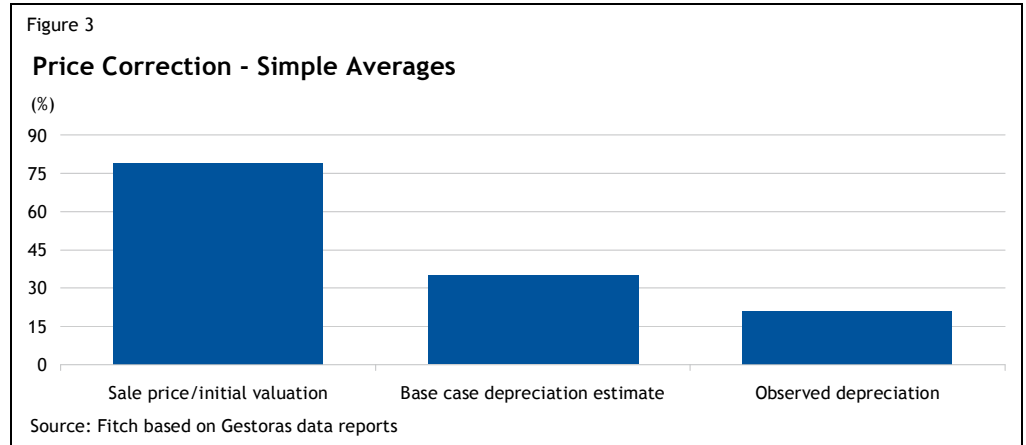
In simple average terms, these are the key findings.

- A sale date in 2010 delivered a sale price equivalent to 79% of the initial property valuation estimate (dated in 2005), compared to 65% obtained under Fitch's current set of assumptions.
- The HPD between the initial and the updated valuation was 5.9%. Note that the HPD only captures the drop in value estimates between two valuation dates.
- The average time between default and property sale was 28 months.

The HPD observed by Fitch is higher than the Official House Price Index (HPI) trend from the Ministry of Housing. This is to be expected, given the forced sale nature of repossessed properties, as opposed to the open market transactions which dominate the HPI. However, it is important to highlight that the HPD deviation is also in part due to the characteristics and size of the sample and the manner in which valuations upon repossession are conducted. The depreciation observed in the sample includes sales to third parties and to firms of the same risk group. If only sales of repossessed properties in the open market are taken into account, then the observed depreciation is higher than Fitch's expectations. However, this

Although the dataset on repossessions and sales comes with limitations, it indicates an average sale price equivalent to 79% of the initial property valuation, compared to 65% obtained under Fitch's current set of assumptions

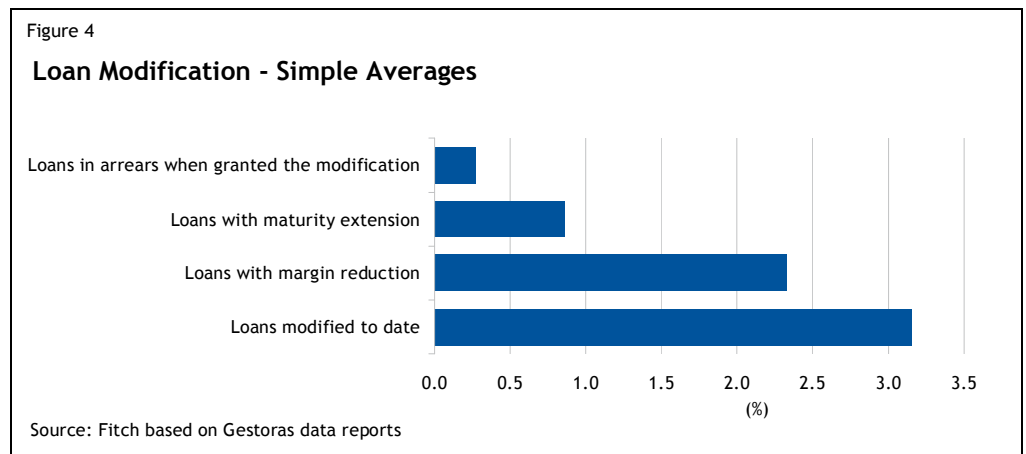
latter sample comprises just 47 assets and is consequently too small to draw further conclusions.



10% of all modifications appear to be granted to loans in the 90+ days arrears bucket. Fitch considers such borrowers to be of weaker credit profile, and therefore implements more conservative credit assumptions when assessing such loans

Loan Modifications

Overall performance deterioration in Spanish RMBS from 2007 caused an initial spike in delinquency rates; indeed, the Fitch Spanish RMBS three month+ delinquency index reached 3.1% in May 2009 (it stood at 1.4% as of December 2010). Various initiatives have been put in place to curb performance deterioration, including public support programmes aimed at reducing loan instalments for unemployed borrowers. However, these have had limited success. Financial institutions have also put in place various measures to adapt loan instalments to the payment capacity of troubled borrowers, including maturity extensions, payment holidays and margin reductions.



Some loan modifications are automatically permitted under structured finance transaction documentations, as long as the total volume of actual modifications is less than a defined threshold (typically 10% of initial collateral balance) and providing a minimum weighted average margin of the collateral is met. These modifications have traditionally been captured by Fitch when rating a transaction, by modifying the amortisation profile of the portfolio and by reducing the margin of the loans to the minimum allowed in the documentation from day one. Note that many mortgage loans have been originated with automatic margin reduction allowances, conditional on the borrower purchasing additional banking products from the lender.

As loan modifications are not usually disclosed within investor reports, Fitch has requested loan-by-loan and aggregated information from all Gestoras. This

Lenders offering refinancing solutions to troubled borrowers can bring short-term benefits to the transactions. However, Fitch is concerned about the transparency of the associated reporting and the sustainability of these solutions

information shows, in simple average terms, that modifications have been granted to about 3.2% of all securitised loans. While this level is not considered material in the overall landscape, Fitch notes that about 10% of all modifications appear to be granted to loans in the 90+ days arrears bucket, and that the maturity extension is on average about 80 months per transaction. The agency considers such borrowers to be of weaker credit profile; Fitch is therefore implementing more conservative credit assumptions within its surveillance analysis.

Granting loan modifications to troubled borrowers in arrears by 90+ days is discouraged by the Bank of Spain. When such instances are allowed, it is always under the condition of additional guarantees pledged by the borrower.

No Gestora has been able to provide information on cases where a potential refinancing solution was extended by an originator to a troubled borrower outside the limits allowed in the transaction documentation; such cases are only reported to the Gestora in the form of prepayments. Fitch acknowledges the positive effect of such cash flows to the transactions; however, the agency is concerned about the lack of information and the sustainability of such practices in the medium term.

The UCI Case

Fitch relies on loan modifications being limited to those allowed by transaction documents when assessing the future performance of transactions. The agency expects loan modifications outside such parameters to cause the early amortisation of the modified loan. However, the agency has been made aware that certain originators are offering payment modifications – such as temporary payment holidays – not specifically envisioned in the documentation, without cancelling the loan.

This was the case in the Union de Creditos Inmobiliarios E.F.C. S.A. (“UCI”) transactions, where payment holiday options were offered to loans belonging to SPVs without removing them from the transaction. The result of such action is to distort performance measures. Fitch recognises that such temporary payment relief could be beneficial for the overall performance of the transaction, generating inflows and preventing loans from defaulting.

However, the agency is concerned that such practises mask the true amount of loans in the various arrears categories; they further prevent such arrears loans from being provisioned for in accordance with the documents. These practices also bypass the structural protection mechanisms for senior notes, such as interest deferral mechanisms.

Appendix 1: Loan Modifications at Transaction Level

Figure 5

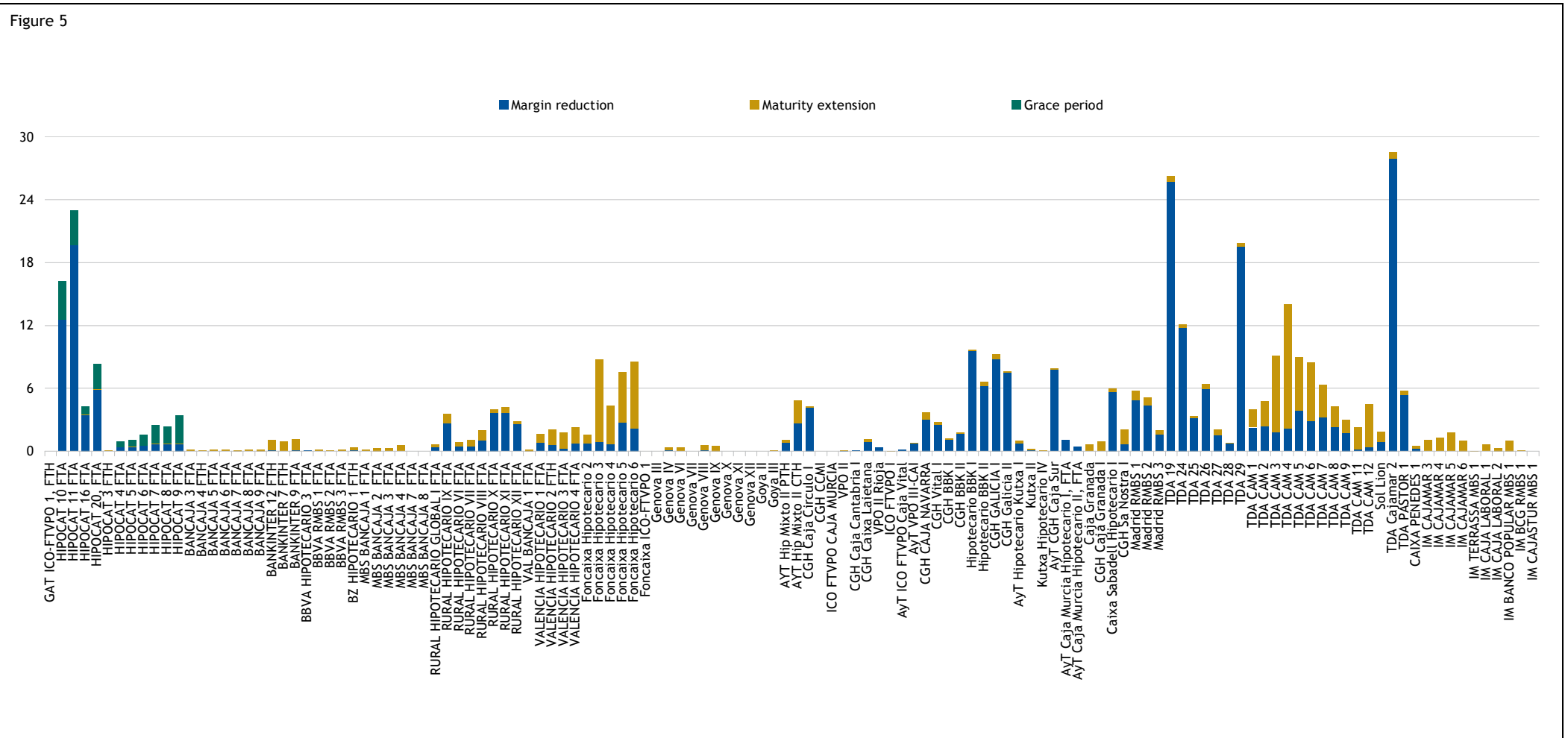
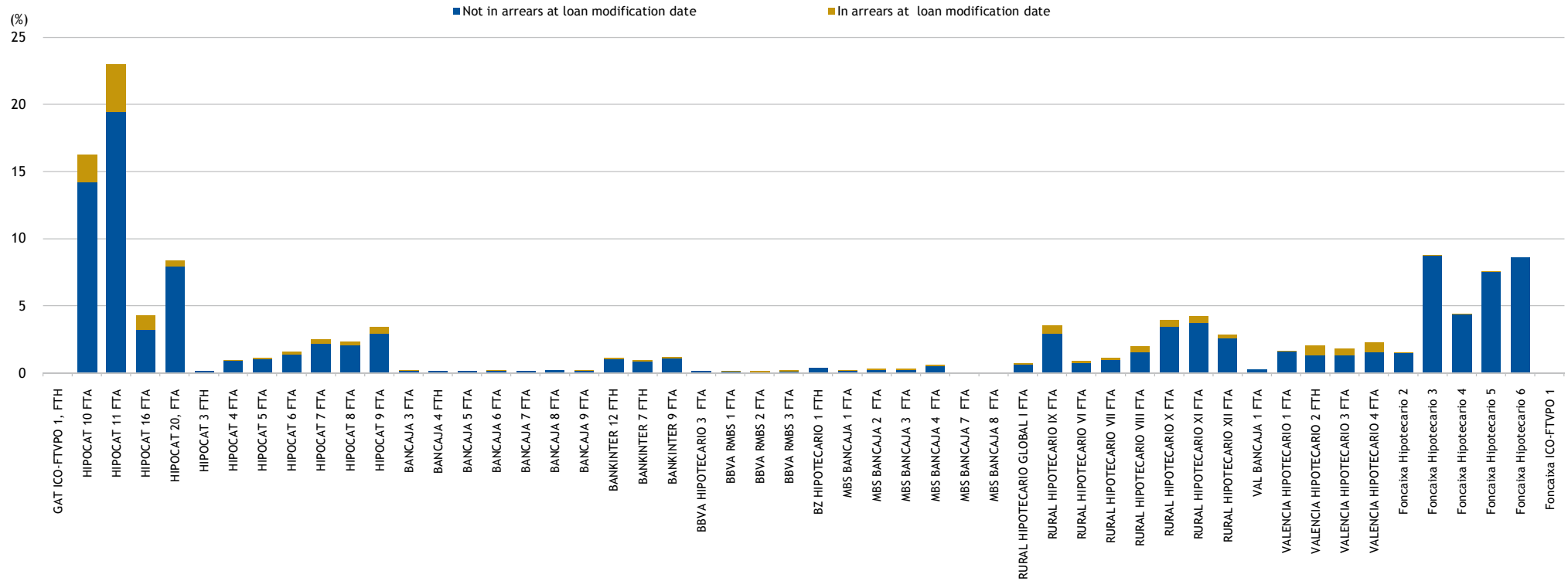


Figure 6

Loan Modifications Per Transaction



Source: Fitch, based on Gestoras' data reports

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