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Spain Suicides Spark Law Risking Bank Losses: Mortgages

By Sharon Smyth - Nov 16, 2012

Spain, responding to street protests and reports of suicides linked to foreclosures, introduced rules to help protect families from eviction, increasing the risk of creditor losses and weakening an already fragile banking system.

Banks won't be able to remove families who can't pay their mortgages for two years, Deputy Prime Minister Soraya Saenz de Santamaria said yesterday after the government's weekly Cabinet meeting in Madrid. The rules apply to households earning less than 1,597 euros ($2,041) per month combined with certain other conditions such as young children in the property.

Spain is trying to balance the threat of social unrest with protecting the banks, four of which have been nationalized. While the rule is designed to help the poor without triggering a larger rise in non-payments it may increase the size of the nation's bank bailout and harm the interests of European lenders with $110.4 billion of exposure to Spanish lenders.

"It seems clearly meant for extreme cases and is supposed to not overly dilute the rights of banks," said Bernd Volk, the head of covered bonds and agency research at Deutsche Bank AG. "However, it seems difficult to assess the practical relevance as anyone can probably claim that some criteria apply and stop paying the mortgage."

The government passed the law under royal decree after 400,000 homes have been foreclosed on in Spain since the collapse of the property boom five years ago. Prime Minister Mariano Rajoy said this week he would rush through measures after Amaia Egana became the second person in the past month to commit suicide in Spain over an eviction when she leapt to her death from her apartment in Baracaldo as officials arrived to change the locks on Nov. 9.

Program's Conditions

Under the terms of the agreement, families that aren't paying their home loans also have to meet another condition to qualify. These include having at least three children; having one child under three; having a disabled dependent to look after; being a single parent with two children or a victim of domestic violence; or being unemployed and not receiving benefits.

"There seem to be loopholes which could be exploited, which in turn could finally trigger a rise in non-performing mortgage losses, according to Volk, who is based in Zurich. This is expected anyway taking into account Spain's very high unemployment, he said.

Rental Homes

The government will also negotiate with banks, including state-controlled lenders, so that they make available foreclosed homes they own to a facility that will rent them at low costs to people who have lost their homes, Economy Minister Luis de Guindos said.

The new measures won't cause an increase in the bad loan ratio for mortgages, De Guindos said during a press conference in Madrid yesterday. The rate is currently at 3.1 percent, according to the Bank of Spain.

"Of course these measures could produce a jump in defaults by families who think they are better off not paying mortgages and they know they can't be evicted for two years," said Fernando Rodriguez de Acuna Martinez, a partner at Acuna & Asociados, a real estate consulting firm in Madrid. "This is going to bring more problems than solutions."

The Spanish Banking Association said in a statement on its website that it shares the government's desire to protect the most vulnerable people in society that are most exposed to the effects of the economic crisis. The association said it also has to underline that the financial cost of the measures will be borne solely by the banks.

Economic Contraction

Bad loans are poised to increase on forecasts for a continued economic contraction in 2013, the government regulator said in its financial stability report published on Nov. 5.

The unemployment rate is Europe's highest at 26 percent and the economy is in its second recession since 2009. It continues to contract as the government pursues austerity measures to cut Europe's joint second-largest largest budget deficit and avoid following Greece, Ireland and Portugal into a full bailout.

About 9 percent of Spanish mortgages have also already been renegotiated, according to Sept. 28 stress tests of the Spanish banking system carried out by management consultants Oliver Wyman. That hasn't been enough to stop Spaniards from losing their homes, helping trigger protests outside lenders.

Jose Luis Cobenas stopped paying his mortgage in 2010 even after his bank cut the 1,360 euro monthly repayment by 78 percent to allow him to stay in his home after he lost his job.

'Stopped Paying'

"The bank told me the new figure of 300 euros wouldn't even cover the interest payments let alone amortize the loan so I just stopped paying," Cobenas said during an interview in Madrid where he and other protesters have gathered outside a branch of Bankia Group for the past three weeks to protest against foreclosures. Bankia is the biggest lender slated to receive funds from Spain's 100 billion euro European bank rescue. Two-and-a-half years later, Bankia has foreclosed on the property after no payments were received.

Cobenas bought his Madrid home with a 100 percent mortgage for 206,000 euros in 2005. "The bank offered me social housing at 280 euros a month but I want a better deal, something less than 200 euros," said Cobenas, who came to Spain 21 years ago from his native Peru. He still lives at the foreclosed property rent free because his lender doesn't want to evict him until alternative accommodation is arranged for him and his family.

In Spain, all home loans are recourse, which means homeowners remain on the hook for their debts even after a foreclosed property is sold or confiscated by the lender for less than the value of the mortgage.

Recourse Loans

Cobenas's home was foreclosed on by the bank at 124,000 euros, or 60 percent of its original 206,000 euro valuation, leaving him in debt to the tune of 82,000 euros which he will owe until he repays it or dies. His request for the bank to waive his debt hasn't been answered.

According to Jesus Alfaro, a professor of Mercantile Law at the Autonomous University of Madrid, there is no short-term solution and any proposal should take into account that it's "socially immoral and counterproductive" to reward those who took irrational financial decisions by allowing them to remain in a home they couldn't afford to buy in the first place paying no mortgage when there are others who acted responsibly and opted to pay rent without having the luxury of owning a home.

"You run the risk of making citizens even more irresponsible, those who make irrational financial decisions should pay for their errors so they don't repeat them and make those around them think twice," Alfaro said during an interview in Madrid.

Deepest Cuts

Rajoy pushed for the changes as he implements the deepest budget cuts on record in Spain, taking the axe to spending on health, education and jobless benefits, while increasing sales tax and levies on income. Thousands of people marched in Spain two days ago to back the second general strike this year.

"There's no such thing as a free lunch in this world," Alfaro said. "What doesn't get paid by debtors get paid by you and me, the taxpayer, and we are already paying enough."

Alfaro said the state's role should be limited to ensuring those who lose their homes have access to social housing.

The government is on the right track and understands the risk, said Angel Mas, president of European mortgage insurance at Genworth Financial Inc.

They're "trying to strike a difficult balance between economic realities, social pressures and potential unintended consequences that could damage our credibility, economy and financial system as a whole," he said.

The measures though may make it even harder for banks to recover their debts and add to taxpayer costs.

Capital Needs

"This could increase banks financing costs and capital needs," said Juan Villen, head of the mortgage advisory service at Idealista.com, Spain's biggest property website. "That would mean greater need for state support if expected cash flow from mortgage repayments diminishes, not to mention the greater provisions they would have to make for the increase in defaults."

Seven Spanish banks have a combined capital deficit of 59.3 billion euros in an adverse scenario, according to a stress test carried out by Oliver Wyman as part of the terms required to win a European bailout of as much as 100 billion euros for its banking system. Although the bank of Spain estimates lenders will only need 40 billion euros, that figure may swell if banks' ability to recover loans diminishes, according to Villen.

Credit Ratings

"A large proportion of Spanish mortgages were securitized and ended up with European funds and banks, and these measures go against the security of the guarantees of these products," Villen said. "This could also mean a large part of non- performing loan portfolios that Spanish banks are trying to sell to improve balance sheets won't find buyers if you take away the fundamental recovery tool for their investment."

Banco Santander SA (SAN) and Banco Bilbao Vizcaya SA, Spain's largest lenders, were downgraded two levels to BBB and BBB-, one level above junk, respectively, by Standard & Poor's on Oct. 16 and the firm also cut the ratings of nine other banks and placed six on credit watch negative.

"Healthy banks such as BBVA and Santander have little exposure to high-risk borrowers," said Alfaro who estimates that savings banks that lent irresponsibly during the boom to expand hold the bulk 60 billion euros of high risk mortgages, those taken out at the peak of the market with loan to values of 100 percent or more.

A threat to recovery rates could cause investors to lose confidence in healthier banks, he said.

Santander fell 2.4 percent to 5.48 euros in Madrid trading today, compared with a 1.4 percent decline in Spain's IBEX 35 Index. (IBEX) BBVA fell 2.5 percent.

European lenders have $110.4 billion in exposure to Spanish banks, with German banks having the highest at $38.4 billion, according to the Bank for International Settlements.

Two-Year Freeze

Spain's banking association pre-empted yesterday's decision by announcing on Nov. 12 a two-year freeze on repossessions in cases of extreme need for "humanitarian reasons." Lenders already signed up in March to a voluntary code designed to reduce evictions, and the association didn't say how the new proposals would be applied.

Santander and BBVA have renegotiated 17,311 and 45,000 home loans respectively. Caixabank has restructured 90,833 and Bankia, which was nationalized last year, has restructured 80,000 mortgages, almost 10 percent of its residential loans.

"The very last thing a bank wants to do is foreclose on a home and it's often a last resort measure taken after years of failed negotiations," said Acuna, "They have no desire to take on homes they cannot sell, have to provision for and pay maintenance and tax on."

Prolonging Pain

Acuna says allowing people to stay on in their properties without paying their mortgages, even for a two-year period, will prolong the problem and encourage people who can pay to stop if the mortgage on their home is more than the current market price of the property.

Spanish home prices have fallen more than 33 percent since the peak in 2007, according to Tinsa, Spain's largest homes appraiser. That's left about a fifth of borrowers in negative equity, a figure that could reach 25 percent by year's end, according to Standard & Poor's.

The government needs to plan for long-term stability, said Genworth's Mas. "As well as stopping the bleeding in the short term, what they need to do going forward is create a new mortgage framework that will introduce prudence into the system," he said.

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