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Neediest Spaniards Stranded After Banks Sell Loans

By Sharon Smyth and Esteban Duarte - Feb 26, 2013

Low-income Spanish homeowners who were promised the greatest help from the government are running into resistance refinancing their mortgages when the loans were packaged into bonds and no longer controlled by their banks.

Spanish lenders created mortgage-backed securities containing less creditworthy loans to help meet investor demand for higher-yielding assets, similar to banks in the U.S., and help fuel a decade-long housing boom. More than 124 billion euros ($162.4 billion) of the debt was packaged into bonds -- mostly with top credit grades -- before property markets crashed in 2008, leading to the worst economic slump in 50 years.

The securities are complicating efforts to help homeowners because they impose restrictions on the types of assistance allowed, including extending mortgages, lowering rates or allowing for grace periods or interest-only repayments.

“Securitized lending should never have been allowed,” said Carlos Banos, president of AFES, a Madrid based association that advises homeowners on how to restructure mortgages and avoid repossession. “Everyone was blinded by the real estate boom. Everything worked fine, mortgages were getting paid on time, the funds paid money for them providing financing for the banks, all parties were happy, then boom the crisis hit and knocked the stuffing out of the securitization business.”

Second Recession

The Spanish government has proposed a battery of measures intended to reduce the burden of defaults and foreclosures amid protests and suicides linked to home seizures, concerned the situation could deteriorate further as the country deals with the second-highest unemployment rate in the European Union. The economy, in its second recession since 2009, will contract a further 1.4 percent this year as the unemployment rate rises to 26.3 percent by year-end from 25 percent in 2012, according to estimates from Moody’s Investors Service.

About 400,000 homes in Spain have been repossessed since the start of the crisis, according to Banos, who cites data from Spain’s Judicial Council. The value of those homes is about 65 percent below the value of the loans on the properties at origination, according to Fitch Ratings.

Mortgage lending in Spain ballooned from 2000 to 2010, expanding more than four-fold as banks seized the opportunity to grow on the back of the country’s soaring residential real estate, which saw 955,186 home transactions at the peak in 2006.

Banks that originated the loans that were later sold usually took on the role of administrator of the securitized mortgage pools. According to the terms of the deals, the ability of servicers to refinance collateral is limited as part of a set of conditions shown to potential investors and rating companies grading the deals.

Bank Freedom

"The degree of freedom that bank managers have to help clients with mortgage-repayment difficulties are severely limited in cases of securitized loans," said Antonio Tena, a Madrid-based analyst for Moody's. "A bank has less opportunity to offer options to a struggling borrower compared with loans which remain on the balance sheet."

There are 124 billion euros of outstanding mortgage-backed securities, according to Spanish Mortgage Association data at the end of 2012. That's equivalent to 13.8 percent of total mortgage lending. The ratio was as high as 17.2 percent in 2009.

Typically, no more than 15 percent of loans backing a securitized pool may be modified by extending the maturity, Moody's Tena said. The maximum extension permitted normally doesn't surpass three years, and interest rates cannot be lowered beyond a set floor.

'Practically Impossible'

"Banks don't want to dedicate more money to refinancing a troubled mortgage that has been securitized; nor does the fund it's been sold to," said Banos of AFES. "So it's practically impossible that the client can get refinancing."

The average loan to value of loans pooled into Spanish residential mortgage backed securities is 73 percent, compared with 60 percent for home loans kept on lenders' balance sheets, according to Moody's data. Higher LTVs typically mean weaker credit quality of borrowers.

Spain built on average 675,000 homes a year from 1997 to 2006, more than France, Germany and the U.K. combined, according to a report by the research arm of Spanish savings bank Cajamar.

The property bonanza that ended in 2008 has left around 2 million unoccupied homes in Spain, representing supply that will take a decade to absorb, according to Madrid-based property research firm R.R. de Acuna & Asociados.

Government Decrees

The government passed two decrees last year forcing Spanish banks to make deeper provisions for losses linked to real estate in an effort to push down prices and boost sales. So far prices have fallen 36 percent from their April 2007 peak, according to real estate website Fotocasa.es and the IESE business school.

In 2009, at the start of the crisis, 80 percent of foreclosures affected immigrants and a further 15 percent were lower-income Spanish families, usually the first to lose their jobs and fall behind on loan payments in a souring economy, according to AFES.

A year ago, as the government calculated how many billions of euros of public aid would be needed to prop up its ailing banking industry, it approved a voluntary code of good practice for banks to promote restructuring of debt before resorting to foreclosure as a first option and as a last resort allow low- income mortgage holders to cancel their debts by handing over their homes.

In November, responding to nationwide protests after the suicide of a woman who faced losing her home, the government took a step further and pledged to impede banks from foreclosing on families who can't pay their mortgages for a two-year period if they earn less than 1,597 euros per month, have at least three children, have one child under three, a disabled dependent to look after, are a single parent family with two children or a victim of domestic violence; or being unemployed and not receiving benefits.

Planned Measures

“It’s not clear yet how the planned measures to relax foreclosure and refinancing terms could be applied for mortgages included in the securitizations vehicles, because those loans don’t belong to“ banks anymore, said Jaime de la Torre, a Madrid-based senior attorney of securities practice at Cuatrecasas, Goncalves Pereira.

“The measures are applicable to all mortgage holders who comply with the level of income and are within the parameters defined in the legislation,” according to a government spokesman, who asked not to be identified in line with policy.

The new measures wouldn’t cause an increase in the bad-loan ratio for mortgages, economy minister Luis De Guindos said during a press conference in Madrid on Nov. 15. The rate was 3.5 percent at the end of September, the highest in at least six years, according to the Spanish Mortgage Association.

Additional Proposals

Last month, as support for Spain’s ruling People’s Party fell to the lowest in the party’s history, the government announced further proposals to help struggling homeowners. Measures included extending to three the payments that must be missed before foreclosure proceedings can start, limiting mortgage arrears interest rates to three times the legal rate and changing the law to allow debtors to cancel their debt if they pay 65 percent of the remaining amount in the fifth year after the home is sold at auction, or 80 percent in the 10th year.

“Positive changes for borrowers could mean bad news for lenders and bondholders due to slower repayment,” said Alexander Fagenzer, a Frankfurt-based fund manager at Union Investment, which manages 191 billion euros. “Even more important is the lack of certainty on the reliability on the rules, which were designed to make the investments resilient during crisis periods,” said Fagenzer, who has avoided investing in Spanish RMBS for more than five years.

Stocks Fall

Spain’s benchmark IBEX 35 Index dropped 3.2 percent today to the lowest since Feb. 4, led by banks. European stocks declined on renewed concern that Italy will dilute its austerity program, deepening Europe’s sovereign-debt crisis.

Moody’s index of cumulative RMBS defaults increased to 2.8 percent in December 2012, up from 2.7 percent in September 2012. Moody’s rates 190 transactions in the Spanish RMBS market, with a total outstanding pool balance of almost 105 billion euros as of December 2012.

Delinquencies will continue to rise as more borrowers are expected to lose their jobs, according to Moody’s analyst Cristina Quintana. “House prices will continue to fall in 2013 as the supply of housing outweighs demand, with falling house prices increasing losses on foreclosed properties,” Quintana wrote in a Feb. 19 report.

Mortgage lending for homes fell 27.8 percent in December from a year earlier, Spain’s National Statistics Institute said today in an e-mailed statement.

Comparable Bonds

Investors demand 360 basis points, or 3.6 percentage points, above the benchmark interbank offered rate to buy a senior Spanish mortgage-backed security. That's almost six times the spread investors demand to hold comparable bonds pooling U.K. prime home loans, according to JPMorgan Chase & Co. data.

Sales of Spanish mortgage-backed securities have virtually disappeared since September 2007, when spreads were at about 65 basis points, before jumping to as high as 750 basis points in March 2009.

According to Banos, the real question is who's left on the hook if a securitized loan goes sour: the fund or the bank.

"Fund prospectuses aren't the Bible and don't spell out what happens when things go wrong," he said. "The most common scenario is that banks don't know the terms of the prospectus and decide to just wash their hands of the matter by telling the client it's no longer in their jurisdiction to refinance."

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