Asociación Hipotecaria Española

The new Spanish mortgage market law

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By Lorena Mullor,
Economist of the Spanish
Mortgage Association

On Saturday the 8 of December of last year, 2007, the new and long-awaited Law 41/2007 of the 7 of December was finally published in the Spanish Official Gazette. By way of this law, Law 2/1981 of the 25 of March, regulating the mortgage market and other rules of the mortgage and financial system are modified, reverse mortgages and long-term care insurance are regulated and certain tax regulations are established.

The scope of action covered by the new law, which had been announced in the two years preceding its publication by the Government, is:

- The modernisation of the consumer protection regime through increased transparency, which allows borrowers to take their decision based on the actual risk of the product.
- To promote a wider range of mortgage products by removing existing legal barriers, for example, those related to the regulation on prepayment penalties.
- To update regulation on different mortgage funding instruments.
- To allow the development of equity withdrawal and equity release, in the latter case by introducing a new regulation on reverse mortgages (by reducing the drawdown associated costs in both cases)
- And to enhance Valuation Companies' independence

This law is the most profound reform of the Spanish Mortgage market's regulatory framework since its origin in 1981.

Besides being an adequate legal text given that, without any doubt, it improves essential aspects of the market and incorporates other new ones, the adoption of the Law met with consensus from all the market participants who played a very important role in the Law's design and content.

As far as the key aspects of the law are concerned, it is important to highlight the new drafting of some articles of the Mortgage Law of 1946 that provides for a greater degree of flexibility with regard to the concept of "mortgage accessoriness" than has been the case.

This, of course, accords a greater capacity to credit institutions for the creation and development of new products. In particular, some of the most frequent and well-known loans in Europe, with different interest rate schemes or repayment methods, could now be provided under the rules contained in this law.

With the newly adopted interpretation of "modifying novation", the modification of any financial term of the mortgage contract of any outstanding loan is also permitted without the previous requirement of the initial mortgage cancellation and the subscription of a new one. This directly results in a reduction of the costs involved in this simple operation.

Hence, this new interpretation introduces the possibility to "recharge" the mortgage loan in order to meet any new financial need by the borrower, without the requirement of the constitution of a new mortgage.

The law also reviews and updates those regulations related to the lender's mortgage funding instruments, in particular, the issuance of "cédulas hipotecarias" and mortgage bonds.

One of the regulator's aims is to consolidate the Spanish mortgage securities market and thus, improve regulations and techniques in order to promote innovation and make the cédulas and mortgage bonds more competitive and secure, and also to allow for a high degree of flexibility for the institutions issuing these securities.

The technical improvements which are introduced focus on two lines of action: the first is the removal of the administrative obstacles which have weighed heavily on the concept of mortgage bonds and the second, which is more profound, is to enable greater financial sophistication of the issuance of "cédulas hipotecarias" and mortgage bonds.

In this latter case, two types of instruments may be included in the cover pool: substitution liquid assets that will contribute towards guaranteeing the liquidity risk in the case of bankruptcy, and also the economic flows generated by the derivative financial instruments linked to each issue, which will cover interest rate risk.

Moreover in the case of the "cédulas hipotecarias", a special accounting Register is established that will contain all the mortgage loans and credits which cover the cédulas in order to facilitate the segregation of the credits and loans in the covered pool from the rest of the assets of the issuer.

The Law also specifies that for the mortgage bonds, as is the case with the "cédulas hipotecarias", the bond holder has full recourse to the issuing institution.

As it is well known, in recent years, a great number of international analysts have pointed out that one of the negative elements of the Spanish mortgage market was its excessively rigid legislation, which prevented the development of new products and lending for new purposes, apart from residential lending. So far the real estate wealth of Spanish households has been without any doubt one of the highest in Europe, but it presented many difficulties to be resolved.

The new law introduces the first design of an efficient equity release framework in order to provide an impulse to the different segments of the market through:

- Second mortgages, by removing the obstacles that prevented their use.

- A wider and efficient regulation of the maximum-sum mortgages, also referred doctrinally to as «floating», designed to meet the funding needs of a specific but nonetheless wide-spread segment of the Spanish economy, mainly composed of small and medium businesses, self-employed workers and family businesses.

- The introduction of the Reverse Mortgage, which enables retired people and elderly people to complement their state pensions.

Another of the objectives of this Law is to achieve a neutral regulatory treatment of the different types of mortgage products on the market. For this, the Law introduces a new early repayment compensation system, more directly linked to the economic loss or benefit suffered by the lender, in order to foster the development of fixed rate mortgages loans at competitive prices.

Lastly, the Law also contains a Chapter, which includes some modifications of the calculation of the tariff costs relating to mortgage loans or credits. Under the general objective of encouraging the transparency of the transaction costs for mortgage market operations and the promotion of greater competition, the tariff costs on the deeds of modifying novation and subrogation of mortgage loans are reduced, as well as those related to cancellations.

Although the effects of this Law on the market must still be analysed in the medium term given the existence of some aspects, which requires further development through subsequent regulation, there is no doubt.