

SPEECH BY THE CHAIRMAN OF THE SPANISH MORTGAGE ASSOCIATION TO THE PARLIAMENTARY HOUSING COMMITTEE

Madrid, 25th September 2008

Mr President and Members of the House:

I would like to very sincerely thank the President and the Committee for the invitation to speak at this informative session of the Committee at such a complicated time for the economy in general and particularly for housing, which in different ways affects a large number of households, companies and workers.

In order to avoid giving the Members of the House an unnecessary exposition of statistical data, I have sent via the Secretary to the Committee, who I expressly thank for the support provided to me, an executive summary and the statistical report by the Association with the latest data from the mortgage market.

I will therefore focus my speech on suggesting some measures to the Committee which, from my point of view, could contribute towards somehow improving the situation experienced by many citizens.

Without further delay I shall now offer the Members of the House my opinion as a professional with many years of activity in the mortgage market.

Current situation of the market

The total credit balance in the Spanish mortgage market at last 31st July was 1.1 trillion euros, approximately 98% of the GDP, with accumulated net annual growth of 37,316 million Euros and a year-to-year variation of 7.9%.

We forecast a net lending for this year of about 50,000 million, which would be a year-to-year variation of approximately 5%.

This rhythm of activity in a market which at the end of 2005 was growing at rates of 27% is without doubt due to the significant slowdown in the residential real estate market activity.

Notwithstanding this, a total of five hundred and fifty thousand operations were formalised in the first six months for the sum of one hundred and five thousand million euros and the growth for the entire year will in any event be slightly more expansive than the one expected in the national economy.

The percentage of doubtful home loans at the end of June was 1.31%, with a balance of eight thousand million euros, and for the real estate activities it was 1.93%, with a total balance of six thousand million euros.

We can complete this quantitative outline of the situation with a brief description to summarise the main features of the current situation.

Spain has the largest relative housing stock in Europe and the biggest percentage of owner occupiers.

Although there is no contrasted and specific information, we also have the largest stock of unoccupied housing.

At the same time there is an unsatisfied demand, apparently significant although not reliably registered or quantified, which cannot access adequate housing either through purchase or rental.

Some recent borrowers are experiencing difficulties to meet the repayments on their loans as a result of the change in monetary policy, and also because the financial crisis is starting to generate significant volumes of unemployment.

Under these circumstances, the financial system must deal with the needs of the real estate activity and of the economy in general, administering certain particularly scarce and expensive resources as a result of the global liquidity crisis.

Determining factors of the current situation

In our opinion there are four main reasons or problems which interact, conditioning the recent evolution of the home finance mortgage market.

The first is the strong increase in house prices. According to the indicators of the "repayment effort" and of the "annual cost of the mortgage debt" published by the AHE (Spanish Mortgage Association) during the first part of the expansive cycle up to 2004, the evolution of the mortgage offer in terms of interest rates, loan duration and LTV allowed to absorb the house price increases, reducing the average cost of the mortgage debt from 5,800 € per year in 1995 to levels under 5,000 €, facilitating access to ownership for large sectors of the population.

From 2004 on, and under pressure from house prices, the annual debt repayment cost passed the 6,500 € barrier and currently exceeds 10,000 €, thereby excluding the most active sectors of demand.

After 2005, when the indicators started to reflect the drop in the demand for housing, both in terms of subscribed operations and credit, the credit demand for housing development strongly increased, bringing forward the risk of a future excess in supply, which most analysts estimate at about 800,000 new housing starts at the end of 2008.

This calculation error by the supply together with the sudden change in the Spanish and world economies, caused by the U.S. crisis, has prompted the inevitable adjustment, announced since 2005, being hastened and worsened in all of its terms.

The second is due to the phenomenon of the U.S. subprime mortgages, which since they burst in the markets, have led to a global liquidity crisis that particularly affects the national economies most reliant on external flows, which includes the Spanish one, and within them, the sectors more reliant on credit like the real estate sector.

Third, the national economic crisis has started to generate unemployment contributing to freezing the demand and producing an added impact on the non-payment of credit.

Fourth, and profoundly conditioning the above, is the high interest risk supported by the Spanish market, the biggest in Europe, as a result of having about 98% of its credit portfolio at variable rates and mainly referenced to an index particularly sensitive to the monetary policy of the ECB.

This interest risk has led those who contracted their loans between the years 2004 and 2005 to face an average increase of 34% of their mortgage instalments, leading to a supervening insolvency which is, at the moment, the main cause for the increase in market arrears.

It is precisely the combination of these four causes or problems, their individual magnitude and, above all, their interactions in the context of the global economy in which we are immersed, which provides this crisis with a complexity and a dimension, the depth and duration of which, we cannot assess, but which very probably situates it amongst the greatest crisis in our recent history.

This is why it is necessary and pressing to adopt a series of political and legislative measures, some structural and others interim, if not to overcome the crisis then at least to alleviate its most serious economic and social effects on housing.

Necessary measures

In the last legislature the Government sent Parliament, and it approved last December, an Act to reform the mortgage market which, without doubt, represents significant progress in its modernisation and future development.

It is true that the Act did not arrive in time to correct some of the main structural defects which had been repeatedly reported and which have been determining factors in triggering this crisis.

Notwithstanding this, all legislative measures which can be taken to overcome the crisis must take into account the protection, and even improvement, of the quality of the mortgages securities (MBS and covered bonds), without the competitive capacity of which it will not be possible to guarantee the necessary liquidity for a market which, at present, has refinanced 45% of its entire mortgage portfolio.

The most urgent measures must be designed to soften, insofar as possible, the effects of the supervening insolvency due to the interest risks in the family economies, the real estate sector and in the economy in general.

- Hence what is needed is a profound improvement to the legal possibilities of restructuring the debt in order to reduce the repossessions and creditors meetings.
- Favour different legislative modifications which will allow *the Dation in payment of debts* at a reasonable cost, as an alternative to repossession.
- And when it is unavoidable, make the judicial proceedings more flexible and drastically reduce the costs of enforcing, sale and disposal of the guarantees.

Simultaneously, effective solutions will have to be provided in order to prevent said interest risks, minimising them in future gross lending and in the outstanding loans, particularly for the group of loans subscribed over the last five years.

Another block of measures should be aimed at facilitating access to owned or rented housing in a situation as difficult as the current one, taking advantage, insofar as possible, of the stock of new and second hand housing on offer, in order to reduce the stress of the debt aggravated by the liquidity crisis.

And last but not least, it would be convenient to advance in the promotion of other ways of market funding, alternatives to those used in the past, particularly in the state-subsidised housing.

In general, most of the measures that we suggest do not involve an additional burden on budgetary resources.

BLOCK 1. MEASURES APPLICABLE IN THE CASES OF INSOLVENCY (DUE TO INTEREST RISK)

1. Actions faced with clear insolvency

- Of households

1.1 The main technical obstacle presented by restructuring of the mortgage debts in order to avoid enforcing the guarantee lies in the rigidity of its formal modification.

When the in-depth reform of the *Novation* procedure was considered in the drafting and approval process of Act 41/2007, it mainly sought to overcome this barrier in order to facilitate if necessary the restructuring, including under the guarantee of the 1st mortgage other possible unpaid debts of the debtor, to incorporate new repayment, deferment or scaling plans of debts, moratorium periods, etc.

Unfortunately, this possibility was expressly excluded for those loans subscribed prior to the Act's publication, which are precisely those most in need as clearly shown by the national and global economic situation.

In our opinion, one of the most effective measures in order to mitigate the effects of the crisis on households would be to urgently extend the possibility of in-depth restructuring for all mortgage loans, being able to renew the guarantee merely with the authorisation of the holders of registered rights and with the sole fees and tariffs than those corresponding to the possible increases in guaranteed capital.

This development of the novation would significantly reduce the enforcement of guarantees.

1.2 Given the special characteristics of this crisis, many citizens who cannot meet the repayments on their homes are resorting to *Dation in payment* in order to avoid judicial enforcement, which is always slower and more onerous. Hence they manage to recover some part of the home's value and, at times, can continue enjoying it by renting it.

In these cases it would be particularly appropriate to eliminate, insofar as possible, the legal costs of the *Dation* operation and of the possible transfer of the property to a public or private legal entity or individual landlord.

Advancing this way of solving the non-payment would also contribute to reducing the burden of the judicial proceedings, clearly benefiting all of these affected.

1.3 Finally, it would be a good idea to revise and reduce the fees inherent to the sale processes for the properties enforced under guarantee, as well as the administrative requirements and formalities in the foreclosure of state-subsidised housing.

- Corporate

1.4 The economic situation makes it necessary to be able to favour companies' refinance, particularly for the real estate development and construction companies, due to the real estate crisis. This is based on the idea of facilitating the continuity of companies in crisis, contributing towards overcoming this situation.

The current Bankruptcy Act does not favour the refinance of companies in crisis, as it establishes the presumption of patrimonial loss in the constitution of real guarantees in favour of pre-existing obligations, or of the new ones constituted to replace them, by acts or contracts signed 2 years before the declaration of bankruptcy, which may be subject to the exercise of the right to terminate.

It would therefore need to be reformed so as to favour the performance of prior agreements with the debtor who is in a situation of imminent insolvency, to refinance the debts with the professional creditors and in favour of the normal creditors for supplies, without this involving any risk that said agreements are terminated with the resulting loss of guarantees.

2. Actions to prevent the interest risk

2.1 One of the main structural defects which Act 41/2007 sought to resolve was the high interest risk in the Spanish mortgage market. This was demanded by the market; Parliament had requested it in its Non-legislative motion of March 2005 and was recommended by the IMF and the ECB amongst other institutions.

Those drafting the Act rightly introduced, and Parliament approved, the inclusion of a penalisation system for interest risk aimed at encouraging the competitive offer of mortgage loans with specific protection against this risk (we are referring to loans at a fixed rate, loans with an initial fixed rate, mixed, with capped rates, etc.).

However, the specific measures passed have been insufficient, both to modify the conditions of the initial offer and to cause the novations of old loans, which are needed in order to "clean-up" the performing portfolio against this risk.

In view of the serious consequences caused by the persistence of this specific, often reported, risk, it seems necessary to urgently redraft article 9 which regulates this

compensation so as to definitively bring about the drastic reduction of the interest risk.

- 2.2 In state-subsidised housing finance operations the control of the interest risk must be particularly monitored and part of the aid must be devoted to the mortgage holders in order to cover them against this risk. At the same time, it is also important to modify the future framework so as to allow for alternative formulas which decrease the exposure to this risk.

BLOCK 2. MEASURES FOR THE CURRENT PROBLEMS IN ACCESSING HOUSING

3. Interim measures for accessing home ownership

- 3.1 It would be a good idea to revise the prior savings incentives in order to make them more attractive both for those wanting free market housing and state-subsidised housing, including the possible extension, expansion and improvement of the housing saving accounts already in force, and allowing them to be applied to both first access and for replacement of the main home.
- 3.2 Furthermore, in the latter case, the maximum term for obtaining exemption from paying the personal income tax due to reinvestment in one's own home must be urgently and immediately reformed for those homes which, guaranteeing a *bridge mortgage* aimed at acquiring a new family home, cannot be sold due to lack of demand in the legally established period (two years).
- 3.3 What must also be taken into consideration is the alternative of permitting, even encouraging in the current situation, the possibility of achieving a return on this type of housing with a bridge mortgage by renting it, without this circumstance preventing the application of the *exemption due to reinvestment* in the inevitable postponement of the sale beyond the legally established period.

This proposal seeks to help to soften the levels of unforeseen effort which the users of this product are experiencing in the current situation and the mobilisation of a relevant part of the stock of houses for sale.

4. Promote the house rental market

The Chamber must be aware that the requirements for the admission of credit risks in financing real estate projects for house rental (free market or state-subsidised) have specific features and very different levels of solvency than those required in projects aimed at final purchasers.

4.1 General Measures (Private landlords)

The fundamental reason for disqualifying owners of empty houses in order to place them on the rental market lies in the sensation of uncertainty caused by a legislative framework which is inadequate, asymmetric and belligerent towards the landlord, the lack of efficiency of the justice system on the matter and the excessive concentration of risk on a considerable part of their assets.

This situation has been worsened since, incomprehensibly, the *Cámaras de la Propiedad* (Chambers of Ownership) were dissolved instead of promoting and encouraging their modernisation and transformation.

In the developing of a broad rental offer does not contribute neither the frequent criminalisation of owners by a minority sector of public opinion nor the permanent threat of tax sanctions if they do not cover, with their assets, a responsibility assigned by the Constitution exclusively to the State and its administrators.

The Ministry for Housing submitted a *Bill on measures to boost rental and buildings' energy efficiency* to a Public Hearing in the first week of September, the spirit and content of which we consider very appropriate in order to resolve the fundamental deficiencies in the current legal framework and to which we only made certain specific comments in the hope of contributing towards perfecting it.

But apart from this important, essential and fundamental reform, we believe that putting these real estate resources into service for society requires some complementary measures which favour the incorporation of private assets into the global supply of rental properties.

Thus, we suggest:

- Promote the creation and competitive offer of specific and flexible insurance policies to cover the many risks to which the landlord is exposed.
- Grant the landlord and the tenant the right to terminate the contract during the extension periods under the same conditions.
- That the Public Authorities facilitate the development of advisory services, legal defence, etc. which in some way used to be provided by the *Cámaras de la Propiedad* (Chambers of Ownership).
- Properly enable the courts to quickly resolve the conflicts deriving from rental.
- Create an accessible registry of defaulting tenants with final judicial decisions against them.

4.2 For the state-subsidised housing sector

In the specific case of state-subsidised housing for rent the efforts by the Public Authorities to contribute to its development are, if possible, even more justified as this is a measure to encourage access to housing offered to the parts of the population with less creditworthiness.

Firstly, the promotions of state-subsidised housing for rental must have some mechanism to ensure the receipt of the revenue flows over a sufficient period of time, not only so as to guarantee the return on the investment for the last recipients of these houses, but in order to enhance the credit quality of the product.

Equally, supporting the public sector by providing grants, coverage and tax incentives would contribute towards mobilisation in the capital market of this type of loans, thereby boosting its funding.

5. Interim measures to mobilise the unproductive real estate stock

It would be advisable to negotiate the most appropriate interim measures with the real estate sector and the institutional investors aimed at mobilising, insofar as possible and if is necessary, the stock of finished housing to the ownership or rental market, with or without purchase option, whether free market or state-subsidised housing.

BLOCK 3. MEASURES TO IMPROVE PROJECT LIQUIDITY AND FINANCE

6. Finance of State-subsidised Projects

6.1 One of the most serious situations which is arising under the current market situation is the supervening insolvency of many households, including those who were awarded houses with some type of public protection.

Therefore, the obligation of not exceeding a level of reasonable effort and the prior existence of sufficient resources in order to cover the unfinanced part of the price and the housing associated cost should be included amongst the requirement for accessing state-subsidised housing.

6.2 There are many Agreements with different procedures, both on a national level and in the Autonomous Regions, which inevitably imply too many administration and monitoring related costs.

It would therefore be advisable to achieve a greater degree of simplification and homogenization in the Agreements so that:

- On the one hand, the basic financial conditions are standardised in each of them and are brought closer to the dominant conditions in the free market.
- And on the other hand, the reduction of the administrative costs associated with their implementation and monitoring.

6.3 Equally, the design of the State-subsidised housing plans must include both the possibility of regulated finance and other finance obtained on the free market, at the borrower's election. Recent experience shows that, under certain circumstances, free market finance may be more advantageous than the regulated finance.

It would therefore be desirable that the beneficiaries of these loans could choose between the different types of loans available to them and enjoy finance adapted to their specific requirements, without losing the grants awarded.

6.4 At the same time, procedures must be developed which allow the entities to issue specific titles over the State-subsidised housing loans with additional guarantees from the State in order to ensure the necessary flows at more stable rates.

6.5 Similarly, refinance could be promoted in the mortgage markets of buildings built under the regime of land transfer with surface rights, which would reduce the final cost of the product.

7. Other general measures

In order to encourage the entry of institutional investors who provide a significant part of the high volume of resources which are needed in order to start-up and develop an effective rental housing market, what is needed is:

7.1 A revisions and update of the Real Estate Investment Funds regulation.

7.2 And the creation of a suitable legal framework for the REITs, both for financing free market projects and those specialised in developing social housing, which could have special treatment depending on their specific destination.

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Mr President, Members of the House, thank you for your attention to my speech and, apart from trying to answer any questions that you would like to ask me, I offer the Parliament, the Committee and the Parliamentary Groups all the personal collaboration and that of the Association which I chair in the development of all relevant initiatives that you decide to take.

Thank you again.