

DEFAULT ON MORTGAGE CREDIT TO HOUSEHOLDS

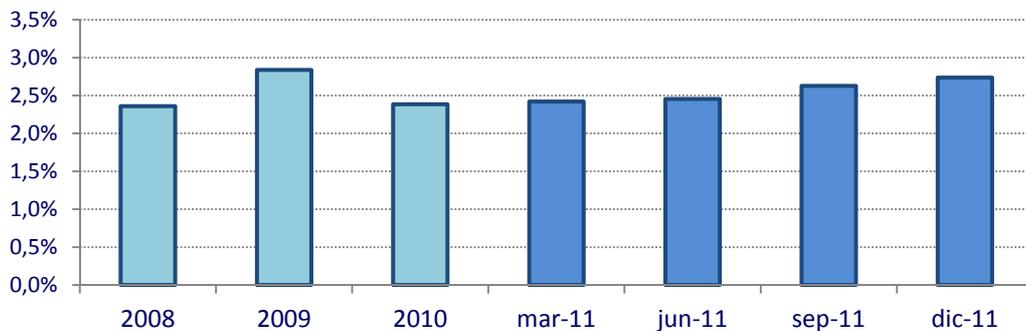
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One aspect that delivers a greater sense of strength in our mortgage market is the default rate on the lending to households' portfolio, currently 2.74%, clearly a high quality rate if we consider the severity of the current economic crisis.

Chart 1. Doubtful loans mortgage lending to households for house purchasing

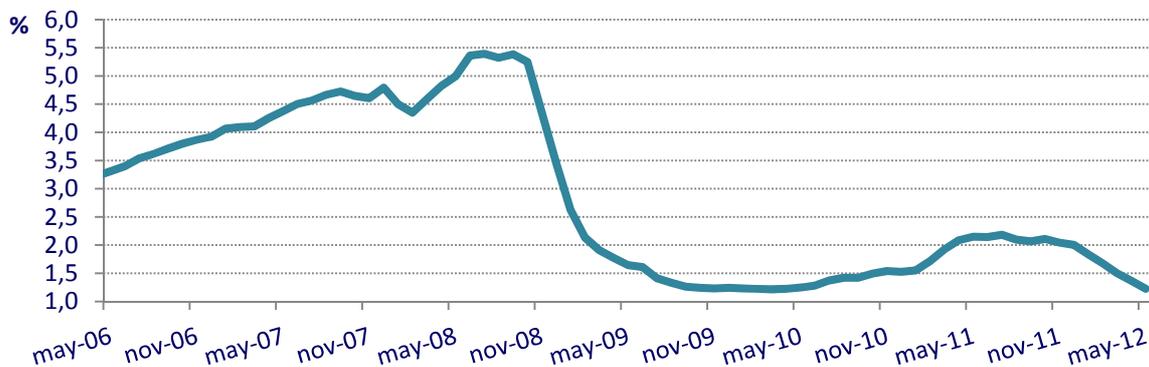


Source: BDE, AHE

These low delinquency rates are neither the result of chance, nor of magic. Instead it has to do with some of the very sound fundamentals on which our mortgage portfolio is based.

Before listing those fundamentals, it is worth noting that there are two factors behind such a positive development of doubtful loans in the Spanish mortgage market: the interest rate trend and the unemployment structure with regard to the loan.

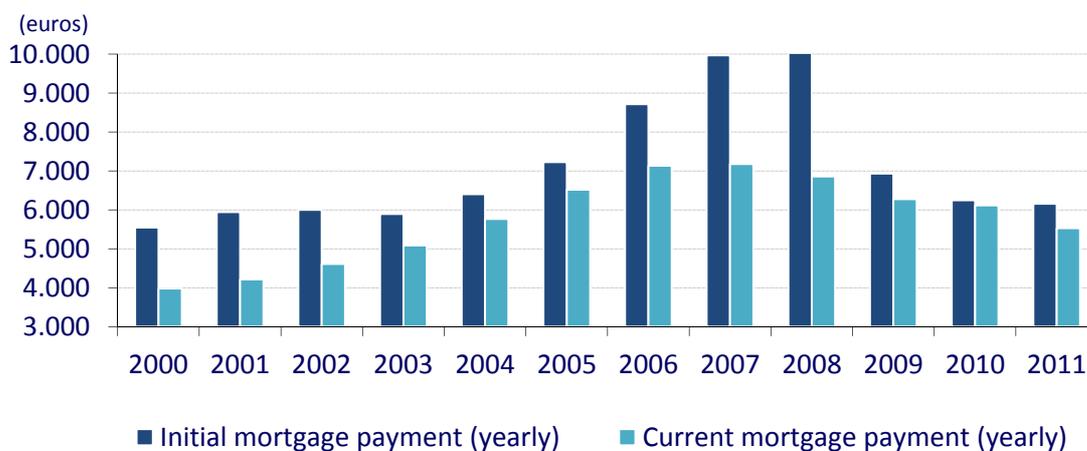
Chart 2. Recent evolution of the Mortgage Euribor.



Source: BDE, AHE

Regarding the first factor, it can be argued that virtually almost the total mortgage portfolio would be facing at the moment lower debt servicing than when the loan was taken out (Chart 3). This is a very important fact because it has not only permitted the generation of *treasury income* or excess cash to a large proportion of mortgage borrowers, but also these low levels have allowed to adapt them to the economic reality in the debt rescheduling processes.

Chart 3. Evolution of the average yearly mortgage payment (initial – current) depending on the year the loan was taken out.



Source: BDE, AHE.

With regard to the second one, we can say that approximately the **percentage of unemployed with a mortgage loan represents around 7-9% of the total mortgage loans taken out by households**. It is a figure that is comparatively low relative to the national unemployment rate (24.4% in March 2012), which determines a weak impact of unemployment on doubtful loans. There are several factors that explain this:

-On the one hand, people accessing to a home purchase share a sound employment profile (despite being structural, the unemployment impact has substantially affected temporary jobs, with less seniority).

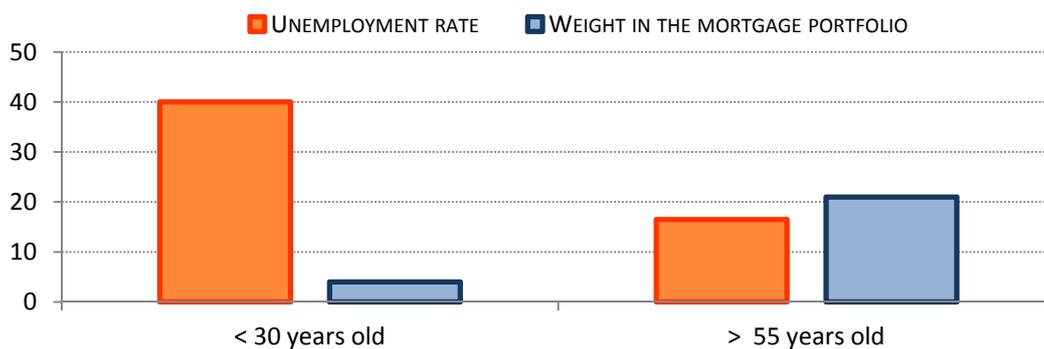
-On the other hand, the percentage of multi-partner transactions (either as borrowers or guarantors) for mortgage lending is above 90%; thus it is very often that at least one of the borrowers is employed.

-And finally, the divergent distribution of unemployment -in several professional groups- of the parties contracting the mortgage by age groups. This is especially relevant for *young people under 30 years of age*, where the unemployment rate would stand at around 40%, but they only accounts for 4% of the total outstanding mortgage loans to households.

The same also applies to *people over 55 years of age* who, despite representing a higher proportion in the portfolio (approximately 21%), the impact that unemployment would have on them would be

lower because most of these loans are close to maturity, being the percentage of the outstanding principal very low compared to the initial capital.

Chart 4. Unemployment rate for each age group compared with the weight in the mortgage portfolio of borrowers in that age range.



Source: INE, AHE

FUNDAMENTALS:

Those factors mentioned above on which the mortgage portfolio of the Spanish financial system is built have to do with both the processes of credit risk management and control and with others, more subjective, related to the socioeconomic characteristics of our country.

- **Retail Banking**

Among the first ones, it is important to note that the mortgage activity in Spain has been linked to the development of our “retail banking” and to this extend, the vast majority of the transactions have been aimed at a home purchase and have been strongly customer focused.

In a greater or lesser degree all transactions have had a *tying* objective (accounts, cards, insurances, etc.) that has resulted in a very close relationship with customers.

This close relationship has boosted the efficiency of the unpaid debt collection management. Credit institutions know their clients and keep a personal relationship with them.

The aforementioned debt collection management is executed by means of two relevant instruments:

- On the one hand via the renegotiation of loans, acting fast to adapt credit to the new socioeconomic situation of borrowers with products with specific characteristics and adequate interest rates contributing to its success.

- On the other hand, via the use of the *datio in solutum* to shorten and reduce the costs of the collection processes. This practice is of special relevance among the immigrant sector.

In addition, as mentioned above, there are other factors that have to do with issues related to the social protection model, working conditions, family support, etc. These issues are often subjective but their efficiency in the credit management is beyond any doubt. Below are highlighted some of them:

- **Budget support to unemployment**

Different forms of coverage aimed at groups affected by unemployment. The Spanish Social Security's benefits are high relative to wages and over a long period of time.

- **Guarantors**

This concept is frequently used and although the most common form is as a “guarantor of security” it has also been used the “repayment guarantor”.

- **Black economy**

Although not measurable, it seems very clear that a very significant part of our economic activity goes along paths not controlled by taxation.

- **Family support**

It is not legally considered a guarantor, but very often family cohesion (very Mediterranean, particularly Spanish) is behind the solution of many situations of default. Parents and siblings not only “help” the family maintenance, but also contribute financially to monthly payments.

All in all, we must conclude that, although the hardness of the economic crisis is strongly affecting Spanish citizens, we should not doubt that the quality of our private mortgage market defined in terms of delinquency rates is not a matter of “magic” but responds to structural factors that make us confident that, **despite the difficulties of employment, future developments will not present alarming signs.**