Spain

By Leyre Lopez, Spanish Mortgage Association

IN A NUTSHELL

→ The Spanish macroeconomic dynamics continued the positive path seen in 2016, contributing to the consolidation of the financial system in terms of new production, whilst two challenges have further remained alive: bank profitability and the market deleveraging.

→ The real estate market has continued gaining momentum, as a result of the domestic and external demand.

→ Continuous demand has had its incidence in housing price, in less or more degree, depending on the geographical area.

MACROECONOMIC OVERVIEW

The Spanish economic activity maintained the favourable behaviour seen in the past years, concluding 2017 with an average annual variation in real GDP of 3.1% (EU 2.5%). In quarterly terms, the economy has recorded four years in a row with positive variations. This favourable trend is likely to persist in the coming years, albeit at a slower pace, given the expected stabilisation of private consumption, resulting from the slowdown in the job creation, in a context of gradual withdrawal of monetary stimulus. The political situation may also play an important role in the economy performance.

On the expenditure side, the well performance of economy was underpinned by domestic demand. To this progress has also contributed the positive development of gross fixed capital formation (5.0%), boosted by the increase in the national and external demand, especially the residential market showed a great dynamism, growing by 8.3%. The input to the economy by the external sector was of 0.3%, given that the import rate (4.7%) was surpassed by the export rate (5.0%).

With regard to the labour market, the unemployment rate stood at 17.2% in 2017, the lowest level reached since the bursting of the crisis. On the other hand, the figure of job creation amounted to 490,300 according to the Labour Force Survey. Despite these efforts, the aftermath of the crisis continued to be visible, especially in job quality.

Inflation rose in the first months of 2017, as a consequence of the increase in fuel and energy prices, gradually slowing on a monthly basis, setting the harmonized consumption prices index (HICP) in average terms at a rate of 2% in 2017.

On the liabilities side, Spain met with the objective committed in terms of public deficit (3.1%). However, the volume of government debt maintained its upward course, closing 2017 in EUR 1,144.3 bn (+3.3% y-o-y) although the ratio of public debt in relation with the GDP dropped by 0.7% y-o-y, up to a rate of 98.3%. Even so, two tenths higher than the EU Commission commitment.

HOUSING AND MORTGAGE MARKETS

HOUSING MARKET

The real estate sector continued featuring the expansive path started four years ago. The key drivers lied in the ongoing strength of the economy context during these last years, coupled with a stronger business and consumer confidence under a scenario of financing consolidation. Because of these fundamentals, there was an acceleration in housing transactions, amounting to 532,367 units in 2017, from 457,738 transactions in 2016 (+ 16.3%). Of these figures, 16.8% were foreigners, while 82.8% were Spanish residents (a more marginal share of 0.4% corresponded to non-identified buyers). First time buyers (FTB), who used to play an important role in the market before the crisis, currently play a more residual role due to the difficult access to finance.

Housing prices continued to drive up given the supply-demand imbalance. The faster growth was in the major cities and coastal regions. Housing market-price (measured as appraisal value) improved by 2.4% y-o-y nationally and it can be considered the best figure seen since 2007.

While demand has been increasing (up), supply remains tight, mainly due to the lack of buildable land. New housing starts slid by91% from the peak of the real estate bubble (2006: EUR 865,561) to 80,786 units in 2017, despite there was a double-digit growth of 26.2% during the last year.

Market dynamic has put the spotlight back to developers and SOCIMIS (the Spanish version of REITs[1] created in 2009) enabling partly to meet costumers needs, both for housing ownership and renting.

MORTGAGE MARKETS

Market dynamics

Since 2014 the positive trend in the macro-economic framework fostered by expansionary monetary and financial conditions have driven the consolidation of the mortgage market, especially in terms of production of new credit.

2017 showed an increase of 3.7% in gross residential lending, amounting to EUR 38.9 bn. Over the last two years, gross lending figures have recorded a remarkably deceleration in the upward trend with respect to the turning point (2014/2015), which can be mainly explained by the fall of remortgaging loans, which assembled from 25.9% in 2015 to 6.1% in 2017 (17,1% in 2016).

With respect to the outstanding residential mortgage portfolio, the growth in new lending was not enough to compensate amortisations and cancelations of loans, which decreased by 2.6% y-o-y with respect to the figure observed in 2016, up to EUR 497.7 bn. Even so, Spain continued the ongoing deleveraging started in 2009, which appears to be closer to its end.

[1] Real Estate Investment Trust

In tune with the monetary policy adopted by the ECB by injecting liquidity to help markets operate and hence, by lowering rates for an extended period of time, the weighted average interest rate for new loans in 2017 came to 1.95% maintaining the downward trend started in 2011, when the interest rate was a 1.42 pps over up to 3.37%.

However, this has had concerning secondary effects on Spanish bank profitably, due to the high proportions of floating interest rates agreements in the outstanding portfolio.

The market share of new fixed interest rate loans represented about 58% in 2017, from 11% in 2009, given the stability they offer to financial entities and to family economy, under the competitive financial offer that the monetary framework has enabled.

Regarding to other mortgage dynamics, the maturity period of new residential loans in 2007 stood at 23.4 years, showing a slight increase from the figure seen in 2016 (23.1 years). LTV ratio for new credits closed 2017 in average terms at 65.1% from 63.9% observed in 2016, although loans with a LTV over 80% have dropped slightly from 14.3% in 2016 to 14.0% in 2017.

The active policy of divestment of Non-Performing Assets (NPAs) adopted by financial entities, together with the favourable scenario of the Spanish economy may explain the improvement in the financial system and, especially, in their doubtful portfolios. In 2017, NPLs of Spanish private-sector credit had continued the positive path started in early 2014, with a doubtful ratio of 7.8%, compared to the 9.1% observed in 2016. However, NPL ratio for housing purchase did not improved roughly compared to 2015 or 2016, setting its rate at 4.7% in 2017 (4.7% in 2016, 4.8% in 2015) due partly to the suspension of foreclosure process in this activity.

Non-market led initiatives

The Bill regulating real estate credit contracts was passed in November 2017 by the Spanish Government, with the conservative Mariano Rajoy as Prime Minister.

This piece of legislation introduces significant innovations on the mortgage regulation currently in force, in order to incorporate to the Spanish legal system, the content of the Mortgage Credit Directive (Directive 2014/17/EU), albeit belatedly. Nevertheless, the intention has been to go one step further and to reinforce the legal certainty, the transparency and the balance in the mortgage credit contracts.

Some of the new provisions introduced by this Bill are those regarding the enhancement of transparency throughout the contractual stage, the reinforce of the control by Notaries and Registrars, and the provisions regulating controversial issues, such as binding practices, the consumer rights referred to multi-currency mortgages, the interests on arrears, the accelerated repayment or early repayment.

The Bill, which was being studied by the Spanish Parliament, is now pending on the new political phase.

MORTGAGE FUNDING

In 2017 no significative changes in the source of funding occurred. Mortgage bank funding depends mainly on saving deposits and Spanish CBs.

Saving deposits of real estate sector[2] at a national level amounted to EUR 1.15 bn (+0.5% y-o-y), representing near to 95% of the entire portfolio with respect to the remaining 5% of government and local authorities. Due to the moderate profitability that this funding mechanism offers to clients (nearly zero rates as the deposit facility remain at -0.4%), there has been a substitution from fixed-term deposits (-32.4% y-o-y) into call deposits (+13.7% y-o-y).

The downward credit trend, although much more moderate, and the recovery of private sector resident deposits in recent years has allowed for a significant reduction of the credit/deposits ratio at a steady pace. Thus, Loans-to-deposits ratio (considering the private sector residents) stood at 109.3% by the end of 2017, while during the real estate upswing (2007) recorded a rate of 168.9%.

In terms of outstanding mortgage lending, covered bonds portfolio that accounts for near 39%[3], fall by 6.5% y-o-y in 2017 to EUR 216.5 bn.

The MBS market plays a more marginal role, ending 2017 with an outstanding amount of EUR 112.9 bn (-8.5% y-o-y). This funding mechanism that has historically enabled the freeing up of regulatory capital, remains on a high fluctuation path, both in positive and in negative terms, but still far from pre-crisis levels.

The standardisation process of the monetary policy is likely to have a positive impact in terms of mortgage funding issues over the coming quarters.

	SPAIN 2016	SPAIN 2017	EU 28 2017
Real GDP growth (%) (1)	3.3	3.1	2.4
Unemployment Rate (LSF), annual average (%) (1)	19.6	17.2	7.6
HICP inflation (%) (1)	-0.3	2.0	1.7
Outstanding Residential Loans (mn EUR) (2)	511,253	497,711	7,013,738
Outstanding Residential Loans per capita over 18 (EUR) (2)	13,421	13,039	16,872
Outstanding Residential Loans to disposable income ratio (%) (2)	73.0	69.7	73.8*
Gross residential lending, annual growth (%) (2)	5.0	3.7	3.5
Typical mortgage rate, annual average (%) (2)	2.0	2.0	2.4**
Owner occupation rate (%) (1)	77.8	n/a	66.4*
Nominal house price growth (%) (2)	1.9	2.4	6.0

* The aggregate EU figure is from 2016.
** Please note that this value is the simple average of the typical interest rate of the EU 28 countries.

Sources:
(1) Eurostat
(2) European Mortgage Federation - Hypostat 2018, Statistical Tables.

[2] The updated data on this chapter have been adapted to the new European framework criteria followed by the Bank of Spain.To this end, there has been a break in the statistics series, which lead to variations with respect to the past exercises.

[3] Latest data known of total outstanding mortgage loans correspond to March 2017.

SPAIN FACT TABLE

Entities which can issue mortgage loans:	In Spain, mortgage lending is always provided by financial institutions. Banks, savings banks, credit cooperatives, and financial credit establishments are the institutions allowed by law to grant mortgage loans and issue securities. It is worth mentioning that saving banks were specially affected by the recent crisis due to the high exposure to the real estate sector. Several saving banks disappeared through liquidation or acquisition, and most of the remaining transformed into banks after Law 26/2013 of 27 December was passed. Since then, only small and regional saving banks operate in the market.
The market share of the mortgage issuances:	In 2017 around an 90% of the total volume of new mortgage loans was granted by banks. Other financial institutions, like credit cooperatives and financial credit establishments, represented the remaining 10%.
Proportion of outstanding mortgage loans of the mortgage issuances:	Banks and former saving banks stand for the major part of the market, representing around a 91% of total outstanding mortgage lending. The remaining 9% is covered by credit cooperatives (8%) and financial credit establishments (1%).
Typical LTV ratio on residential mortgage loans:	On average terms, the LTV ratio on new residential mortgage loans stands at around 65% (according to Bank of Spain statistics). The most common LTV for first time buyers is 80%.
Any distinction made between residential and non-residential loans:	Residential loans include loans granted to households for housing purchase or renovation.
Most common mortgage product(s):	The most common mortgage loan product in Spain is the variable rate mortgage loan reviewable every 6 or 12 months with a French amortisation system. In variable rate mortgage loans the interest rate is linked to an official reference index (being the most common the Euribor 12m). Since the end of 2008, initial-fixed interest rate mortgage loans, with a fixation period up to 5 year, have gaining increasing importance in the market, representing nowadays around a 27% of gross lending. As well, since 2015 as a result of the security they offer, initial-fixed interest rate mortgage loans, with a fixation period of over 10 years, have gaining momentum, representing around 27% of gross lending.
Typical maturity of a mortgage:	The average maturity for a mortgage loan in Spain is 20-25 years. Although the real amortisation period is usually lower, between 10 to 15 years.
Most common way to fund mortgage lending:	Deposits, covered bonds and RMBS/CMBS.
Level of costs associated with a house purchase:	The main transactions cost associated with house purchase are VAT for new housing, that represents a 10% of the value of the house and the Tax on property transfer for second hand dwellings (normally between 6-10%, depending on the geographical area). Other transaction costs like land property registration, certified legal documents tax, notary fees, and costs related with the mortgage can come to a 3-5% of the housing value.
The level (if any) of government subsidies for house purchases:	In 2013 the tax relief that had been into force for home buyers ended. In 2018 has come into force a new State Housing Plan for 2018-2021 which seeks to facilitate access to housing property for vulnerable young people under 35 years old whilst at the same time tries to boost the regeneration of urban and rural areas affected by depopulation.