An overview of the Spanish Covered Bonds and their cover pools

Q3 2024

Preliminary Comments

The information presented in this report has been obtained from data provided by the issuers of covered bonds subscribed the Covered Bond Label program and operate within the national scope. This initiative provides financial institutions with a quality label that guarantees transparency standards in the covered bond market, facilitating decision-making and access to information for investors, regulators, and other market participants.

At the national level, this initiative includes 12 Spanish credit institutions[1] with a very significant share in the mortgage market.

RDL 24/2021 requires identifying and selecting a cover pool dedicated to the issuance of mortgage bonds, prioritizing its credit quality.

Spanish Covered Bonds (cédulas hipotecarias) are a source of funding for financial institutions, offering a double guarantee for investors. This double protection includes a credit claim against the issuer and preferential claim on the assets that make up the cover pool.

The entry into force of **Royal Decree-Law 24/2021** (RDL 24/2021) on July 8, 2022, introduced significant changes to further harmonize the regulation of covered bonds at national level, improving their quality and strengthening their management and supervision.

Among the most relevant changes, the redefinition of the cover pool used as collateral in the issuance of *cédulas hipotecarias* stands out. Until then, the pool of assets backing the payment obligations included the totality of the issuer's outstanding mortgage loans, except those that were pledged to a securitization issuance. However, since the entry into force of this RDL, the cover pool has been segregated and is now limited to a defined set of assets, which includes primary assets (mortgage loans), substitution assets (with a 10% limit), liquid assets, and derivative instruments.

[1] ABANCA Corporación Bancaria, Banco Sabadell, Banco Santander, Bankinter, BBVA, Caixabank, Caja Rural de Navarra, Eurocaja Rural, Grupo Cooperativo Cajamar, Ibercaja Banco, Kutxabank and Unicaja Banco.

Profile of the Spanish Covered Bonds

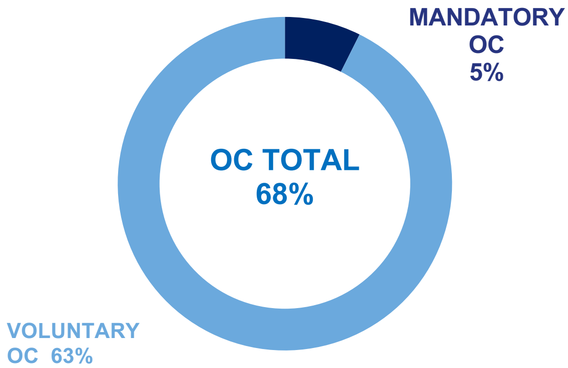
€181.87 billion in bond issuances

European Covered Bond Premium

Overcolateralization (OC) of 68%

4 years maturity (WA life)

As of September 2024, the cover pool for this sample amounted to €305.25 billion, in contrast to the €181.87 billion issued in *cédulas hipotecarias*. This implies that the analyzed bonds have a weighted average collateralization of 168%, with a range from a minimum of 129% to 241%, significantly exceeding the regulatory minimum of 105%.

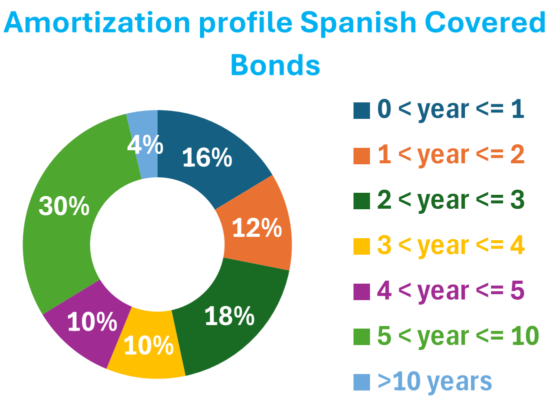


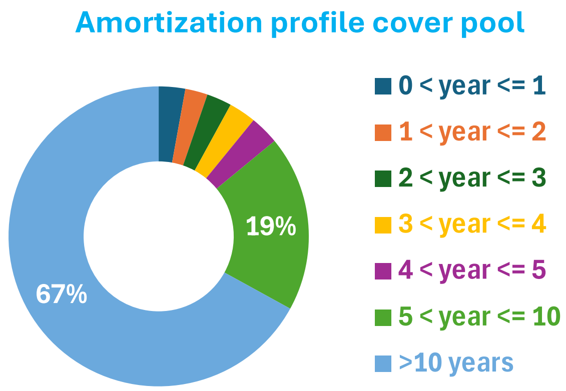
It is worth noting that all Spanish mortgage bonds comply with the requirements established in Article 129 of the **Capital Regulatory Requirements (CRR)** and, therefore, are considered **European Covered Bond Premium**.

Within the assets that make up the cover pool, **1.5% of the balance**, equivalent to approximately €4.5 billion, is attributed to **liquid assets** such as deposits or assets held with central banks. The **remainder**, around €300 billion, consists of primary assets corresponding entirely to **mortgage loans**.

In terms of **weighted average life**[2], **these financial instruments have an average of 4 years to amortize,** although 16% of the capital is expected to be amortized over the next 12 months. In contrast, only 3% of the **cover pool** will be amortized during the same period, while its **weighted average life y is 11 years and 4 months**.

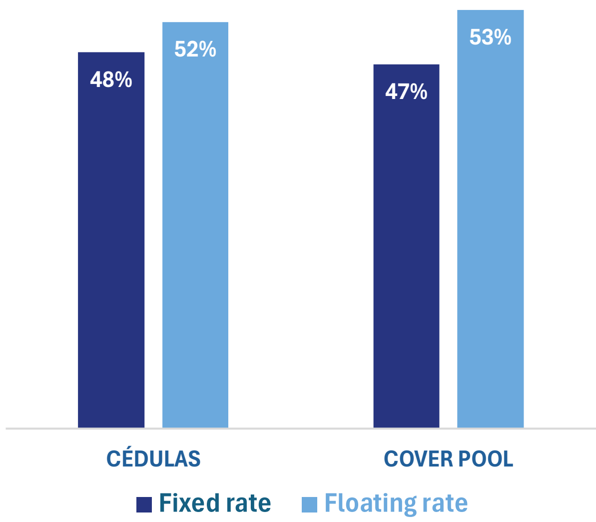
[2] It refers to the weighted average maturity, considering the scheduled partial amortizations.





Almost all of the *cédulas hipotecarias* have been issued in euros, although there is a minimal percentage of 0.6% in U.S. dollars.

Regarding the interest rate type, **48% of the outstanding issuances pay a fixed coupon**, while **52% of the balance has a variable interest rate**, typically indexed to the 'mid swap' or 3- or 6-month Euribor, plus a spread. **On the asset side,** the composition is similar, with **47% of the capital granted subject to a fixed interest[3] rate and 53% linked to a variable rate.** In this regard, it is worth noting that the fact that 100% of the issuances and the cover pool are not entirely tied to variable rates, and therefore do not adjust according to the same market conditions, highlights the need to use hedging instruments in certain cases. Among these instruments, interest rate swaps and other similar tools stand out, as they allow institutions to mitigate the partial risks arising from interest rate volatility. Furthermore, the risk is influenced not only by the current interest rate environment compared to the one at the time of issuance, but also by the different maturities at which the bonds and loans are subscribed, as well as their various amortization schemes.



[3] Fixed refers to all loans with an initial fixed period longer than one year.

Profile of the Mortgage Assets in the Cover Pool

€300.75 billion outstanding assets

≈ 4 M of mortgage loans

0% NPL

49% LTV

11 years and 4 months of WA life

90% are residential properties

The primary assets backing the cover pools in our analysis are entirely mortgage loans. These loans stand out for their quality and low level of risk. Below are some of their most characteristic features:

Almost the entire portfolio is up to date with payments or, at least, has **no loans overdue for more than 90 days.**

The real estate collateral backing the loans is constituted with first-ranking rights over the full ownership of the entire property.

The **average loan-to-value (LTV) ratio of the analyzed portfolio is 49%,** with a range between 45% and 57%, with all the capital concentrated at levels below 80%. It is important to clarify that the new regulation establishes that only mortgage assets with an LTV below 80% for residential loans, or 60% for commercial loans, can be included in the cover pool. **In the residential portfolio**, the weighted average LTV was **50.3%**, while in the **commercial portfolio** it drops to **38.6%**

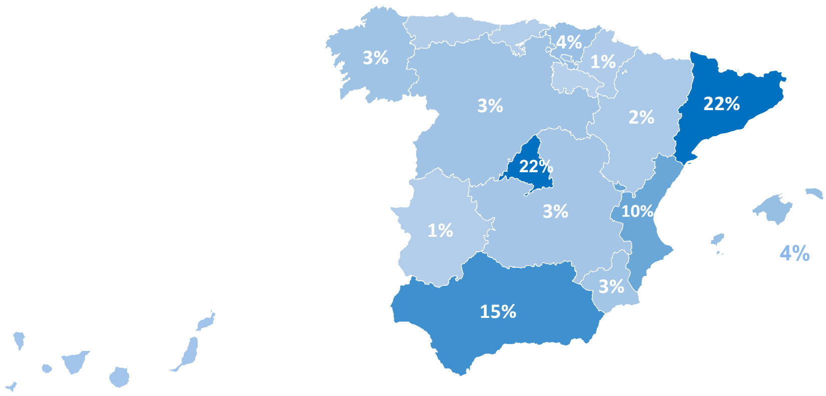
Residential loans have a majority presence in the portfolio, accounting for 90%. Within this segment, primary residences of the borrowers dominate, representing 88% of the residential balance**.**

The weighted average seasoning of the mortgage assets is 6 years and 5 months, while the weighted average maturity, without considering the partial payment schedule, is 17 years and 6 months. In total, **the average total duration of the loans is close to 24 years**, which aligns with the average term of new mortgage loans according to data from the Bank of Spain and is below the 30-year threshold set by the RDL.

When the outstanding principal is weighted according to the scheduled payment calendar, the **weighted average life** decreases to **11 years and 4 months**. Within this metric, it is noteworthy that only 14% of the capital is expected to be repaid within the next 5 years, and given the life horizon of this type of asset, the bulk is concentrated in a period of more than 10 years.

The vast majority of mortgage loans (99.8%) have been granted in euros; however, **0.2% of the balance is denominated in foreign currencies,** mainly Japanese yen; U.S. dollars, and -to a lesser extent- Swiss francs and British pounds.

Regardless of whether the transaction originates in Spain, **1.5%** of the balance corresponds to **properties located in Portugal**. **The rest is in Spain**, with nearly 60% of the assets located in Madrid (22%), Catalonia (22%), and Andalusia (15%).



Nearly half of the balance **corresponds to loans** with an **interest rate fixation period of more than one year**.