Spain

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IN A NUTSHELL

→ GDP grew 5.1% after a 10.8% contraction in 2020.

→ Gross residential lending grew due to pent-up demand and interest rates at all-time lows.

→ Fixed-rate loans continued to increase in volume

→ Support measures and economic growth have caused a reduction in NPLs, although at a slower rate than pre-pandemic.

→ The Royal Decree-Law 24/2021 of 2 November transposes the Covered Bond Directive 2019/2162 creating a more harmonised covered bond framework.

MACROECONOMIC OVERVIEW

GDP grew by 5.1%, although still 6% below pre-pandemic levels. Domestic demand contributed 4.7 pps to GDP growth, while the external demand contributed just 0.4 pps. The retail sector particularly stood out, it increased by 14.2% after a 25.7% contraction in 2020, thanks to the vaccination and gradually eased lockdowns. The recovery sustained employment levels, with the creation of 840,600 new jobs. Due to this, the number of employed persons stood above 20 mn persons, while the unemployment rate decreased from 15.5% in 2020 to 14.8% in 2021. HICP continued to increase, increasingly in the last part of the year as a result of the increase in fuel and electricity prices. On average, the HICP stood at 3.0%, while core inflation was just 0.7%.

Given the employment creation, tax collection increased resulting in a decrease in the public deficit to 6.8%. Government debt reached an historical level in absolute terms, although the GDP ratio improved by 1.6 pps, to 118.4% of GDP at year end.

LOOKING AHEAD

In light of the war in Ukraine and more permanent inflation, forecasts suggest more subdued economic growth in 2022, from an expected almost 6% at end-year 2021 to about 4%, according to the last European Commission estimate at the time of writing. Initially, economic activity was supported by solid fundamentals, following the implementation of the Recovery and Resilience Plan enacted by the Government on the basis of the European Funds and the positive inertia of recovery after the height of the pandemic. However, as a result of the war in Ukraine, the outlook has deteriorated due to a shock in commodity markets.

In terms of housing, 2022 housing sales and new mortgage dynamics were expected to remain strong, albeit at a slower pace, given the high savings rates and the low interest rates. This scenario may moderate if the war continues, inflation becomes more persistent and the ECB ultimately tightens its monetary policy, as foreseen.

HOUSING MARKETS

Real estate and housing activity indicators (i.e., house prices, new building permits and housing sales, among others) pointed to recovery after the pandemic disruption. Apart from the maintenance of the expansive monetary policy, vaccination (which reached 80%) and a gradual lifting of most lockdown restrictions have been key drivers of the recovery and have helped reinforce both producer and consumer confidence.

Housing production increased which has intensified as the year progressed. In total, these permits were issued for more than 108,300 dwellings with an investment of around EUR 10.6 bn, a figure 27% higher compared to 2020, marking an 11-year high. The 2020 trend in the development and sale of detached houses due to changes in consumer behaviour and residential preferences since the pandemic continued, although at a slower rate as the year progressed. Single-family houses, which accounted for a quarter of new building permits, grew by 31% y-o-y, against the 25% for multi-family houses.

Demand was also positive. The main drivers were the increase in saving rates and a new trend for larger homes as a result of the Covid-19 confinement, against a backdrop of high liquidity and low interest rates. Housing sales reached 674,000 a volume not seen since 2007 and 38% higher than in 2020, which follows from the fact that in the previous year sales fell by 14%, but is also higher than the 570,000 dwellings sold in 2019. In relative terms, the Balearic and the Canary Islands, as well as areas on the Mediterranean coast led this trend, suggesting a recovery of the second-home market which was especially hampered during the pandemic due to national and international mobility difficulties. In primary dwellings, second-time buyers continued to grow relative to first time buyers who still face housing affordability difficulties.

After contracting in the pandemic, house prices increased. On an annual average basis, considering the average of all 2021 quarters, prices rose by 2.1%, although the year closed with an annual increase of 4.4% in Q4 2021. Prices rose more for newly-built properties due to the shortage of new developments and the rise in production costs. Once again, regions such as Madrid or Barcelona showed stronger increased by year end, increasing in Q4 2021 by 7.2% and 4.3%, respectively.

MORTGAGE MARKETS

MARKET DYNAMICS

Favourable conditions in the real estate market were reflected in the mortgage market. Gross lending amounted to EUR 59.4 bn, 35% relative to both 2020 and 2019. Volumes in 2020 were affected by the pandemic and in 2019 by the approval of the *Law 5/2019 on real estate credit agreements*. Growth 2021 was driven by falling interest rates due to increased competition between banks in a context in which the ECB maintained its expansionary monetary policy. The weighted average mortgage rate reached an all-time low of 1.49% on new mortgages. Additionally, supported the preference of both banks and consumers towards fixed interest rates continued to narrow the spread between floating and fixed rates, reaching the latter about 75% of the market.

Lower interest rates led to a decrease in the mortgage payments for many Spanish households[1]. However, this was not the case for newly originated loans due to their greater amount. The average loan maturity stabilised at around 24.5 years.

In terms of outstanding loans, bank lending for house purchases increased by 1.1%, after more than a decade of reduction. This was due to increased lending activity, despite repayments increasing due to both households using savings to reduce their debt and the resumption of payments after the expiry of moratoriums. Despite the expiries, doubtful exposures continued to decrease albeit at a slower rate than prior to the pandemic. The NPL ratio for residential loans remained stable at 3%, with a coverage ratio of 28% as of December 2021, in line with the pre-pandemic picture, but almost 4 pps lower than in 2020. The risk of an activity slowdown stemming from existing geopolitical tensions and the potential tightening of the monetary policy could led banks to increase provisions.

NON-MARKET LED INITIATIVES

Some of the measures approved in 2020 to mitigate the impact of the pandemic were withdrawn throughout 2021. The payment moratoriums for households, which represented 9% of household credit with a suspended balance of EUR 58 bn, expired at the end of March 2021. The temporary employment regulation scheme (Spanish acronym: ERTE) that relieved companies of labour costs while guaranteeing household incomes, although continuing through the year, were used less: at year end there were 102,500 people under ERTE, 97% less than at the height of the pandemic. This, together with state guaranteed loans, which mobilised more than EUR 135 bn of loans by December 2021 for non-financial companies (NFCs), meant supported the private sector, with loan impairment remaining low practically across the board in all portfolios. At the same time, significant steps were taken in the development of the macroprudential regulatory framework, specifically the Banco de España published *Circular 5/2021* in 2021, which develops three new macroprudential tools to mitigate risks in specific credit segments, including the application of a countercyclical capital buffer in specific risk exposures, limits on sector concentration, and limits and conditions on credit standards in terms of maturity or indebtedness.

MORTGAGE FUNDING

The financial system continued to be marked by a high volume of liquidity. In order to continue providing financial support to households and companies, Spanish financial institutions further resorted to liquidity auctions under the ECB's Long Term Repo Operations program, although at a slower pace than in 2020, when the volume doubled. In 2021 the balance outstanding stood at EUR 289.5 bn, 11% more per year. In net terms, the strong increase in mortgage activity during 2021 was not matched by an increase in the balance of mortgage securities, which has decreased by 5.6% to EUR 298.3 bn (considering not just 'Cédulas Hipotecarias' but also MBS). The first refinancing resource of mortgage-related banking assets will change from July 8, 2022, due to the transposition of the *European Directive 2019/2162* (the Covered Bond Directive) into Spanish law, after the entry into force of Royal Decree-Law 24/2021. Changes include the configuration of a genuine cover pool; the designation of a cover pool monitor; the appointment of an independent bankruptcy administrator; the introduction of a liquidity buffer; the possible use of a soft bullet mechanism; and the reduction of regulatory levels of overcollaterisation. This should allow for a better functioning covered bond market, if possible, since it should be noted that covered bonds have traditionally been a resource widely used by Spanish institutions, especially in times of uncertainty.

GREEN FUNDING

Green funding is still at an early stage, although it is gradually gaining prominence due to public and private initiatives, in line with the European Renovation Wave, to advance the modernisation and decarbonisation of the economy through the subsidy and funding of 'green' actions that pursue, among other aspects, the rehabilitation of one of the oldest housing stocks in Europe. Approximately half of Spanish buildings were built before 1980 and about 80% have an energy rating E, F or G (that is, deficient).

From the Next Generation EU funds, the government has approved the Urban Rehabilitation and Regeneration Plan for an amount of about EUR 7 bn. This program aims to multiply by 10 the current rate of renovations by the end of the decade, from just under 30,000 per year to 300,000. The aid involves a different degree of subsidy with respect to the renovation project, granting a higher level of subsidy to homes or buildings in which there is a clear improvement in energy efficiency, as well as also those sectors where, due to their characteristics of low incomes greater public funding is required. A large part of the aid will be put forward together with private initiatives, in order to achieve a multiplier effect.

	SPAIN 2020	SPAIN 2021	EU 27 2021
MACROECONOMIC VARIABLES			
Real GDP growth (%) (1)	-10.8	5.1	5.4
Unemployment Rate (LSF), annual average (%) (1)	15.5	14.8	7.0
HICP inflation (%) (1)	-0.3	3.0	3.0
HOUSING MARKET			
Owner occupation rate (%) (1)	75.1	75.8	70.0
Gross Fixed Investment in Housing (annual change)(1)	-11.2	-5.3	6.6
Building Permits (2015=100) (2)	172.1	218.0	134.0
House Price Index – country (2015=100) (2)	110.0	112.4	145.2*
House Price Index – capital (2015=100) (2)	124.3	126.3	146.1*
Nominal house price growth (%) (2)	-1.1	2.1	10.3*
MORTGAGE MARKET			
Outstanding Residential Loans (mn EUR) (2)	481,913	487,146	6,508,621
Outstanding Residential Loans per capita over 18 (EUR) (2)	12,355	12,441	17,782
Outstanding Residential Loans to disposable income ratio (%) (2)	64.9	64.2	62.8*
Gross residential lending, annual growth (%) (2)	0.9	35.1	12.2
Typical mortgage rate, annual average (%) (2)	1.7	1.5	2.0

* Please note that this value is the simple average of the available values in 2021.

Sources:
(1) Eurostat
(2) European Mortgage Federation - Hypostat 2022, Statistical Tables.

[1] Considering that approximately 75% of the outstanding mortgage loan portfolio it is linked to a floating rate

SPAIN FACT TABLE

Which entities can issue mortgage loans in your country?	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 especially affected by the financial 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.
What is the market share of new mortgage issuances between these entities?	As in previous years, in 2021, around 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%.
Which entities hold what proportion of outstanding mortgage loans in your country?	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%).
What is the typical LTV ratio on residential mortgage loans in your country?	On average, in 2020, the LTV ratio on new residential mortgage loans stood at 65% (according to Bank of Spain statistics). However, the most common LTV for FTB is 80%, while for second houses the maximum level is normally 70%.
How is the distinction made between loans for residential and non-residential purposes in your country?	Residential loans include loans granted to households for housing purchase.
What is/are the most common mortgage product(s) in your country?	The most common mortgage loan product in Spain was 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 2015, as a result of the security they offer, initial-fixed interest rate mortgage loans, with a fixation period of over 10 years, have gained momentum, representing more than 60% of gross residential lending by the end of 2021..
What is the typical/ average maturity for a mortgage in your country?	According to Bank of Spain statistics, the average maturity for new mortgage loans in Spain stood at around 24 years and a half, with the most typical term for FTB being 30 years. As usual, the real amortisation period is usually lower, around 15 years on average.
What is/are the most common ways to fund mortgage lending in your country?	Covered bonds, RMBS/CMBS and deposits
What is the level of costs associated with house purchase in your country (taxes and other transaction costs)?	The main transactions cost associated with house purchase are VAT for new housing, which represents 10% of the value of the house, and the Tax on property transfer for second hand dwellings (with a rate normally between 6-10%, depending on the geographical area). As of 2019, after the new *Law 5/2019 regulating Real Estate Credit Contracts* was passed, all cost linked with the constitution of the mortgage must be covered by the bank (Mortgage Stamp Duty – "AJD" Tax; notary, registry and agency fees), except the cost of the valuation of the property and the notarial copies requested by the client, which are responsibility of the borrower. Another cost which is compulsory for the borrower when taking out a mortgage is the cost of fire insurance.
What is the level (if any) of government subsidies for house purchases in your country?	In 2013,the tax deduction that had been in force for years aimed at aiding homebuyers came to an end, remaining exclusively for those homebuyers who had purchased a property before that date. In 2018, a new State Housing Plan for the 2018-2021 period (recently extended until 2025) came into force, which seeks to facilitate access to housing property for vulnerable young people under 35 years old, whilst trying at the same time to boost the regeneration of urban and rural areas affected by depopulation. Eligible beneficiaries must buy a home in a municipality with less than 10,000 inhabitants and the amount granted under this scheme shall not exceed EUR 10,800 per dwelling, limited to 20% of the purchase price.