Special Feature

CODES OF GOOD PRACTICE FOR PRINCIPAL RESIDENCE MORTGAGES AND SUPPLEMENTARY MEASURES

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The global financial crisis had important consequences for mortgagors in terms of adjustments to their spending levels, defaults on their financial obligations and, in certain cases, the loss of the mortgaged residence. Royal Decree-Law (RDL) 6/2012[1] was approved to protect the most vulnerable households. This RDL implemented the creation of a "Code of Good Practice" (CGP) to which credit institutions and other professional mortgage lenders could voluntarily sign up. This CGP bound those that did so and established certain arrangements, essentially aimed at fostering, in accordance with the terminology used in RDL 6/2012, the viable forbearance[2] of the mortgage loans of those mortgagors facing extraordinary difficulties to meet their repayment obligations.

Against the economic and geopolitical backdrop following Russia's invasion of Ukraine, RDL 19/2022 amended some of the measures in the CGP under RDL 6/2012 and established a new temporary code for potentially vulnerable mortgagors, which will remain in force until December 2024, alongside other additional measures, such as the temporary waiver of fees for converting variable-rate into fixed-rate mortgages. On this occasion, the rationale for the new RDL was, first, to help alleviate the situation of vulnerable households with variable-rate mortgages and smooth their adaptation to the new higher interest rate environment. At the same time, these measures aimed, more generally, to facilitate the switch from variable-rate to fixed-rate mortgages and prevent high inflation and rising interest rates from placing certain segments of the at-risk households in a situation of vulnerability.

This special feature details the measures in RDL 19/2022 and explains how much they differ from those envisaged in RDL 6/2012. It also contains an analysis of the historical data on application of the CGP under RDL 6/2012, assessing its possible structural and conjunctural functions, and the potential warning signs in the characteristics of forborne transactions in the recent period. On the basis of the criteria established under RDL 19/2022 and the historical experience of RDL 6/2012, ranges are estimated for the potential size of the population of eligible mortgagors under the different CGPs in force after the 2022 reform and for the actual proportion of them that were ultimately able to opt for the measures.

The easing of vulnerable and potentially vulnerable households' debt burden resulting from application of the CGP measures will foreseeably boost consumption

1 RDL 6/2012 on urgent measures to protect mortgagors experiencing financial hardship.

2 This special feature uses the terms forbearance and forbearance plans in line with the terminology in RDL 6/2012. The consideration of a loan as forborne for loan loss provision purposes depends on specific legislation which is separate from RDL 6/2012. Section SF.3.3 of this special feature analyses this matter in greater detail.

and economic activity in the short term. However, the counterpoint to some of these measures would be a higher level of household debt for longer and an increase in interest cost in the long term. They could also have implications for these households' access to new loans in the future. These different macroeconomic and financial effects are also analysed in later sections.

Lastly, this special feature analyses the credit quality of the mortgage loans on banks' balance sheets that have been identified as forborne, in accordance with accounting regulations for banks. Amending the terms and conditions on loans for borrowers experiencing financial hardship may, when appropriately implemented, enable defaults to be managed and corrected or, in the best case, prevent them, lowering impairment charges as a result.

Overall, the information in this special feature aims to aid comprehension of the CGP measures adopted and contribute to the ex ante analysis of their economic and financial consequences. This prior analysis combines the characteristics of these measures with different data available to December 2022, before the reformed CGP framework stemming from RDL 19/2022 began to be applied. Future Financial Stability Reports will conduct an ex post analysis, once information is available on the actual outcomes of applying this reform.

SF.1 The Codes of Good Practice in Royal Decree-Law 6/2012 and Royal Decree-Law 19/2022

SF.1.1 Description and main characteristics of the Royal Decree-Law 6/2012 Code of Good Practice

The RDL 6/2012 CGP was approved primarily in order to facilitate the forbearance of mortgage loans amid the fallout from the global financial crisis. In 2012, after four years of economic crisis, the prolonged unemployment or economic inactivity of certain groups of households limited their debt servicing capacity, leading to a sharp rise in defaults and, ultimately, mortgage foreclosures. To prevent the adverse socioeconomic effects of losing their dwelling for those mortgagors facing significant financial hardship, measures were introduced to facilitate mortgage loan forbearance and to relax mortgage foreclosure.[3]

RDL 6/2012 also sought to safeguard and maintain the soundness of the Spanish mortgage system by making the adoption of the CGP by lenders voluntary and limiting its effects to the most vulnerable mortgagors. Credit

3 A mortgage is a form of collateral whereby the property provided as the security directly or indirectly ensures a particular obligation is discharged. It should be entered in the real estate registry to duly qualify as a right in rem. Under Articles 106 and 107 of the Spanish Mortgage Law, immovable property and other rights in rem can be mortgaged.

institutions and other professional mortgage lenders could sign up to the CGP under RDL 6/2012 voluntarily. Having done so, the provisions of the CGP became obligatory[4] for those mortgage loans where certain conditions were met regarding the immovable property and, primarily, mortgagors who had provided their principal residence as collateral,[5] considering whether they were below an exclusion threshold that prevented them from fulfilling mortgage repayment obligations and being able to feed the household.

Under RDL 6/2012, a mortgagor would be considered as being below the exclusion threshold on account of having low income, the household unit's purchasing power having become significantly deteriorated and having a high mortgage servicing ratio. With respect to income, the overall income of the members of the household unit could not exceed a limit of three times the Multipurpose Public Indicator of Income (IPREM),[6] which was raised under certain circumstances.[7] To identify the deterioration in the household unit's purchasing power,[8] in the four years prior to submitting the application for mortgage forbearance, the mortgage servicing ratio needed to have increased by 1.5x, or unforeseen circumstances rendering the household unit particularly vulnerable needed to have arisen in that period (large families, single-parent households, etc.). In addition, mortgage instalments needed to exceed 50% of the net income received by all members of the household unit (40% if any member of the household unit had above a certain degree of disability). In any of the above-mentioned cases, mortgagors were required to prove that their household unit had no other assets or sources of income that they could use to repay the debt. This CGP also limited the selling price of the dwelling associated with eligible loans based on the size of the municipality and the household's circumstances.[9]

The mortgage debt burden relief measures under RDL 6/2012 basically involved the establishment of a payment holiday and amended maturities and interest rates. Under the CGP,[10] the mortgagee was to submit a financial viability plan to the mortgagor within one month of receipt of the application for mortgage

4 To oversee compliance with RDL 6/2012, the Royal Decree-Law created an oversight committee comprising representatives from the Ministry of Economic Affairs and Competitiveness, the Banco de España, the National Securities Market Commission and the Spanish Mortgage Association.

5 The scope of RDL 6/2012 included mortgagors with a mortgage on their principal residence, in addition to sureties and guarantors, vis-à-vis their principal residence.

6 14 payments per year. The IPREM is a benchmark index used in Spain for granting aid, subsidies and unemployment benefits. It was launched in 2004 as a new benchmark, replacing the national minimum wage.

7 This limit would increase to four or five times the IPREM based on the disability or legal incapacity of the members of the household unit.

8 The conditions regarding the deterioration in purchasing power and the mortgage servicing ratio detailed in this special feature refer to the Amendment of 15 May 2013 to the original wording of RDL 6/2012, which envisaged different criteria that were not in force for particularly long and are not detailed any further in this special feature.

9 See Article 5 of the Amendment of 15 May 2013 to the original wording of RDL 6/2012.

10 Forbearance plan conditions in accordance with the CGP in the Annex to RDL 6/2012, as per the Amendment of 15 May 2013. The substitutive and supplementary measures in the following paragraph are also from this version of the RDL.

loan forbearance. The forbearance measures involved applying an interest-only period[11] of up to five years, extending the term to 40 years (from the loan origination date) and applying, during the interest-only period, an interest rate equal to the relevant EURIBOR + 0.25 percentage points (pp). Banks could consolidate all the mortgagor's debts in the viability plan.

Should the loans prove to be unviable after forbearance, possible substitutive and supplementary measures were envisaged. If, despite the established forbearance, the mortgage loan was still unviable,[12] the mortgagor could request a partial acquittance of the outstanding principal, which the bank could then choose to accept or not. In addition, should none of the measures envisaged prove viable, mortgagors were entitled to request dation in payment of the principal residence. The bank was required to accept it, and this would discharge the mortgage debt. Furthermore, the mortgagor could remain in the dwelling as a lessee for two years, paying an annual rent equal to 3% of the outstanding mortgage debt on the date of the dation in payment. Rental was also possible in the case of stayed foreclosure.

SF.1.2 Changes introduced in Royal Decree-Law 19/2022

The reform of the Royal Decree-Law 6/2012 Code of Good Practice

RDL 19/2022 envisages the reform of the CGP initially established under RDL 6/2012 and other additional measures with a view to preventing the socioeconomic costs stemming from the inflationary episode and the sharp rise in interest rates in 2022. Despite the reduction in household debt between the global financial crisis and 2022,[13] robust employment data and the measures deployed to mitigate the effects of rising energy prices, inflationary pressures and the surge in the EURIBOR (e.g. more than 350 basis points (bp) in the 12-month EURIBOR since January 2022) have made defaults and mortgage foreclosures more likely. Ahead of further potential increases in borrowing costs, the reform of the CGP seeks to bolster the financial viability of vulnerable households, make it less likely that average-income households become vulnerable and make it easier for all households with variable-rate mortgages to adapt to the new interest rate environment. See Figure SF.1 for a summary of all the measures described below.

After the reform under RDL 19/2022, the CGP under RDL 6/2012 continues to target vulnerable households, although the exclusion threshold has been

11 Loan payment holidays mean those periods where the borrower is not required to repay either the principal or interest, or both. In the case of the CGP under RDL 6/2012, the payment holiday referred solely to the principal. The amount unpaid during the interest-only period was to be paid after the payment holiday, either upon maturity in a final instalment or prorated in the remaining repayment instalments, or via a combination of the two.

12 For these purposes, an unviable plan means one in which the mortgage servicing ratio exceeds 50% of income.

13 The consolidated debt of households and non-profit institutions serving households amounted to 54.4% of GDP in 2022 Q3, compared with the peak of 85.6% during the global financial crisis.

Figure SF.1

CODES OF GOOD PRACTICE IN FORCE AFTER THE REFORM UNDER RDL 19/2022 (a)

Structural arrangements. CGP, RDL 6/2012	Temporary arrangements. NCGP, RDL 19/2022
Eligibility criteria	**Eligibility criteria**
Socioeconomically vulnerable households: — **Income** not exceeding between three and five times the IPREM, based on the degree of disability in the household — **Increase,** in the four years prior to the application, in the mortgage servicing ratio or circumstances rendering the household especially vulnerable — **Mortgage servicing ratio** exceeding 40%-50% — **Selling price** of the mortgaged residence lower than €300,000	Potentially socioeconomically vulnerable households: — **Income** not exceeding between three and a half and five and a half times the IPREM, based on the degree of disability in the household — **Increase,** in the four years prior to the application, of 1.2x in the mortgage servicing ratio or circumstances rendering the household especially vulnerable — **Mortgage servicing ratio** exceeding 30% — **Selling price** of the mortgaged residence lower than €300,000 — **Loans arranged** before 31 December 2022 and term of two years
Forbearance measures	**Contractual amendments**
If the mortgage servicing ratio increases by less than 1.5x and there are no circumstances rendering the household especially vulnerable: — **Interest-only period** of up to two years — **Extension of the term** by up to seven years (maximum term of 40 years) — **Interest rate** limited during the payment holiday, resulting in a 0.5 pp reduction in the loan's NPV (b) If the mortgage servicing ratio increases by more than 1.5x or there are circumstances rendering the household especially vulnerable: — **Interest-only period** of up to five years — **Extension of the term** (maximum term of 40 years) — **Interest rate** limited to EURIBOR - 0.1 pp during the payment holiday	Geared towards stabilising mortgage instalments at their June 2022 level: — **Extension of the term** by up to seven years (maximum term of 40 years) — Option for an **interest-only period** of up to one year alongside the **extended loan term** — **Interest rate** limited during the payment holiday, resulting in a 0.5 pp reduction in the loan's NPV (b) — Possibility of converting the variable interest rate on the mortgage loan to a fixed rate
Substitutive/supplementary measures	**Substitutive/supplementary measures**
If the forbearance plan is unviable (c): — Possibility of a **partial acquittance** of the outstanding debt, subject to the bank's approval If the partial acquittance does not suffice to ensure the loan's viability: — Right to apply for **dation in payment** during a period of up to two years — In the event of dation in payment, the mortgagor may remain in the residence as a **lessee** for two years, paying an annual rent equal to 3% of the mortgage debt — The possibility of mortgagors **leasing** the property whose **mortgage foreclosure** is stayed is maintained	N/A

SOURCE: Banco de España.

a RDL 19/2022 reforms the criteria and conditions in the Code of Good Practice (CGP) established by RDL 6/2012, establishes a New Code of Good Practice (NCGP) and introduces further measures.
b NPV = net present value.
c For these purposes, an unviable plan means one where the mortgage servicing ratio exceeds 50%.

lowered. The requirements for income level – which should generally be below three times the IPREM (up to five times where a household member has a disability) – and the mortgage servicing ratio – which should exceed levels of between 40% and 50% – are unchanged. However, the criterion for judging whether there has been a deterioration in the household's purchasing power in the four years prior to submitting the application has been lowered. It now suffices for the mortgage servicing ratio to have increased by any amount, even if by not as much as 1.5x. Such an increase is, however, used as a benchmark to calibrate the characteristics of the forbearance plans under this CGP. The reform under RDL 19/2022 simplifies the limits on the prices of eligible mortgaged residences, which may not exceed €300,000 under any circumstance.

RDL 19/2022 lowers the interest rate applicable during payment holidays under forbearance plans subject to the CGP under RDL 6/2012 for the most vulnerable households, while other conditions remain unchanged. Where the increase in the mortgage servicing ratio in the four years prior to submitting the application exceeds 1.5x or where households are particularly vulnerable (e.g. large households), the interest rate applicable during the payment holiday is the relevant EURIBOR - 0.1 pp in variable-rate mortgage loans, thus lowering the rate by 0.35 pp compared with the conditions previously in force in the RDL 6/2012 CGP.[14]

For these cases, the interest-only period of up to five years and the extension of the term to a maximum of 40 years from loan origination are maintained.

The reform of the RDL 6/2012 CGP also introduces possible forbearance measures for households that, while vulnerable, have seen their purchasing power deteriorate less. However, these measure are more limited. It also introduces the possibility of a second forbearance plan for all households. If the household's mortgage servicing ratio in the four years before submitting the application has increased by less than 1.5x and there are no circumstances rendering it especially vulnerable, the interest-only period will be restricted to two years and the term may only be extended by seven (again, without exceeding 40 years from loan origination). In this case, the interest rate applicable during the interest-only period will be that which reduces the net present value of the loan by 0.5 pp. Both in these cases and for the most vulnerable households, under certain circumstances mortgagors may request, at the end of the interest-only period, a second forbearance plan with a five-year interest-only period.

The conditions for some of the substitutive forbearance measures in the RDL 6/2012 CGP are now more in the borrower's favour following the RDL 19/2022 reform, while the conditions for partial acquittance are unchanged. The time

14 RDL 19/2022 also stipulates that in fixed-rate mortgage loans, the fixed rate shall be applied at its present value throughout the payment holiday.

frame for applying for the dation in payment of the residence if the forbearance plan proves to be unviable is extended by a year to two years. The possibility of the mortgagor requesting to lease the dwelling for a period of two years when applying for dation in payment is maintained. In addition, the period in which the mortgagor can apply to lease the property whose mortgage foreclosure has been stayed has been extended from six to 12 months. By contrast, the conditions for the partial acquittance of the principal as a supplementary measure to the forbearance plan are not substantially different under RDL 19/2022.

Creation of a new Code of Good Practice under RDL 19/2022

The new Code of Good Practice (NCGP) established under RDL 19/2022 is aimed at households that are not vulnerable but are at risk of becoming vulnerable. Thus, the income and financial burden thresholds are less stringent than according to the CGP under RDL 6/2012. The NCGP will apply to loans or credits taken out up to 31 December 2022 that are secured by a mortgage on the principal residence of the borrower or guarantor and whose acquisition price does not exceed €300,000. Certain additional requirements must be met to qualify as potentially vulnerable. The limits to household income for mortgage borrowers availing themselves of the NCGP are, in this case, 3.5, 4.5 and 5.5 times the IPREM, based on the level of disability or incapacitation of household members. The mortgage servicing ratio must also have increased at least 1.2 times during the four years preceding the request and the mortgage instalment must be at least 30% higher than the net income of the household members' joint net income.[15] Households that meet the requirements to opt for the CGP under RDL 6/2012 will also generally be able to alternatively avail themselves of the NCGP under RDL 19/2022.

As debtors within the scope of the NCGP have greater economic capacity, the measures to alleviate their mortgage burden are restricted to different loan novation options.[16] First, the extension of the loan's term by up to seven years is considered, without the new total term exceeding 40 years from the date it was granted. A twelve-month total or partial capital repayment holiday in addition to the term extension is also considered, with the aim of setting the mortgage instalment at its June 2022 amount or at the first instalment amount.[17] The unamortised principal amounts will accrue interest at a rate reducing the loan's net present value by 0.5%.

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15 The NCGP applicable to households at risk of vulnerability is detailed in the Resolution of 23 November 2022 of the State Secretariat for Economic Affairs and Support to Enterprise, whereby the Resolution of the Council of Ministers of 22 November 2022 is published.

16 The novation of a loan generally refers to any change in its terms subsequent to signing, while forbearance under the CGP of RDL 6/2012, amended by RDL 19/2022, refers more specifically to changes in conditions which seek to prevent difficulties in complying with the loan obligations.

17 The instalment would be set at the amount of the first instalment in the case of loans arranged after June 2022. This is something that may occur, since the NCGP under RDL 19/2022 addresses mortgage loans arranged up to December 2022. In any event, if the total capital payment holiday were unable to reduce the instalment amount to the target value, the effects of the change in conditions will be limited to this total capital payment holiday.

In any event, the extension may not lower the mortgage instalment level below the level at June 2022 or at the first reference date. The lender may offer the mortgagor the possibility of converting the variable-rate loan to fixed rate, at whichever level is freely determined, through a clear, transparent and comparable offer.

The voluntary nature of the CGP under RDL 6/2012 is maintained in this NCGP. However, the latter is conjunctural and temporary (in force for 24 months), as it was driven by the specific economic situation following the start of the war in Ukraine in 2022. Credit institutions and other professional mortgage lenders may voluntarily adhere to the NCGP, but once adopted they will be bound by it, in this case during this specific 24-month period. As noted earlier, the inflation and interest rate increases observed in 2022 pose specific risks to middle-income households of becoming vulnerable. According to the RDL, this increase in the probability of households having financial problems is not structural. It therefore limits how long this new measure to help households adapt to the new circumstances will be effective.

Measures additional to the Codes of Good Practice under RDL 19/2022

RDL 19/2022 also includes measures to limit fees linked to early repayment or to the conversion of the type of interest rate on mortgage loan contracts. When a variable interest rate is converted to a fixed one under the framework of a revision to mortgage loan conditions,[18] the early repayment fee will be limited to 0.05% of the capital repaid early. From entry into force of RDL 19/2022 to end-2023, in certain circumstances no fees shall accrue for total or partial early repayment of variable rate mortgages,[19] or for converting the variable rate to a fixed one (see Figure SF.2).

Lastly, RDL 19/2022 establishes measures to facilitate the subrogation of creditors and to promote financial education. The definition of real estate lenders which can be subrogated as creditors is broadened,[20] information is required about the subrogation expenses in the binding offer made to the borrower and the requirements for the original creditor to oppose the subrogation are tightened. These measures seek to promote greater competition and transparency in this field in order to improve debtors' possibilities of modifying their loan terms and conditions. As regards financial education, the Banco de España should publish a guide for mortgagors with payment difficulties including the CGP measures discussed earlier.

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18 In particular, RDL 19/2022 addresses novation of the interest rate applicable and a third party's subrogation to the creditor's rights. If there is no early repayment of the principal, then no fee may be charged in this connection.

19 Specifically, for early repayments or redemptions under the factual situations provided for in Sections 5 and 6 of Article 23 of Law 5/2019 of 15 March 2019 regulating real estate credit agreements.

20 Subrogation means that a new creditor substitutes the original creditor in the loan contract.

Figure SF.2
ADDITIONAL MEASURES ENVISAGED IN RDL 19/2022 (a)

Mortgage Loan Fees	Financial Education	Subrogation
Indefinite measures envisaged: — Maximum limit of 0.05% on the early repayment fee when a variable rate is converted to a fixed rate in certain loans Temporary measures envisaged, from the entry into force of RDL 19/2022 in November 2022 to end-2023: — Suspension of the acrrual of fees for early repayment of variable rate mortgage loans under certain circumstances envisaged in Law 5/2019 — Suspension of the accrual of all kinds of fees for the conversion of mortgage loans from variable rate to fixed rate	The Banco de España will publish on the Internet material to facilitate the dissemination and understanding of the measures included in the Codes of Good Practice: — Guide of tools for mortgagors with payment difficulties, including information on the RDL 6/2012 CGP and the RDL 19/2022 NCGP — Simulators of eligibility criteria and of the impact of the measures	Measures aimed at promoting competition and transparency in the subrogation of creditors: — Amendment of the definition of creditors which can be subrogated, which will refer to real estate lenders — Binding offers of subrogation are to include a summary of associated expenses — Introduction of more restrictive conditions for the original creditor to oppose the subrogation

SOURCE: Banco de España.

a RDL 19/2022 amends the criteria and conditions of the Code of Good Practice (CGP) provided for by RDL 6/2012, establishes a New Code of Good Practice (NCGP) and introduces additional measures.

It will also publish simulators of eligibility criteria and of the impact of applying the CGP or the NCGP.

SF.2 Analysis of the use of Codes of Good Practice

The economic results of the Codes of Good Practice depend on credit suppliers' and households' decisions on the use of the framework. The CGPs do not prescribe specific actions for these agents, but rather set a range of possibilities which can be applied in different ways. Depending on the macro-financial environment and the characteristics of pre-existing loans, lenders and households may choose the optimal option. To better understand the economic impact of these decisions, this section analyses the historical experience in the use of the CGP under RDL 6/2012 and presents a range for the households potentially covered by the new framework following the reform of RDL 19/2022.

SF.2.1 How application of the CGP under RDL 6/2012 evolved

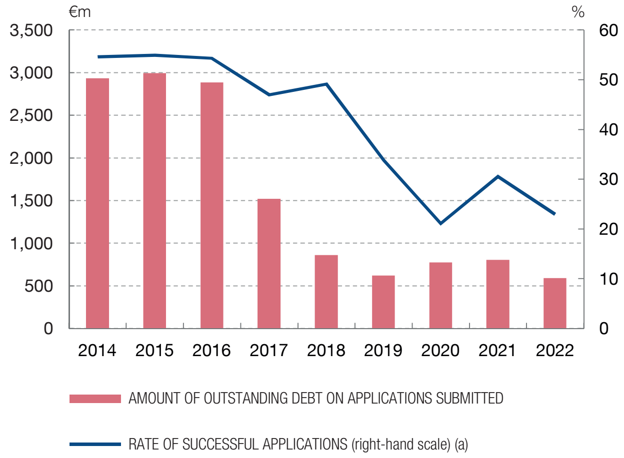
The largest volume of loans under the original RDL 6/2012 CGP was concentrated in the years closest to the end of the global financial crisis. Thus, in the period 2014-2016 the annual average volume of loans for which application of

Chart SF.1

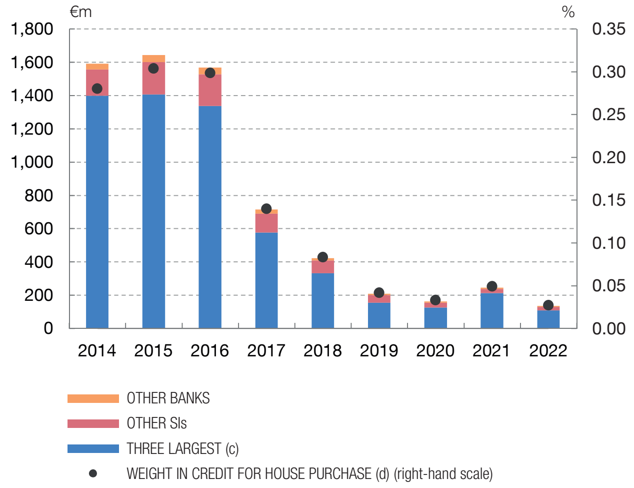
USE OF THE CGP UNDER RDL 6/2012 IS CONCENTRATED IN THE YEARS CLOSEST TO THE END OF THE GLOBAL FINANCIAL CRISIS AND IN THE LARGEST BANKS, WITH LITTLE WEIGHT IN THE TOTAL NUMBER OF MORTGAGES

The period 2014-2016 saw an annual average volume of around €3 billion of outstanding debt associated with applications for the use of the RDL 6/2012 CGP and a rate of successful application of nearly 50%; both figures are much higher than the average in subsequent years. Measures implemented under the CGP are concentrated in the largest banks, in line with their bigger mortgage portfolios overall. The percentage of CGP measures implemented in any given year does not exceed 0.3% of total mortgage credit in Spain.

1 APPLICATIONS AND RATE OF SUCCESSFUL APPLICATIONS



2 AMOUNT OF OUTSTANDING DEBT ASSOCIATED WITH MEASURES IMPLEMENTED, BY BANK, AND WEIGHT IN CREDIT FOR HOUSE PURCHASE (b)



SOURCE: Banco de España.

a Ratio of outstanding debt associated with measures implemented to applications submitted in the period. Some measures may have been applied for one year and implemented the next. In any event, the rate of successful applications relative to the cumulative volume of applications submitted since 2014 shows a declining pattern.
b The amount of outstanding debt accumulated during the year is shown.
c These banks have the largest volume of debt outstanding on loans during the period 2016-2022, considering the composition of the financial groups existing at December 2022.
d The weight is calculated by adding the amount pending payment on loan transactions conducted in the year as a whole and dividing that amount by the outstanding blance of credit to households for house purchase at the end of each year.

this CGP was requested was around €3 billion,[21] corresponding to an annual average number of requests of close to 25,000 (0.5% of the total number of households with mortgages at the start of the global financial crisis). A declining trend is observed from 2017, to €600 million in 2019, with under 6,000 requests that year (approximately 0.1% of the total number of households with mortgages at the start of the health crisis). The rise associated with the onset of the COVID-19 pandemic, with the average volume of loans amounting to €800 million for the 2020-2021 requests, is very moderate and temporary (see Chart SF.1.1).

21 Under RDL 6/2012, institutions adhering to the Code are required to report monthly to the Banco de España information on the application of the CGP, including the number of applications and measures implemented (and outstanding debt on associated loans) and distinguishing by type of measure (forbearance, dation in payment, etc.). The analysis of this sub-section is underpinned by the information included in these reports from 2014, following completion of the amendment of 15 May 2013. Measures implemented under the CGP in 2014-2022 represent approximately 90% of the total carried out over the period 2012-2022.

The rate of successful applications follows a declining path in line with that of the volume of loans. The proportion (in terms of volume of debt outstanding on associated loans) of successful applications (those resulting in viable forbearance, debt reduction or dation in payment) has also declined, from 54.7% in 2014 to 23.5% in 2022, in line with the rate of successful applications. Once again, the onset of the COVID-19 pandemic marked a temporary and moderate interruption of the declining trend (see Chart SF.1.1).

The patterns observed in the volume of loans and the rate of successful applications are consistent with the greater conjunctural importance of the RDL 6/2012 CGP in response to severe crisis episodes, but also with a structural function that has a narrower scope. The greater volume of applications in the years around the global financial crisis is consistent with a greater number of households with mortgage debts and in a vulnerable situation as a result of this crisis. A priori, determining the relationship between the rate of successful applications and the economy's cyclical position is more complex,[22] but, in any event, the available data show that the number of applications has performed cyclically. This type of mechanism would thus have a stabilising role against severe crises. Use of the CGP decreases notably during recovery years, but does not disappear, and can be identified as structural support for households affected by idiosyncratic shocks. The weak rise in the use of the CGP during the health crisis appears to be attributable to the strength of other measures adopted to ensure households' ability to pay, such as specific moratorium schemes associated with COVID-19, short-time work schemes (ERTE by their Spanish abbreviation) and tax moratoria.

Measures under the RDL 6/2012 CGP have been highly concentrated in certain larger banks and only represent a very small percentage of total mortgage credit in the Spanish banking sector. The three most active banks in the application of the CGP,[23] which are subject to banking supervision by the European Central Bank (ECB), account for 84.5% of the debt amount[24] associated with the CGP measures implemented (considering total measures from January 2014 to December 2022). Other significant institutions (supervised by the ECB) represent 12.8% of this amount and other institutions 2.7% (see Chart SF.1.2). Significant institutions' greater CGP activity is logically related to their bigger mortgage credit portfolios. This concentration has declined slightly over the years. In any event, CGP measures implemented as a percentage of the total balance of credit to households for house purchase is very limited, ranging for any given year between 0.3% in 2014-2016 and a mere 0.03% in

22 During a weak phase in the economic cycle, households may effectively decide to apply for CGP measures, despite the future costs they will have to bear in the form of less access to credit or more indebtedness, and although banks' scope for decision-making is limited by the CGP, they would also have greater incentives for using these options to avoid defaults that are more likely to arise than in a better part of the cycle.

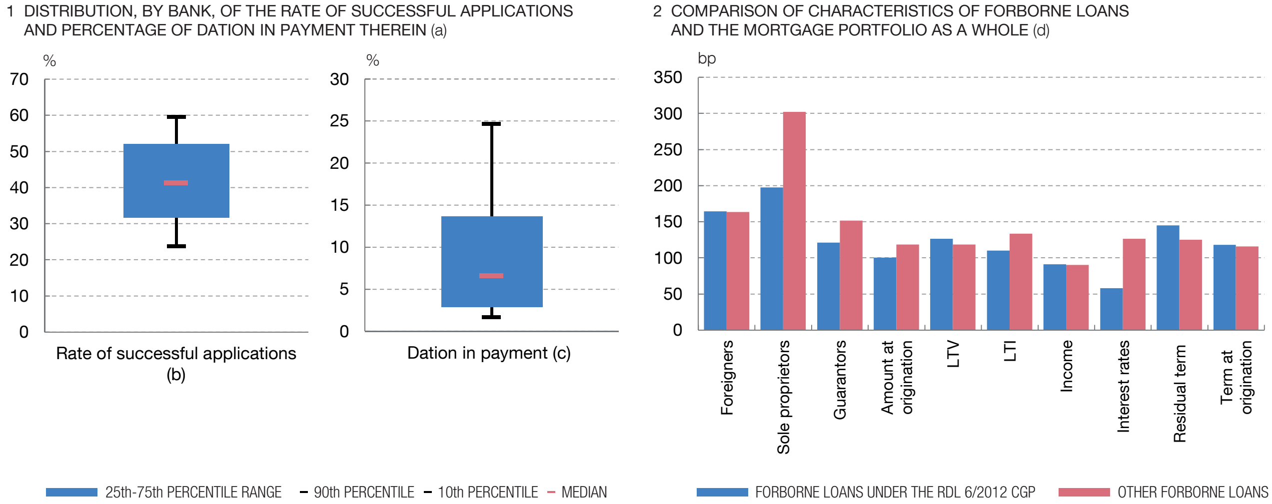
23 For mergers and acquisitions, the banking group structure at end-2022 is applied to the 2014-2022 period as a whole.

24 The debt is measured as the amount outstanding when the measure under the RDL 6/2012 CGP is implemented.

Chart SF.2

THE PRACTICAL IMPLEMENTATION OF THE RDL 6/2012 CGP HAS BEEN HETEROGENOUS AMONG BANKS. IT IS ALSO NOTEWORTHY THAT, IN THE MOST RECENT PERIOD, LOANS FORBORNE UNDER THE RDL 6/2012 CGP DO NOT HAVE RISKIER PRE-EXISTING CHARACTERISTICS THAN OTHER FORBORNE MORTGAGE LOANS

Between 2014 and 2022 the rate of successful applications and the proportion of measures implemented involving dation in payment has changed substantially in the cross-section of banks, which seems to reflect differences between them in terms of the pre-existing vulnerable mortgagors' portfolios. No evidence has been observed, for the most recent period, that the pre-existing characteristics of forborne loans under the RDL 6/2012 CGP are riskier than others. In fact, their LTI ratios at origination are lower than and close to those of loans that have not been forborne.



SOURCE: Banco de España.

a The distribution between the 10th and 90th percentiles in the cross-section of banks during the period 2014-2022 is shown for each variable. Only banks whose market share in the amount of outstanding debt on the loans for which forbearance has been requested is higher than 0.1%, in cumulative terms since January 2014, are shown.

b The rate of successful applications is defined as the ratio of outstanding debt associated with forbearance measures implemented to that relating to forbearance measures applied for. The period 2014-2022 as a whole is considered.

c The proportion of dation in payment is defined as the ratio of outstanding debt associated with forbearance implemented with dation in payment to that relating to all loans for which forbearance has been implemented. The period 2014-2022 as a whole is considered.

d The ratio of the value of each characteristic in forborne loans (under the CGP of RDL 6/2012 and other forborne loans) to its reference value in the portfolio of loans that have not been forborne is shown. The reference values for the portfolio of loans that have not been forborne (=100) are as follows: foreigners: 11%; sole proprietors: 15%; guarantors: 25% of loans; amount at origination: €179,726; term at origination: 33 years; LTV at origination: 86.4%; LTI at origination: 4.9%; income: €39.210; residual term: 25.9 years. CCR data at loan level for the period 2017-2022 are used.

2022 (see Chart SF.1.2). Overall, the total volume of measures implemented under the 2012 CGP in 2014-2022 was very low, amounting to €7 billion (more than 60,000 loans), which is equivalent to 1.4% of the mortgage debt outstanding at end-2022 (approximately 1.2% of households with mortgages at that date).

Considerable heterogeneity is observed among banks in terms of rates of successful applications and dations in payment as a percentage of total CGP measures. For 2014-2022 as a whole, the rate of successful applications (in terms of volume of outstanding debt at the time of the application) has a median value among institutions of nearly 40%, but ranges between 23% and 59% in the 10th and 90th percentiles. Although the median value among banks for dations in payment is low (around 6.5%), there is also some dispersion, reaching 25% in the 90th percentile (see Chart SF.2.1). There are multiple causes for this variation among banks, which is largely based on the characteristics of the pre-existing mortgage portfolios, thus reflecting the importance of the framework's flexibility and of not excessively restricting the possibilities therein envisaged.

SF.2.2 Recently observed characteristics in forbearance according to the Code of Good Practice under RDL 6/2012

The Banco de España's Central Credit Register (CCR) is used to analyse, for the most recent period, the characteristics of forbearance under the RDL 6/2012 CGP and of other forbearance measures. This database is used to consider the stock of mortgage loans to individuals and sole proprietors for the purchase of their principal residence, month by month, from January 2017 to December 2022.[25] Each loan is checked to ascertain whether it has been declared to be forborne under the RDL 6/2012 CGP at some point or whether it has been subject to any other forbearance process. A comparison is made of the two types of forbearance and with the set of mortgage portfolio loans that have never been forborne.

Loans forborne under RDL 6/2012 have features that are riskier ex ante than the total mortgage loan portfolio risk; however, compared with other forborne loans, their LTI ratio and amount at origination are lower. As regards the overall mortgage debt, forborne loans generally relate to lower income (proxied by average household net income according to the National Statistics Institute (INE) for the loan's postcode), greater LTV and LTI ratios at origination, a longer term (both at origination and residual at the time of forbearance), an older main debtor (considering the age of the oldest borrower on the mortgage), more borrowers and guarantors on the mortgage and a larger number of foreign mortgagors (see Chart SF.2.2). All of which suggests that forborne loans had greater ex ante risk, which has materialised over time. Also, the LTI ratio and the amount at origination are slightly higher for forborne loans outside the RDL 6/2012 CGP. This would indicate a better ex ante risk profile for those carried out under this framework, although the differences in other variables are not very pronounced.

The descriptive analysis based on the CCR would thus find no evidence, for the recent period and in a normalised cyclical situation, that forborne loans under the RDL 6/2012 CGP have a worse risk profile. It should be borne in mind that loan forbearance is a credit risk management tool which banks may use, regardless of the existence of the RDL 6/2012 CGP, to maximise the economic value of the loan without

25 The information in the CCR was expanded substantially from 2016, allowing for this type of analysis to be made. This was not possible previously, owing to the lack of granular information that would enable loans subject to transactions CGP measures to be specifically identified. See Circular 1/2017. The exercise was commenced in 2017 to avoid transition effects and to more adequately identify forbearance characteristics.

being prescribed to do so by the legislator. The fact that the loan forbearance characteristics under the RDL 6/2012 CGP are not riskier than those of other measures of this kind in the period 2017-2022 indicates that this framework would not be forcing the adoption of riskier forbearance measures than those which banks are willing to assume under their own forbearance policies. This should be interpreted with caution since, in a period of greater tension on households' ability to pay, this comparison of characteristics could change. Moreover, even when banks have their own incentives to grant forbearance or adopt other measures modifying loan terms and conditions, the CGP framework may make them more efficient, by introducing some degree of standardisation, and may influence how the benefits of forbearance are shared by lenders and debtors.

SF.2.3 Eligible households and participation in transactions subject to CGPs following RDL 19/2022

The broadening of the mortgagor eligibility criteria under RDL 19/2022 has significantly increased the proportion of mortgagor households entitled to benefit from the CGPs. Were the mortgage reference rate to rise by 400 bp (similar to that observed since the start of 2022), some 549,000 households would be eligible to benefit from the temporary NCGP introduced by RDL 19/2022 (see Chart SF.3).[26] This is around 404,000 households more than would have been eligible under the original version of the CGP introduced by RDL 6/2012. The outstanding principal of the households entitled to benefit from the RDL 19/2022 NCGP would be around €46.9 billion, around €37.7 billion more than under the original conditions of the previous CGP. Further, nearly 218,000 households could benefit from the more structural mechanism of the RDL 6/2012 CGP in its version amended by RDL 19/2022 (see Chart SF.3),[27] 73,000 more than would have been eligible under the previous version of the code. The principal outstanding of these households would amount to some €17.9 billion, around €4.8 billion more than under the original version of the RDL 6/2012 CGP.

The process of household deleveraging following the global financial crisis limits to some extent the absolute volume of debt affected by the CGPs. By 2022, the total volume of lending to households for house purchase had declined by 23.7% from its peak in 2010. The reduction in the systemic weight of the real estate sector over the last decade and more prudent mortgage lending standards have gone some way to limiting the aggregate impact of the mortgagor support programmes.

Further, not all households eligible under the CGP are likely to apply for the measures, and nor will all applicants ultimately benefit from them. Expectations for the number of households that might benefit from the CGPs following the RDL

26 These estimates are based on data from the 2020 Spanish Survey of Household Finances.

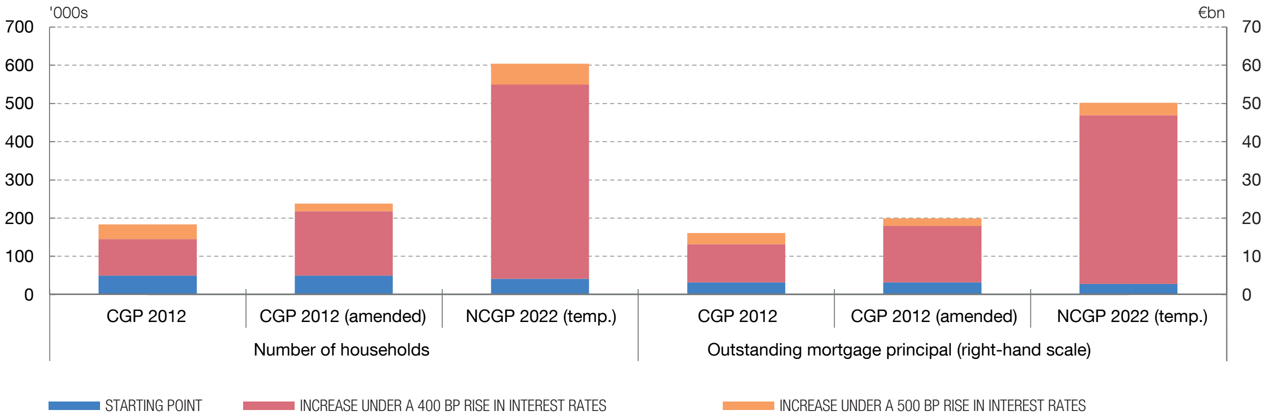
27 Eligible households under the RDL 6/2012 CGP as amended in 2022 will, generally speaking, also be eligible under the NCGP of RDL 19/2022, having the option to choose between one or the other. Accordingly, the number of eligible households under these two mechanisms should not be added together, nor their outstanding principal.

Chart SF.3

RDL 19/2022 SIGNIFICANTLY INCREASES THE PROPORTION OF THE POPULATION ELIGIBLE TO BENEFIT FROM CODES OF GOOD CONDUCT RELATIVE TO THE MEASURES ENVISAGED UNDER RDL 6/2012

Were the mortgage reference rate to rise by 400 bp, some 549,000 households would be eligible to benefit from the temporary Code of Good Practice approved in late 2022 (NCGP 2022). This figure is around 404,000 households more than would have been eligible under the 2012 Code of Good Practice (CGP 2012). The outstanding principal of households eligible under NCGP 2012 would be around €46.9 billion, some €37.7 billion more than under the CGP 2012.

1 HOUSEHOLDS WITH PRINCIPAL RESIDENCE MORTGAGE ELIGIBLE FOR THE CODES OF GOOD PRACTICE (a) (b) (c)



SOURCES: Banco de España and Spanish Survey of Household Finances (2020).

a This chart estimates the eligible population and the associated mortgage debt for three codes of good practice: that established under RDL 6/2012 of 9 March 2012 (CGP 2012, designed to be structural); its version amended by RDL 19/2022 of 22 November 2022 (amended CGP 2012) and the temporary Code of Good Practice (NCGP 2022, temporary) introduced by the last RDL and implemented in the Resolution of the Council of Ministers of 22 November 2022.

b Eligible households under the amended CGP 2012 will, generally speaking, also be eligible under the temporary NCGP 2022, having the option to choose between one or the other. Accordingly, the number of eligible households under these two mechanisms should not be added together, nor their outstanding principal.

c It is assumed that interest rate increases are fully passed through to the cost of variable rate debt.

19/2022 reform will need to be revised, based on the information available on applications that ultimately led to measures being applied under the previous CGP of RDL 6/2012. Given that neither the possible beneficiaries nor the current context are directly comparable with those observed in previous years, two scenarios are considered to approximate the percentage of valid applications.

The first scenario – more representative of the consequences of a profound crisis – is based on the two consecutive years with the highest number of beneficiaries under the previous CGP (2015 and 2016). In that period, 64% of eligible households applied for the measures under the CGP of RDL 6/2012, although just 35% ultimately benefited from them.[28] As Chart SF.4 illustrates, based on this beneficiary rate and a 400 bp increase in the reference interest rate, some 193,000 households would benefit from the NCGP under RDL 19/2022, with outstanding principal of €16.4 billion. The CGP of RDL 6/2012, in its version amended in 2022, would benefit some 76,000 households with outstanding principal of €6.3 billion.

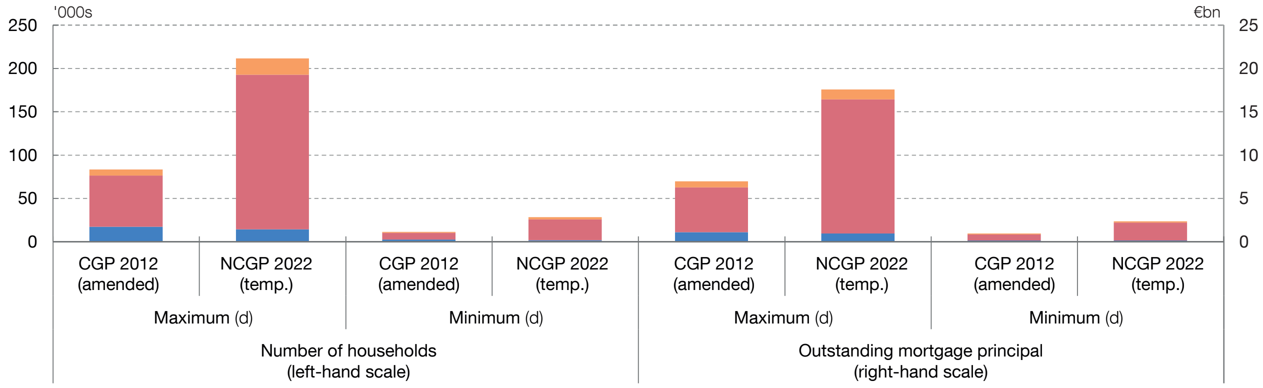
28 The same percentages are applied to obtain the outstanding principal of the households that ultimately benefit from the CGP.

Chart SF.4

THE ELIGIBLE POPULATION THAT ULTIMATELY BENEFITS FROM THE CGPs MAY VARY SUBSTANTIALLY BASED ON THE NUMBER OF APPLICATIONS AND TRANSACTIONS

For a 400 bp increase in the reference interest rate and a percentage of successful applications similar to the two consecutive years with the highest number of beneficiaries under the CGP 2012 (2015-2016: 35% of eligible households), some 193,000 households would benefit from the RDL 19/2022 NCGP, with outstanding principal of €16.4 billion. Around 76,000 households would benefit from the more structural mechanism provided by the amended version of the CGP 2012, with outstanding principal of €6.3 billion. Were the number of successful applications to match that of the two-year period with the lowest number of beneficiaries (2019-2020: 4.7% of eligible households), the number of beneficiary households and their outstanding capital would be far lower.

1 RANGE OF HOUSEHOLDS WITH PRINCIPAL RESIDENCE MORTGAGE THAT COULD ULTIMATELY BENEFIT FROM THE NEW CODES OF GOOD PRACTICE (a) (b) (c)



SOURCES: Banco de España and Spanish Survey of Household Finances (2020).

a This chart estimates the eligible population and the associated mortgage debt for three codes of good practice: that established under RDL 6/2012 of 9 March 2012 (CGP 2012, designed to be structural); its version amended by RDL 19/2022 of 22 November 2022 (amended CGP 2012) and the temporary Code of Good Practice (NCGP 2022, temporary) introduced by the last RDL and implemented in the Resolution of the Council of Ministers of 22 November 2022.

b Eligible households under the amended CGP 2012 will, generally speaking, also be eligible under the temporary NCGP 2022, having the option to choose between one or the other. Accordingly, the number of eligible households under these two mechanisms should not be added together, nor their outstanding principal.

c It is assumed that interest rate increases are fully passed through to the cost of variable rate debt.

d Approximation of the number of households applying to benefit from the CPGs that are ultimately approved, based on the maximum and minimum number of successful applicants under the 2012 CPGs (out of total eligible households) in two consecutive years in the period 2012-2020.

The second scenario – more representative of a financial situation of no significant strain on households' ability to pay – considers the two consecutive years with the lowest number of beneficiaries under the previous RDL 6/2012 CGP (2019 and 2020). In this reference period, just 4.7% of eligible households benefited from the code. Under these assumptions, the RDL 19/2022 NCGP would benefit some 26,000 households, with outstanding principal of €2.2 billion. The CGP under RDL 6/2012 would affect around 10,000 households with outstanding capital of close to €0.8 billion (see Chart SF.4).

SF.3 Macroeconomic and financial impact of the CGPs

SF.3.1 The potential impact of RDL 19/2022 on consumption and activity

The direct relief of financial pressure on vulnerable mortgagors provided by the CGPs would, in the near term, entail a very moderate stimulus to the level of

household consumption and real GDP. The vulnerable households eligible for the measures under the RDL 6/2012 CGP and those under the RDL 19/2022 NCGP stand at the lower end of the income distribution (less so in the case of the NCGP) and have a high marginal propensity to consume (MPC). Accordingly, much of the reduction in mortgage instalments – resulting from the forbearance or novation measures – is likely to translate into higher levels of consumption in the near term. For example, under the assumption of relatively high beneficiary rates, and based on the experience of the RDL 6/2012 CGP, in 2023 the measures would increase the level of consumption by approximately 0.1 pp and the level of real GDP by approximately 0.03 pp (see Chart SF.5).[29] The programmes would elicit a relatively short-lived response from these variables, partly due to the eligible households' high MPC, which would see the savings in terms of mortgage payments used fairly immediately to uphold consumption.

Extended payment holidays and other measures, such as dation in payment or reduced fees, could introduce more prolonged stimuli for consumption and activity. Extending payment holidays beyond 2023 would, at least for some households, entail additional positive shocks in terms of the funds available for consumption, foreseeably providing a further boost to such spending. Likewise, the additional measures introduced by RDL 19/2022 (e.g. the suspension of certain bank fees) and the substitutive and supplementary measures introduced in the CGP of RDL 6/2012 are also conducive to easing the financial pressure on households and boosting their spending power in the short term, and in some cases would also reduce their level of indebtedness, thus playing something of a stabilising role in the economic cycle. In any event, the scale of these additional effects would be moderate.

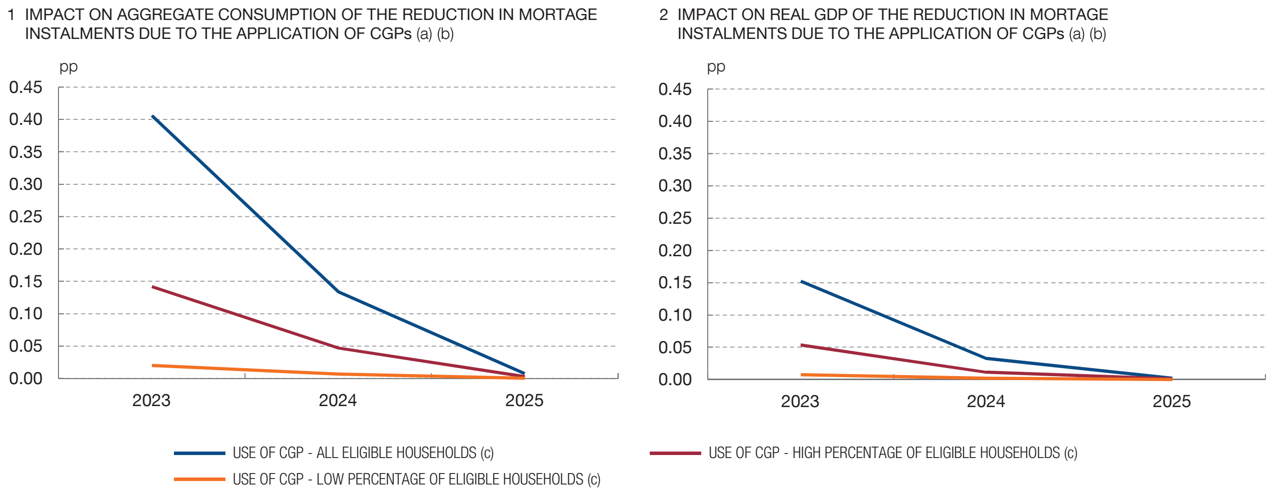
The aggregate effect of the measures is likely to be limited by the relative size of the eligible population and the slim prospect of the entire eligible population benefiting from them. As described in more detail in previous subsections, the eligible population for these measures is restricted to mortgagor households which are vulnerable or potentially vulnerable, which make up a relatively small share of the overall household sector. This is a desirable feature of the programme, thus limiting potential distortions to the mortgage lending market and preventing changes in contractual conditions that entail a transfer of income from lenders to non-vulnerable borrowers. Further, past experience with the CGP under RDL 6/2012 indicates that just a fraction of the eligible households would actually benefit from the measures. Were the current uncertain economic environment to have a smaller-than-expected impact on households' ability to pay and if the percentage applying for the measures were relatively low, the historical data for RDL 6/2012 CGP suggest that the impact on consumption and GDP would be negligible. The effect on these macroeconomic

29 The macroeconomic benefits of such forbearance could include preventing households from defaulting on mortgage payments, which would weigh on their confidence and consumption level. In this section, only the direct effect of a lower debt burden is quantified.

Chart SF.5

RECOURSE TO THE STRUCTURAL AND TEMPORARY MEASURES UNDER THE CODES OF GOOD PRACTICE MAY PROVIDE SOME STIMULUS FOR THE LEVELS OF CONSUMPTION AND ACTIVITY IN THE SHORT TERM

Under the assumption that the current crisis prompts a high percentage of households (based on the past experience of applications and acceptance under the CGP of RDL 6/2012) to opt for the measures under the CGP and NCGP, the levels of consumption and real GDP could grow in 2023 by 0.15 pp and 0.05 pp, respectively, with the response proving relatively short lived. If the payment conditions of households remain stable despite the crisis environment and a low percentage opts for the measures, the macroeconomic impact would be negligible. The assumption that all eligible households opt for the measures represents a very high upper bound for the effect, given the past experience of limited participation in the CGP of RDL 6/2012.



SOURCE: Banco de España.

a Shown is the response of the variable of interest (level of aggregate consumption or real GDP) to a positive income shock in 2023 for households in lower-income groups and with a high marginal propensity to consume. The positive income shock is calibrated according to the expected reduction (vis-à-vis a baseline scenario of no measures) in mortgage payments due to application of the measures for vulnerable households under the RDL 6/2012 CGP and for potentially vulnerable households under the RDL 19/2022 NCGP. Likewise, this calibration considers the proportion of the total household sector accounted for by vulnerable and potentially vulnerable households, along with different assumptions regarding the application and success rates for the measures under the CGP and NCGP. The reduction in mortgage instalments in years subsequent to 2023 as a result of these measures would generate additional effects.

b Shown is the deviation (in pp) of the level of the variable in each year vis-à-vis the scenario of no measures.

c Three assumptions are considered regarding the percentage of vulnerable households that ultimately benefit from the relief measures under the CGP and the NCGP: i) all eligible households benefit from the measures; ii) a high percentage of eligible households benefit from the measures, based on high rates of application and acceptance observed in the time series for the CGP of RDL 6/2012, and iii) a low percentage of households benefit from the measures, based on low rates of application and acceptance observed in the time series for the CGP under RDL 6/2012.

aggregates if all eligible households were to benefit from the measures should be viewed as a high upper bound for the potential effects only (see Chart SF.5).

Over a longer time horizon, the impact of the various measures introduced by RDL 19/2022 on pre-existing levels of household debt would also have implications for activity. As discussed in greater detail in the next subsection, when payment holidays and extended repayment terms are applied to mortgage borrowing, mortgage debt tends to hold at higher levels for longer. This may increase the interest expenses paid over a household's lifetime, thus diverting funds away from the consumption of goods and services in subsequent periods. Were this adverse impact to occur during periods of lower vulnerability in the household's lifetime, it would still be consistent with the stabilising function of such measures. Conversely, measures such as reduced early repayment fees or the substitutive and supplementary measures envisaged in the RDL 6/2012 CGP would help to reduce the pre-existing level of household debt, limiting its negative impact on activity growth in the long term.

Recourse to the CGPs may also restrict access to new credit in the future. Making use of these measures might signal a debtor's lower creditworthiness. This would increase the anticipated cost of lending to such borrowers in terms of impairment provisions, thus diminishing the capacity of, and incentives for, banks and other credit providers to grant them new loans.[30] Such barriers to the credit market going forward would reduce these households' capacity to cushion adverse income shocks in the future or to anticipate stronger growth expectations. This limits the incentives for vulnerable households still able to service their debts to make strategic use of the CGPs. For households which, in the absence of changes to contractual conditions, would be unable to make their repayments, the signal of poor creditworthiness attached to recourse to the CGP of RDL 19/2022 would not constitute a differential cost, since the alternative (default) would likewise be a negative signal and would put even greater constraints on their future access to credit.

SF.3.2 The potential impact of RDL 19/2022 on households' indebtedness and debt burden

In the short term, the various measures under RDL 19/2022 could help to limit the growth in households with a high debt burden.[31] As discussed in the main body of this report, the share of these households (see Chart 1.9 of Chapter 1) will foreseeably increase – in the absence of measures – as a result of higher reference interest rates. By definition, these households are more likely to satisfy some of the CGPs' eligibility criteria – such as increased mortgage burden or the minimum level of this relative to their net income – and thus benefit from measures such as payment holidays, which by their very design could, in the near term, significantly reduce their borrowing costs and potentially offset the effect of the higher interest rates. The use of the supplementary and substitutive measures envisaged in the RDL 6/2012 CGP, such as debt reduction and dation in payment, would have an even greater impact in terms of reducing the debt burden. Part of the growth in households with high debt burden will foreseeably take place outside of the lower income groups (above the 40th percentile), which, generally speaking, would not be eligible for payment holidays, term extensions or other measures under the CGPs. These higher-income households could still benefit from lower fees for converting to fixed rate mortgages and reduce their interest rate risk at a lower cost.

30 Such opposing effects of the support measures for households are important in the framework of other policies. These effects can even extend to the entire eligible population and not just the portion benefiting from the measures. For instance, the introduction of certain measures intended to protect tenants may reduce the supply of rental housing. See, for example, D. López Rodríguez and M.ª de los Llanos Matea (2020) "Public intervention in the rental housing market: a review of international experience".

31 Net financial burden is considered high when it exceeds 40% of the household's income.

However, the application of payment holidays and lengthy term extensions may be conducive to a higher average level of indebtedness over a household's lifetime, debt that would be sensitive to the future level of interest rates. By definition, such measures prolong the term of mortgage debt, while further interest rate increases would cause this debt to be higher for longer. Under the most commonly used amortisation schedules (e.g. the French method), the earlier the instalment, the lower the share of principal repayment relative to interest payment. As a result, extending the term automatically means the principal is repaid more slowly. The higher the future level of interest rates, the more acute this effect becomes since interest payments would make up a larger share of the earlier instalments (see Chart SF.6.1). Conversely, the reduction in fees for early loan repayment – which may provide incentives for households to increase such early repayments – and the substitutive and supplementary measures in the RDL 6/2012 CGP would reduce household indebtedness. Further, the measures adopted to encourage borrowers to convert variable rate loans to fixed rate would, for households taking advantage of this option, eliminate sensitivity to future interest rates changes.

Likewise, a household having higher debt levels for longer could translate into higher interest expenses over the lifetime of the loan. A higher level of mortgage debt would increase the calculation base for interest payments in multiple future periods.[32] Some of the measures, such as the limit, under the RDL 6/2012 CGP, on the interest rate applicable during the payment holiday for the most vulnerable households (EURIBOR less 0.1 pp), may at least partially offset this increase in interest expenses. Over the lifetime of a variable rate loan, particularly if it has a lengthy term, future reference interest rates that deviate from initial expectations can have a material impact on cumulative interest expenses (see Chart SF.6.2). Again, households benefiting from measures that reduce their debt would experience the opposite effect.

The effects of RDL 19/2022 on households' debt levels and borrowing costs entail various costs and benefits for both households and credit providers which should be assessed as a whole. The primary objective of the forbearance and novation measures envisaged in the RDL 6/2012 CGP and the RDL19/2022 NCGP is to prevent the liquidity constraints of vulnerable or potentially vulnerable households from ultimately resulting in the loss of their home. This comes at a severe socio-economic cost, both directly for the household in question and for society as a whole, since the household members will plausibly become less productive and see their consumption plans disrupted, in addition to the loss of value of the property serving as collateral. The forbearance and novation measures

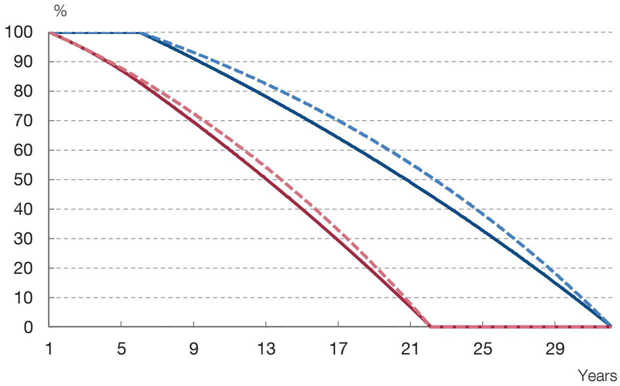
32 Even if the forbearance were to reduce the net present value of the loan for the creditor, it might entail the debtor facing higher interest payments and principal repayments on certain future dates, thus straining the household's ability to pay. For instance, concentrating all previously agreed instalments plus a small interest surcharge on the loan maturity date would reduce the net present value of the loan, but would exert severe pressure on the borrower's ability to pay on that final date.

Chart SF.6

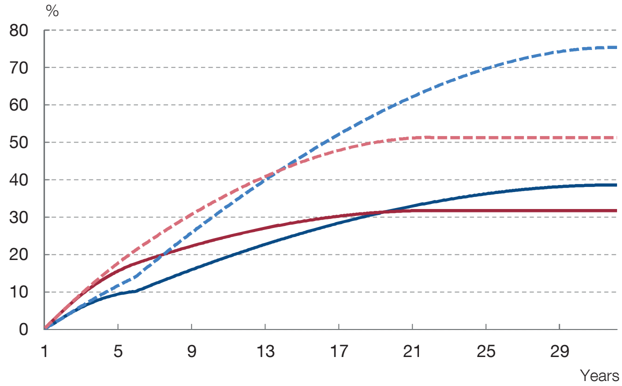
SOME CHANGES TO CONTRACTUAL CONDITIONS UNDER THE CGPs ALSO ENTAIL A COST FOR HOUSEHOLDS, IN THE FORM OF HIGHER DEBT LEVELS FOR LONGER, AND HIGHER EXPENSES

The primary objective of the measures envisaged in the RDL 6/2012 CGP and the RDL19/2022 NCGP is to prevent the liquidity constraints of vulnerable households from ultimately resulting in the loss of their home, which comes at a severe socio-economic cost. However, measures such as payment holidays or term extensions result in households facing higher debt levels for longer, and a higher level of interest expenses in the long term, in addition to greater sensitivity to any future interest rate increases.

1 FORBEARANCE UNDER RDL 6/2012 CGP: EFFECT ON PRINCIPAL (a) (b) (c)



2 FORBEARANCE UNDER RDL 6/2012 CGP: EFFECT ON CUMULATIVE INTEREST EXPENSES (a) (b) (c)



FORBEARANCE (5y PH +10y TERM) - REFERENCE SCENARIO

ORIGINAL CONDITIONS - REFERENCE SCENARIO +200 bp

ORIGINAL CONDITIONS - REFERENCE SCENARIO

FORBEARANCE (5y PH +10y TERM) - REFERENCE SCENARIO +200 bp

SOURCE: Banco de España.

a Based on a mortgage with its original conditions, a term of approximately 21 years and an interest rate of 4.8%. These assumptions are representative of the conditions of a pre-existing variable rate mortgage loan at the beginning of 2023. Forbearance assumptions are based on the forbearance measures under the RDL 6/2012 CGP for a loan with a 5-year payment holiday (at EURIBOR -0.1 pp) and a term extension to 10 years. During the payment holiday, the principal remains unchanged and repayment is resumed and completed between the end of the 5th year and the 31st year. Under the reference scenario, the EURIBOR and the average mortgage rate decrease in unison by approximately 300 bp from the end of the first remaining year of the term and until the end of the fifth year, remaining constant thereafter through to maturity of the loan. Under the alternative scenario, the EURIBOR and the mortgage rate at the end of the first five years are 200 bp higher than under the reference scenario, holding constant at this higher level thereafter.

b These simulations are presented for illustrative purposes only. In practice, among other factors, deviations from the assumptions in terms of interest rate paths, payment holiday terms and maturity applied, or the pro rata approach to outstanding principal payments during the payment holiday, may generate different paths for repayment of the principal and payment of the interest accrued. The interest rate scenarios used should not be viewed as forecasts.

c At each date, the ratio between outstanding principal and principal at the initial date of the simulation exercise is shown.

d At each date, the ratio between the interest expenses accumulated to that point and the principal at the initial date of the simulation exercise is shown.

support the extra financial effort required to address sudden liquidity needs, thus helping eligible households to avoid this dire outcome, but do not eliminate the need to incur the associated borrowing costs. The substitutive and supplementary measures under the RDL 6/2012 CGP (e.g. debt reduction and dation in payment), the suspension of fees and the support for early repayment all reduce households' financial debt, but at the cost of transferring higher financial costs to credit providers, whose solvency may be eroded to some extent. As indicated above, this might also weigh on their intermediation capacity, while households benefiting from the measures could plausibly have limited access to credit to cover their spending needs in the future.

SF.3.3 Measures in the CGPs and quality of the portfolio of bank loans secured by residential properties

In accounting regulations, forbearance is linked to mortgagors with payment difficulties. Forbearance, along with similar changes a lender can make to a loan transaction (e.g. refinancing), differs from a straightforward renewal or renegotiation of terms because the borrower may have difficulties meeting their repayment obligations if it is not granted.[33] From an accounting point of view, the financial position of a mortgagor requiring forbearance or refinancing tends to be associated with risk flags that lead to their mortgage being classified as Stage 2[34] (e.g. they have payments that are between 30 and 90 days past due) or even as non-performing.[35] In this latter case, it is important to distinguish between payment arrears (which reduce banks' cash flows and are more burdensome) and classification of a loan as non-performing for subjective reasons (when no payment is more than 90 days past due), but the characteristics of the mortgagor or the mortgage mean that such a situation is deemed very likely. However, it must be remembered that these contractual modifications are a risk management tool that can prevent or help rectify a further deterioration in credit quality. In any case, when forbearance and refinancing are applied to a non-performing or Stage 2 loan, the regulation – in line with proper risk monitoring from an accounting perspective – sets out strict requirements for its eventual reclassification as performing.[36]

When there are no repayment difficulties, an amendment to the terms would not be considered forbearance nor would it necessarily be linked to a downgrade of the credit quality for accounting purposes. For such a downgrade to occur, payment difficulties must have been demonstrated and the lender must have granted some contractual leeway to the specific borrowers involved in the lending transaction. Similarly, it is also worth noting that the cap of 0.5 pp on the discounted present value of mortgages as the result of updates to interest rates in certain periods – envisaged for novations in the NCGP under RDL 19/2022 –, along

33 Paragraphs 18 et seq. of Annex 9 of Circular 4/2017 define several situations by which a loan's terms can be modified, differentiating refinancing and forbearance from renewals or renegotiations. The main difference between these two types is that refinancing and forbearance are options granted by a bank so that the borrower can stay up to date with their payment obligations. In refinancing or renewal, a new loan is made to encourage fulfilment of the original loan, while forbearance and renegotiation make changes directly to the original loan's terms. The CGP under RDL 6/2012 and the NCGP under RDL 19/2022 only contemplate changes to contractual terms, not refinancing or renewal.

34 In line with paragraph 92 of Annex 9 of Circular 4/2017, mortgages that do not qualify for classification as non-performing or write-offs but show significant jumps in credit risk since their initial balance sheet recognition shall be classified as Stage 2. Circumstances that entail forbearance can, in many cases, also lead to the mortgage being classified as Stage 2.

35 Being classified as an NPL can be the result of objective non-payment (non-payment for more than 90 days) or subjective circumstances (e.g. a sharp fall in the turnover of a company with a mortgage). The deterioration of the solvency of the mortgage or mortgagor is deemed to be manifest and irreversible in the case of write-offs. See paragraphs 103 and 126, respectively, of Annex 9 of Circular 4/2017.

36 For example, see paragraphs 100 et seq. and paragraphs 115 et seq. of Annex 9 of Circular 4/2017. In particular, reclassifications out of Stage 2 require a probation period long enough to confirm the improvement in credit quality.

with the measures for vulnerable households with a smaller loss of purchasing power – envisaged in the CGP under RDL 6/2012 –, should directly limit the likelihood of these loans being classified as prudential default, even if the mortgage is in forbearance.[37]

The various measures in the CGPs thus have a range of probabilities associated with classification as impaired credit quality. In general, from an accounting perspective, novation or the renegotiation of contractual terms occurring in the absence of signs of a significant jump in credit default risk, when accounting for the whole life of the transaction, does not require reclassification away from performing. In this case, the measures would be essentially preventive and temporary. The amendment of contractual terms in line with the CGP under RDL 6/2012, reformed by RDL 19/2022, in particular in the case of forbearance, tends to be linked to higher levels of classification as Stage 2 – if the signs of credit quality impairment are clearer – or even as non-performing for accounting or prudential purposes[38] – if there are even more marked signs of impairment or past-due payments –, and especially if there is a material reduction in the mortgage's discounted present value. Applying measures entailing longer maturities or payment holidays may increase the likelihood of a mortgage being classified as non-performing.[39] Granting debt reductions as a supplementary measure alongside viable forbearance – as envisaged in the CGP under RDL 6/2012 – would generally be linked to classification as non-performing. Dation in payment, as envisaged in the CGP under RDL 6/2012, would lead to the handover of the home securing the mortgage, while the lender would recognise the loss corresponding to the portion of the mortgage not covered by the value of collateral.

The banking sector would bear the impact of the macro-financial downturn and of the potential reclassifications – resulting of application of measures in the CGP – from an initially favourable situation in terms the credit quality of mortgage lending to households. As a proportion of total bank mortgage exposures to households, loans subject to forbearance and refinancing have been trending down since the end of the global financial crisis. In particular, consistent with the normalisation of economic activity and the broad improvement in the quality of banks' balance sheets in the wake of that crisis, the proportion of non-performing forborne

37 The application since 1 January 2021 of EBA guidelines (EBA/GL/2016/07) relating to the new definition of default pursuant to Article 178 of (EU) Regulation No 575/2013, has given rise to some differences in the amounts classified as "NPLs for accounting purposes" (accounting definition contained in Banco de España Circular 4/2017) and "prudential default" (according to the above-mentioned EBA guidelines). One of the criteria for determining prudential default is whether the discounted present value of the loan has fallen by more than 1%.

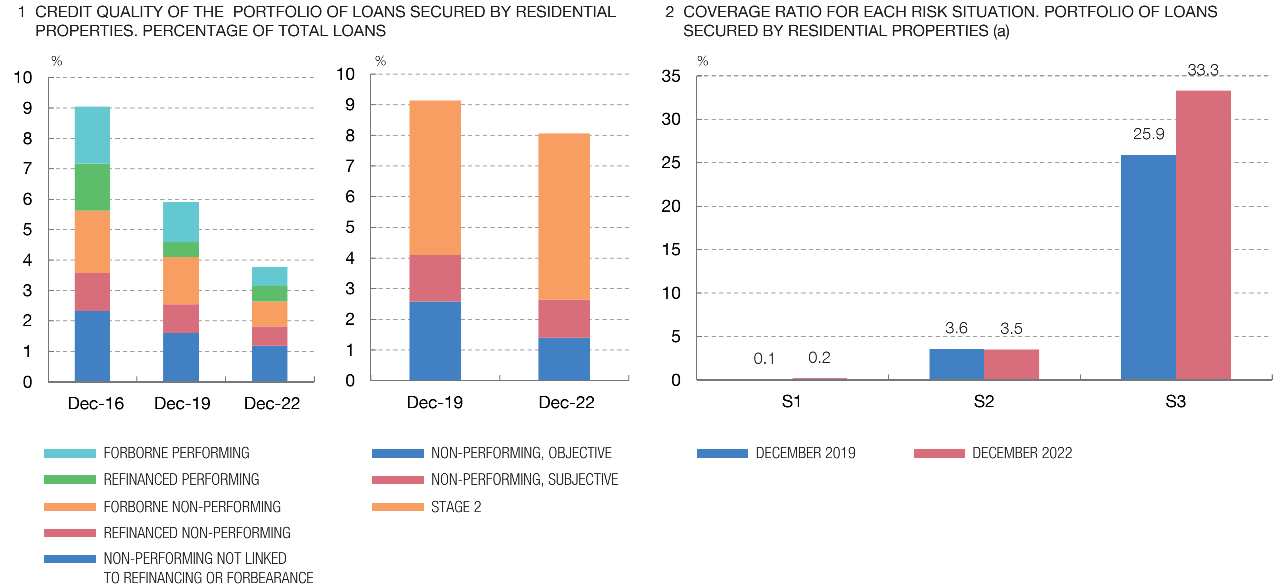
38 Article 47 bis(2) of (EU) Regulation No 575/2013 stipulates that exposures with non-payment as set out in Article 178 of this regulation ("prudential defaults") and exposures considered to be impaired under the applicable accounting framework shall be classified as "non-performing exposures" (when Circular 4/2017 applies, they shall be "NPLs for accounting purposes" as set out in its accompanying Annex 9).

39 Specifically, in accordance with paragraph 116 of Banco de España Circular 4/2017, payment holidays longer than two years would lead to a mortgage in forbearance or that has been refinanced being classified as non-performing.

Chart SF.7

FORBORNE AND REFINANCED LOANS REPRESENT A SIZEABLE FRACTION OF NON-PERFORMING MORTGAGE LOANS, BUT THESE MEASURES ALSO HELP TO PREVENT OR REMEDY NON-PERFORMING STATUS AND LIMIT THE ASSOCIATED COSTS

As a proportion of total mortgage lending to households, forborne and refinanced loans declined in the period 2016-2019, which is consistent with the normalisation of economic activity and the improved average quality of balance sheets. The portion of such loans classified as non-performing is larger than that classified as performing, indicating that in the past these have been used more as corrective rather than preventive measures. There is a large difference between non-performing loans and others in terms of provisions coverage, indicating the potential benefit of properly applying the measures to amend contractual terms under the CGP.



SOURCE: Banco de España.

a The stages of impairment S1, S2 and S3 shown in the chart relate very closely to the "performing", "Stage 2" and "non-performing" stages in Circular 4/2017.

mortgages has fallen by 1.2 pp since 2016, standing at approximately 0.8% in 2022. The share of non-performing refinanced mortgages has fallen by 0.6 pp to 0.6% (see Chart SF.7.1). The easing in pressure on households' ability to pay has led to reduced reliance on these financial tools to manage mortgage borrowers' liquidity and solvency difficulties. The weight of NPLs not subject to forbearance or refinancing measures also fell between 2016 and 2019. However, in the most recent period there was a 0.4 pp uptick in the weight of Stage 2 loans in the total portfolio, reaching 5.5% in 2022 (see Chart SF.7.1).

Forborne and refinanced mortgages account for a higher volume of impaired credit. Specifically, in 2022 non-performing forborne (refinanced) loans accounted for 26% (30%) more of the total portfolio than performing forborne loans. In 2022, refinanced and forborne mortgages classed as non-performing accounted for 1.5% of the total portfolio, compared with 1.2% for those classed as performing. This pattern – the bulk of forborne and refinanced mortgages being classified as non-performing – was likewise seen in years past (see Chart SF.7.1). This shows that these tools are playing a leading role in managing credit impairment in the portfolio as a whole, rather than being used as preventive measures. It must also be noted that, in accordance with the regulations, a portion of the performing forborne and refinanced mortgages corresponds to loans that have been reclassified from non-performing to Stage 2. However, even for loans classified as non-performing, granting forbearance can still prevent their falling into payment arrears and being classified as past due. These observations are consistent with the fact that these tools can help, in some cases, to limit new NPLs, and that this function could potentially be more significant in forbearance measures under the CGPs.

Forbearance and refinancing may increase banks' short-term costs as a result of impairment provisions, but in the medium term these measures can contribute to lower costs if they can prevent loans from sliding into worse classifications or smooth their subsequent return to performance. In residential mortgage lending to households, use of the home to secure the loan helps to keep the expected loss relatively low in the event of non-payment. In spite of this, mortgage loss provisions, and their associated expenses, rise considerably when a loan is reclassified away from performing. 2022 data for all deposit-taking institutions point to the coverage ratio (loan loss provisions relative to loaned amount) rising from 0.2% for performing loans to 3.5% for Stage 2 exposures and 33.3% for non-performing loans (see Chart SF.7.2). In addition, dation in payment and the resulting settlement of the borrower's liabilities requires coverage of the full amount of the mortgage above the value of the collateral property. Insofar as forbearance measures in the CGP under RDL 6/2012 and the NCGP under RDL 19/2022 contribute to slowing loans' movement down the classification scale or help them to recover to better classifications, they will lead to lower impairment costs for banks.

It is important to note that the CGPs are primarily intended to help vulnerable or potentially vulnerable households. It is mortgagors in these groups whose ability to pay is most sensitive to a downturn in macro-financial conditions. This is the case regardless of whether any contractual amendments or, in particular, forbearance measures are applied in line with the CGP under RDL 6/2012, reformed by RDL 19/2022. The credit quality impairment suffered by those who see their employment situation or income worsen during a time of crisis is expected to be as severe or even worse in the absence of measures to amend contractual terms. In fact, in these cases forbearance may serve to mitigate the consequences of the macro-financial shock for both lenders and borrowers. By contrast, if the measures in the CGPs were not targeted and were overly prescriptive, income could be simply transferred from lenders to borrowers, driving up additional provisions for the former and thereby limiting their intermediation capacity. Thus, it is important that these measures are implemented properly in line with the eligibility criteria stipulated in the implementing regulations. In this respect, it should be remembered that classifying a loan as non-performing means that the borrower may have greater difficulty accessing credit as long as this position persists, and possibly also in the future. This limits the potential moral hazard that this type of measure could originate, since there is a cost to the borrower.

SF.4 Conclusions

RDL 19/2022 establishes a broad protective framework for vulnerable and potentially vulnerable households, thus broadly helping all mortgage borrowers to adjust to the higher interest rate environment. As set forth in Sections SF.1 and SF.2, the share of households eligible for the various measures under the CGPs of this RDL is significantly higher than the share that could benefit from the original version of the CGP under RDL 6/2012. Furthermore, additional measures in RDL 19/0222, such as the temporary suspension of fees for the conversion of loans from variable rate to fixed rate, affect all mortgage borrowers. However, it must be borne in mind that the measures applicable to households affected by the broadened scope of eligibility are generally more limited in their coverage and duration than those contained in the original drafting under RDL 6/2012. This is a reflection of their lesser relative vulnerability and short-term nature, insofar as the risks they address are linked to macro-financial shocks in the wake of the Russian invasion of Ukraine.

The experience of applying the CGP under RDL 6/2012 suggests that this type of measure has a particularly relevant role to play as a way to absorb the consequences of a crisis and play a more limited role under normal conditions. Both the volume of applications to benefit from the CGP under RDL 6/2012 and the acceptance rate were significantly higher in the years immediately after the global financial crisis and saw an uptick during the pandemic, albeit a more moderate one since the pandemic had a lesser effect on households' ability to pay given the support measures that were rolled out. In non-crisis situations, the CGP under RDL 6/2012 has been applied on far fewer occasions, although there have been some, meaning that it also provides a secondary structural support to vulnerable households affected by idiosyncratic factors under normal conditions of the economic cycle. The reform in RDL 19/2022 has a predominantly near-term orientation, introducing an entirely temporary measure in the form of the NCGP, suspending certain bank fees until 2024, and amending the conditions of the CGP under RDL 6/2012 (which is a permanent mechanism), depending on the degree to which the household's purchasing power has declined, which can be expected to be greater in times of crisis.

It is to be expected that the implementation of these measures will have a moderate positive effect in the short term on consumption and GDP. The vulnerable and potentially vulnerable households targeted by these measures have a high marginal propensity to consume, in particular in an unfavourable macroeconomic environment. The short-term reduction in borrowing costs associated with the various measures under the framework set out in RDL 19/2022 can be expected to lead to a boost in consumption, which should also be passed through to real GDP. The full extent of the macro stimulus would, however, be restricted by the limited number of eligible mortgagors. Moreover, not all eligible households will choose to benefit from the measures, as seen historically with the CGP under RDL 6/2012.

The measures under the framework of RDL 19/2022 may also entail costs for households in the form of higher debt levels and reduced access to credit in the future. Measures such as payment holidays or term extensions play a critical role in preventing a loss of liquidity leading to the loss of the home, which would entail higher levels of debt for the household for longer. The increased indebtedness also drives up the interest expenses borne by households to whom these measures apply for the lifetime of the mortgage and raises their sensitivity to future rate hikes. Some of the measures covered, such as the temporary suspension of early repayment fees under RDL 19/2022, or the substitutive and supplementary measures in the CGP under RDL 6/2012, have the opposite effect and may reduce households' debt. Converting variable rate mortgages to fixed rate may inhibit sensitivity to future rate hikes. In any case, a household resorting to these measures is a negative sign in terms of their credit quality and may hinder their future access to credit. The latter could cause their future expenses to be more sensitive to income shocks.

In general, contractual amendments are a tool that can allow banks to remedy, or prevent further impairment to, credit quality, particularly when carried out under the CGPs. Without any mitigating measures, such as forbearance or other contractual amendments, the credit quality of a vulnerable mortgage borrower would be impaired by a greater degree in the face of severe macroeconomic shocks, which increases the likelihood of their mortgage being classified as non-performing or written off. Granting extensions or payment holidays may help to prevent, or to manage and avert, further deterioration in credit quality, containing banks' coverage costs. By contrast, other measures, such as debt reduction or dation in payment, would constitute a net cost to banks and would, to some extent, reduce their intermediation capacity. The framework set out in RDL 19/2022 must be properly implemented in order to fully harness its potential and limit the costs for households and lenders. As highlighted in this ex ante analysis, based on available data up to December 2022, establishing an appropriate a time frame and focusing the measures on financially vulnerable groups will be key to achieving the expected outcomes. An ex post assessment of these issues will be needed in future reports as more information comes to light on the deployment of the overhauled CGPs.