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24. Jun. 2015 Rating news – RMBS

Scope assigns (P) AA-(SF) Rating to FT RMBS SANTANDER 4

FT RMBS SANTANDER 4 is a cash-flow securitisation of non-conforming mortgages granted by Banco Santander SA (A+/S-1/Stable Outlook) to finance residential properties in Spain. The transaction is expected to close on 3 July 2015.

Scope Ratings has assigned preliminary ratings to the notes issued by FT RMBS SANTANDER 4 as follows:

Class A (ISIN: ES0305078000), EUR 2,360m: new rating (P) AA-$_{SF}$

Class B (ISIN: ES0305078018), EUR 590m: new rating (P) CC$_{SF}$

Class C (ISIN: ES0305078026), EUR 147.5m: new rating (P) C$_{SF}$

FT RMBS SANTANDER 4 is a granular true sale securitisation of a EUR 2,950m portfolio of non-conforming first-lien mortgage-secured loans granted by Santander to Spanish individuals and resident foreigners to finance the purchase, construction or refurbishing of residential properties in Spain. The assets have been originated by Santander, Banesto (a banking franchise now fully integrated in Santander) and their respective brokers. The transaction is expected to close on 3 July 2015 and the expected legal final maturity of the notes will be on 15 September 2063.

The ratings reflect the legal and financial structure of the transaction; the quality of the underlying collateral in the context of the Spanish macroeconomic environment; the capability of Santander as the servicer; counterparty risk arising from exposure to Santander as the account bank and paying agent; and the managing capability of Santander de Titulización SGFT SA.

RATING RATIONALE

Scope believes that the substantial credit enhancement provided by the structure is sufficient to protect the class A notes against losses from a portfolio of mortgages we consider high-risk assets. In addition, the short-term outlook on the Spanish economy reflects positively on the transaction. The securitised mortgages can be labelled as 'non-conforming' because of insufficient collateralisation, high probability of default and/or aggressive terms and conditions like very long maturities. Nevertheless, we consider the management of performance problems by Santander has been very proactive and prompt. This will limit the volatility of credit losses around our high expectation as the transaction slowly deleverages.

The class B and class C notes lack adequate protection against these risks and we expect them to default.

Scope has accounted for the high default risk which results from the credit weakness of the obligors. The portfolio has a high expected lifetime default rate because: i) the pool has 4.9% of resident foreigners who are more than three times more likely to default on average than the average Spanish obligor, according to Santander; ii) the pool has 20.9% of so called 'reconducted' mortgages originated to restructure other stressed, albeit performing, debts; iii) the pool has an additional 20.8% of very weak mortgages that have been in arrears in the last 12 months; iv) the pool has 1.0% of mortgages originated via brokers, known to underperform branch-originated mortgages.

Scope has also accounted for the recovery risk resulting from high current loan-to-value (LTV) ratios —weighted average is 103%—and limited servicer flexibility. High LTV ratios resulted from the market price correction of residential properties in Spain, even when the original LTVs were just below 80% on a weighted average basis. The collapse of the real estate bubble in Spain followed the end of the aggressive credit expansion period in 2007. A significant share (53%) of the portfolio was originated before 2008 and original LTV levels were sometimes aggressive and biased by inflated appraisal values. However, Santander has completed and provided a prudent revaluation of the properties underlying the mortgages which results in the very high LTVs used in our analysis.

Santander has limited servicer flexibility given the already stretched terms and conditions of the mortgages (i.e. high LTVs, low interest rate margins, constant annuity amortisations, long times to maturity). Furthermore, Santander has adhered to the code of good banking practice (contained in law 1/2013) which limits the ability of the servicer to enforce security rights over mortgaged collateral and we thus expect long recovery lags after default. Our analysis models a recovery lag of five years.

KEY RATING DRIVERS

Improving Spanish economy (positive). Scope believes the Spanish economy is improving slowly, while threatened by political uncertainty. The positive impact of this trend for class B notes is less certain, due to the fragility of the recovery and still significant fundamental imbalances.

Stressed performance references (positive). Scope calibrated the portfolio modelling default rate assumptions with vintage data from 2007 to 2014 a period of high stress for the Spanish economy with particularly high unemployment rates. Scope modelled a mean lifetime 90dpd default rate of 44%, a coefficient of variation of 15.5%, a cure rate of 25% and a base case recovery rate of 73.7%.

Updated appraisals of collateral (positive). Scope has calculated fundamental recovery rates incorporating significantly corrected market values of the underlying properties. The updated appraisal values of the finished properties that back the loans in this portfolio are now 1.2 years old on weighted average.

Combined waterfall protects liquidity (positive). The deal features a plain-vanilla, swapless, strictly-sequential, three-tranche structure with a combined priority of payments. The combined priority of payments supports timely class A interest payments even if the thin cash reserve fund is depleted by the provisioning of assets 18 months in arrears or more.

Limited counterparty risk (positive). The notes bear significant counterparty risk exposure to Santander. This risk is mitigated by the credit quality of the bank rated A+ with Stable Outlook by Scope, and a substitution trigger at loss of BBB.

Low asset quality (negative). Santander and Banesto originated 53% of the loans in the portfolio before 2008, during the housing boom in Spain when underwriting practices were more aggressive. Scope overweighted the historical performance of the 2007 vintage in order to build representative default rates for the analysis.The portfolio comprises high LTV loans as a result of recent reappraisals, which Scope has taken into account in its recovery analysis. Scope has applied further value declines from indexation, stressed market value losses, and fire-sale discounts.

The portfolio contains 21% of restructured – or ‘reconducted’ – mortgages, expected mostly to default given payment incidents in 85% of the exposure since restructuring, despite low interest rates. Scope’s analysis assigned a 75% lifetime default rate to this segment with a cure rate of 0%.

Overall as much as 45% of the portfolio balance has had payment incidents over the last 24 months. Scope analysed obligor-specific internal PDs provided by Santander to support the results of our vintage analysis of defaults, rather than rely on debt-to-income data, which is typically point-in-time, incomplete and highly unreliable.

Limited servicer flexibility (negative). By and large, we believe the terms of these mortgages have already been modified or restructured. Furthermore, Santander has adhered to the code of good banking practices (contained in law 1/2013) which limits the ability of the servicer to enforce security rights over mortgaged collateral. We have modelled a long recovery lag of five years in addition to the aforementioned high mean expected default rate.

Broker channel (negative). A negligible share of the portfolio (1%) has been originated through the prescriber channel, typically real estate agents or developers. These mortgages have higher lifetime default rates than conforming mortgages, with an expected default rate of 41% and 21% respectively.

Long time to maturity (negative). The portfolio will amortise slowly, making the transaction more vulnerable to future economic downturns. The weighted average current remaining time to maturity is 26 years.

Low excess spread (negative). The portfolio has low WA interest and margin, which results in increased loss severity for the class B and class C notes, with significant negative carry given the long recovery lag.

Negligible interest risk (positive). The lack of a swap does not represent a material risk because the transaction is naturally hedged. Most loans are referenced to 12-month Euribor (98.5%), highly correlated to the note’s 3-month Euribor rate, and margin reset dates are uniformly distributed in the year.

RATING STABILITY & BREAK-EVEN ANALYSIS

Scope has tested the resilience of the model results towards stresses of the base case values of the main input parameters: the mean default rate, the default rate coefficient of variation and the recovery rate. These tests have the sole purpose of illustrating the sensitivity of the rating to input assumptions and should not be considered indicative of expected or likely scenarios.

A 25% and 50% reduction of the base case recovery rate negatively affects the model results for class A by 4 and 6 notches respectively. Model results for class A notes indicate investment-grade level even under a stressed coefficient of variation 200% larger than the one derived for the analysis.

Model results for the class B and the class C ratings are insensitive to stresses, which is consistent with Scope’s assumptions as these classes are close to default under the base case assumptions. Model results for the class B notes indicate a downgrade to C_{SF} under the aforementioned recovery haircuts.

Break-even analysis also shows the robustness of the class A rating. The break-even portfolio default rate for the class A notes is 22.6% under a zero RR assumption—a very harsh assumption for a mortgage portfolio—and 48% under Scope's recovery rate assumption of 50% applicable to a AA_{SF} rating target.

NOTES

This is the fourth securitisation under the non-conforming RMBS series originated by Santander and it is the first to be publicly rated by Scope. This is the first securitisation incorporated in Spain under the new legal form "Fondo de Titulización" as defined in law 5/2015. The previous transactions were incorporated under the now extinct legal form "Fondo de Titulización de Activos". A detailed rating report will be published by Scope on the closing date and will be freely available on www.scoperatings.com.

Important information

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Executive Board: Torsten Hinrichs (CEO), Dr. Stefan Bund.

The rating analysis has been prepared by Carlos Terre, Executive Director.
Responsible for approving the rating: Guillaume Jolivet, Managing Director.

The rating concerns an issuer which was evaluated for the first time by Scope Ratings AG.

Information on interests and conflicts of interest

The rating was prepared independently by Scope Ratings but for a mandate of the issuer of the investment as represented by Santander de Titulización SGFT SA.

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Key sources of Information for the rating

Offering circular and preliminary contracts; operational review presentations; delinquency and recovery vintage data; loan-by-loan preliminary portfolio information; draft legal opinion; and final portfolio audit report.

Scope Ratings considers the quality of the available information on the evaluated entity to be satisfactory. Scope ensured as far as possible that the sources are reliable before drawing upon them, but did not verify each item of information specified in the sources independently.

Examination of the rating by the rated entity prior to publication

Prior to publication, the rated entity was given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the rating was not modified.

Methodology

The methodology applicable for this rating 'Structured Finance Instruments Methodology Guidelines', dated July 2014. The credit committee also applied the principles contained in 'Rating Methodology for Counterparty Risk in Structured Finance Transactions (Call for Comments)', dated July 2015. Both files are available on www.scoperatings.com. The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's default rating, definitions of rating notations and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency's website.

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