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ROYAL DECREE LAW 6/2012, OF MARCH 9, 2012 ON URGENT MEASURES TO PROTECT LOW INCOME MORTGAGE DEBTORS

Royal Decree-Law 6/2012, of March 9, 2012, approving urgent measures to protect low income mortgage debtors (the “**Royal Decree-Law**”), was published in the Official State Gazette on March 10, 2012 and came into force on the following day.

The Royal Decree-Law was passed to protect a large number of households that, in the current drawn-out economic downturn, are unable meet their mortgage payments on their homes. Its provisions (i) define the persons falling into the group it aims to protect; (ii) establish the immediate moderation of late-payment interests applying to that group; (iii) set out a code of good practice, to which credit institutions may voluntarily accede, and aimed, firstly, to encourage the renegotiation of the loans of the referred group and, if this is not possible – and as replacement of foreclosure proceedings – the dation in payment of the home to the lender; (iv) set out specific tax measures to support those mechanisms; and, (v) lastly, relax the formalities for out-of-court foreclosure proceedings.

Consequently, the measures included in the Royal Decree-Law are confined to the mortgage loans held by the identified group, “without undermining the fundamental elements of mortgages, the security and reliability of which forms the historical basis for our mortgage system”, as expressed by the preamble to the Royal Decree-Law.

The main effects of the Royal Decree-Law are summarized below in the form of questions and answers.

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1. MEASURES TO PROTECT LOW INCOME MORTGAGE DEBTORS

1.1 Do the measures contained in the Royal Decree-Law apply to all mortgage loans?

Apart from the amendments to out-of-court foreclosure proceedings and the eligibility for financial assistance for tenants, which are described below and apply across the board, the Royal Decree-Law only applies to mortgage loans and credit facilities in force in which the debtor falls below what the Royal Decree-Law refers to as the “exclusion threshold.”

1.2 Which debtors are regarded as falling below the exclusion threshold?

Debtors falling below the exclusion threshold are debtors who have entered into loans or credit facilities secured by a mortgage on their principal residence and who, by reason of their professional and financial circumstances, cannot meet their mortgage payments and their basic living expenses.

All of the following conditions must be met:

- (a) No members of the family unit receive income from work or economic activities. The family unit includes the debtor, the debtor's spouse (provided they are not legally separated) or registered *de facto* partner, and any children residing at the property.
- (b) Mortgage repayments exceed 60% of the family unit's net income.
- (c) The members of the family unit do not have any other financial rights or assets which would be sufficient to pay the debt.
- (d) The mortgage debt relates to the only property owned by the debtor and the mortgage was taken out in order to purchase that property.
- (e) There is no collateral or personal security for the debt, apart from any personal security of debtors in the circumstances described in (b) and (c) above.
- (f) If there are any codebtors who are not part of the family unit, they must meet the conditions described in (a), (b) and (c) above.

1.3 Who has to prove that the conditions for the debtor to fall within the exclusion threshold are met? How is this done?

The debtor must prove to the lender that the conditions placing the debtor below the exclusion threshold are met by submitting the documents listed in the provisions, such as certificates from the appropriate public employment service, the tax office

and the property registry, documentation evidencing the debtor's family situation (family record book) and ownership of and encumbrances on the assets, as well as a solemn declaration that the conditions are met¹.

1.4 Do the measures contained in the Royal Decree-Law become obligatory for lenders when the debtor evidences eligibility?

A distinction must be drawn between two types of measure:

- The limit on late-payment interest referred to in question 1.5 comes into effect and becomes obligatory for the lender immediately as soon as the debtor proves that he falls within the exclusion threshold.
- The measures in the Code of Good Practice apply to all debtors who prove that they fall within the exclusion threshold but only if the lender has acceded to the Code.

1.5 How will late-payment interest be affected?

The Royal Decree-Law places a limit on late-payment interest for all mortgage credit facility or loan agreements where the debtor falls within the exclusion threshold, such that the default interest does not exceed the amount resulting from adding to the stipulated interest payable on the loan, a 2.5% over the outstanding loan principal.

This limit applies as soon as the debtor evidences that he falls within the exclusion threshold.

1.6 What is the Code of Good Practice?

The Code of Good Practice lays down various measures to restructure the mortgages of debtors who fall within the exclusion threshold, measures which the institutions that accede to the Code undertake to apply. These measures range from the stage prior to foreclosure to the possible delivery of the property in payment of the debt (dation in payment), as well as the release of the debtor's obligations before the lender. For more details, see questions 1.14 and 1.15.

1.7 Who can sign up to the Code of Good Practice?

The Code of Good Practice is open to credit institutions as well as other institutions that provide mortgage loans or credit facilities in a professional capacity, and draws no distinction between Spanish and foreign institutions.

It is not specified whether the Code of Good Practice is open to institutions that do not provide loans but acquire loan portfolios or collection rights from institutions that do, such as, for example, securitization vehicles. We see no reason why the debtors for these transferred or securitized loans should not benefit from the advantages afforded to the debtors of lending institutions, where they meet the appropriate conditions. Thus, we

¹ The Royal Decree-Law provides that the committee that will oversee compliance with the Code of Good Practice will approve a solemn declaration form.

understand the new legislation could be interpreted extensively on this point, hence allowing the institutions that acquire loans or collection rights to accede to the Code of Good Practice and the debtors under the loans transferred to those institutions to benefit from the advantages offered by the Code (see question 1.11).

1.8 Is the Code of Good Practice obligatory?

Although lenders can choose whether or not to accede to the Code of Good Practice, once they have done so, they must comply with the Code with respect to mortgages on homes purchased for prices exceeding certain thresholds (see 1.12), once the debtor proves that he falls within the exclusion threshold. In this regard, the consequences of a breach by the lenders that have acceded to the Code and which described in question 1.31 below should be taken into consideration.

1.9 Can only part of the Code of Good Practice be applied?

The Royal Decree-Law does not seem to allow for a partial application of the Code of Good Practice by the institutions that have acceded to it. Institutions that have not acceded to the Code may, however, agree to amend mortgages with debtors as they see fit, without applying the benefits under the new legislation.

1.10 Can the parties agree to modifications over and above those contained in the Code of Good Practice?

The Royal Decree-Law does not prevent debtor and lender from agreeing to measures on top of those provided for in the Code of Good Practice, although it seems unlikely that they would be able to agree on additional measures placing the debtor in a worse situation.

1.11 How does the Royal Decree-Law affect transactions that have been transferred, securitizations or transactions that are secured by the issue of covered bonds?

The new provisions of the Royal Decree-Law apply to mortgages that have been transferred, including securitizations, or mortgages underlying covered bonds to the same extent as any other mortgage, hence also applying the late-payment interest limit referred to in question 1.5.

In the case of transferred mortgages, however, the new lender will choose whether to sign up to the Code of Good Practice (see question 1.7), including in cases of “silent” transfers (which are not notified to the debtor), such as securitizations, unless the contractual documents provide for powers of disposal as regards management of the loan by the originating or managing institution which include accepting an extension of the term and dation in payment. Therefore, in the case of securitizations, we understand it should be for the management companies of each vehicle to decide whether or not to accede to the Code of Good Practice.

Although the terms of the documents for each vehicle will apply, in view of the customary restrictions placed on the disposal of loans it seems likely that management companies will be unable to accede to the Code of Good Practice on behalf of the vehicles as a general rule and only be able to accept novations or datations in payment in

specific cases. The tax advantages referred in question 1.25 could not be available, however, to debtors affected by novations and dations in payment unilaterally accepted by the vehicle management companies, provided they did not result from signing up to the Code of Good Practice, although these debtors could benefit from the lower registration and notary costs arising from the dation in payment (see question 1.20).

To avoid potential disputes with debtors, it would therefore be advisable for originating entities that have transferred mortgage loans, in or outside the context of securitizations, to state when they accede to the Code of Good Practice that doing so does not affect the transferred loans, even if they continue to be managed by those institutions, and that it shall be for the new lenders to choose whether to accept the new financing conditions.

In the case of mortgages underlying covered bonds, we think there should be no limits on the ability to sign up to the Code of Good Practice even if the originating entity has issued covered bonds.

1.12 What is the maximum value of the mortgaged property below which the measures established in the Code of Good Practice can apply?

The Code of Good Practice will apply to mortgages taken out to secure loans or credit facilities for the purchase of residential properties where the purchase price does not exceed the following amounts:

Municipalities with more than 1,000,000 inhabitants	€200,000
Municipalities with between 500,001 and 1,000,000 inhabitants or forming part of the metropolitan areas of municipalities with more than 1,000,000 inhabitants	€180,000
Municipalities with between 100,001 and 500,000 inhabitants	€150,000
Municipalities with up to 100,000 inhabitants	€120,000

1.13 Is it necessary for repayments to have been missed before the measures contained in the Code of Good Practice can be applied?

Although it may be assumed that a large majority of mortgages may have unpaid installments, the aim of the Royal Decree-Law is to avoid foreclosure proceedings against debtors who fall within the exclusion threshold and neither it nor the Code of Good Practice require any loan repayments to have been missed before the debtor can ask for the lender to apply the measures contained in the Code.

1.14 What do the measures contained in the Code of Good Practice involve?

Basically, the Code of Good Practice aims to do the following:

- Firstly, to achieve a viable restructuring of the mortgage loan using various measures prior to foreclosure, measures which are obligatory for lenders that have signed up to the Code;
- Secondly, even if after these measures the debtor is still unable to repay the loan, it is suggested that the lender offers the debtor a release; and
- Lastly, if after the elapse of 12 months from the date on which the restructuring was requested, the creditor has yet to allow a viable loan (on objective terms as established by the Code), the debtor is entitled to discharge the loan against delivery of the residential property (dation in payment) after which the debtor can nonetheless remain in the property under a rental arrangement.

1.15 What form does the restructuring process take until it can reach the dation in payment stage?

(a) Measures prior to foreclosure

- Debtors who fall within the exclusion threshold may (if the auction notice has not been given, where foreclosure proceedings have already commenced) ask the lender to restructure their mortgage debt (upon evidencing their situation as described in question 1.3) with a view to making the debt viable in the medium- and long-term.
- Within a month from when the request was submitted, the lender must offer the debtor a restructuring plan, providing details of the implementation and financial consequences for the debtor of applying all of the following measures:
 - grace period of 4 years for repayment;
 - reduction in the applicable interest rate to Euribor + 0.25% for the grace period; and
 - extension of the total repayment period up to 40 years from the date the loan was granted.

The lender may give the debtor the chance to consolidate its debts into one. The Royal Decree-Law makes no distinction between debts with the same lender and debts with third parties.

Early repayment of the loan within 10 years following date the restructuring plan was approved will not give rise to any compensation costs.

Should the case arise, the creditor must notify the debtor that the plan is unviable or that, if the plan becomes unviable, he may apply for the additional measures described in the following paragraph.

A restructuring plan is deemed to be unviable if the monthly mortgage repayment exceeds 60% of the total amount of income being received by the family unit.

(b) Additional measures:

If the restructuring plan described in the previous paragraph is not viable, in view of the debtor's financial circumstances, he may apply for a release from the outstanding principal.

The lender has a month to accept or reject the release, although the Royal Decree-Law suggests using the following methods:

- A 25% reduction.
- A reduction equivalent to the difference between the repaid principal and the total loaned principal in the same proportion the number of installments paid by the debtor bears to the total installments owed.
- A reduction equivalent to half of the difference between the current value of the residential property and the value resulting from the initial appraisal value minus twice the difference from the loan granted.

(c) Dation in payment of the principal residence

If after the end of 12 months from the date the restructuring plan was requested, and despite the restructuring and the additional measures accepted by the lender, the situation continues to be unviable for the debtor (because the monthly loan repayments are above 60% of the total income received by the family unit), the debtor may request the dation in payment of his principal residence, which the lender is obliged to accept.

1.16 How are the modifications agreed to during the restructuring process documented?

Although the Code of Good Practice seems to provide that at least the modifications under the restructuring plan are obligatory for the lender, it also provides that either of the parties may require the other to execute a public deed recording the contractual novation under the provisions contained in the Code of Good Practice. The costs of executing the deed must be borne by the party that requests it.

The Code of Good Practice provides that the contractual novation will not entail an alteration or loss of ranking of the registered mortgage, on the terms set forth in Article 4.3 of Law 2/1994.

The requirements for the mortgage ranking to remain (in Article 4.3 of Law 2/1994) to the effect that the mortgage liability figure cannot be increased or the term extended as it is do not seem to apply.

The Code of Good Practice says nothing either about registration of the novation at the property registry, although according to Article 4.3 of Law 2/1994, it would appear that the novation must be entered as a note in the margin for the entry on the mortgage, for which a public deed would be needed.

We think these uncertainties regarding the documentation of the novations should be clarified.

1.17 Can the debtor be required to change the conditions if his circumstances improve?

The Royal Decree-Law does not give the parties the option to agree to change the terms of the loan if the financial circumstances of the debtor improve, after the restructuring has been agreed to, although it does not say they cannot do so.

1.18 Is dation in payment available in all cases where the restructuring plan is unviable?

The Royal Decree-Law states that dation in payment will not be available in the following cases:

- Where foreclosure proceedings are ongoing and an auction has already been announced; and
- Where there are charges on the property which postdate the mortgage.

1.19 What does dation in payment involve?

Dation in payment completely discharges the debt secured by the mortgage and the personal liability of the debtor and third parties to the institution by reason of that debt.

The lender is entitled to receive the property itself or to appoint a third party to receive it.

1.20 What are the notarial and registration costs associated with a dation in payment

A 50% reduction is allowed to notarial and registration fees arising from the discharge of the mortgage in cases of dation in payment involving a mortgage debtor who falls below the exclusion threshold.

The reduction seems to apply to all datations in payment agreed to with a mortgage debtor who falls below the exclusion threshold without the need to comply with the other requirements contained in the Code of Good Practice or the Royal Decree-Law.

1.21 Can the purchaser charge any of the costs associated with the dation in payment to the debtor?

According to the Royal Decree-Law the debtor cannot bear any additional costs of the lender that acquires ownership of the now mortgage-free asset.

1.22 Does the debtor have to deliver possession of the property immediately upon the dation in payment?

If a dation in payment occurs, the debtor may, if he so requests, remain in the property for 2 years as a rent-paying tenant, as explained in the next question.

1.23 What conditions will apply to the rental of the property after the dation in payment?

The following conditions will apply to the rental of the property by the debtor after the dation in payment:

- The Urban Leasehold Law will apply, except as regards the minimum term for the rental agreement and rent reviews.
- Rental term: 2 years, with the option to extend.
- Annual rent: equal to 3% of the total debt outstanding on the date the dation occurred for the first two years and the open market rent thereafter.
- Late-payment interest in the event of nonpayment: 20%.
- Eviction: the landlord may initiate eviction proceedings: (i) 6 months after nonpayment occurred, unless the arrears have been paid; or (ii) if at the end of the two-year term of the agreement the tenant has not vacated the property and no agreement has been reached on an extension, in which case the landlord may claim unpaid rent from the tenant at the open market rate for the months when the property was wrongfully occupied.

1.24 Can other debtors apply for the release under the Code of Good Practice?

Although lenders are under no obligation to accept any such application, (i) debtors who are involved in a foreclosure proceeding where the auction notice has already been given, and (ii) debtors who fall below the exclusion threshold but were unable to elect dation in payment due to the existence of charges on the property postdating the mortgage, may apply for the release under the Code of Good Practice.

1.25 What tax treatment applies to the measures provided for in the Code of Good Practice?

The following tax measures are provided:

- An exemption from stamp tax for the public deeds recording any contractual novations made under the Code of Good Practice.
- Taxpayer status for the tax on increase in urban land value for the institution acquiring the building in cases of dation in payment under the Code of Good Practice, and none of the tax paid may be recovered from the mortgage debtor.

- An exemption from personal income tax on any capital gains that the debtors may receive as a result of the dation in payment of its property under the Code of Good Practice.

1.26 What happens if the debtor unrightfully benefits from the measures in the Royal Decree-Law or the Code of Good Practice?

Any debtor who unrightfully benefits from the measures in the Royal Decree-Law or the Code of Good Practice, without meeting the necessary requirements, will be liable, in all cases and in addition to any other types of liability, for any damage and loss caused and all expenses incurred as a result of applying the measures, and it is stipulated that the amount payable in respect of damage, loss and expenses cannot be less than the unrightfully obtained benefit.

Any debtor who voluntarily and deliberately attempts to place or keep themselves below the exclusion threshold with a view to being able to apply the measures, all of which must be proven by the lender, will be held liable on the same terms.

1.27 How can institutions sign up to the Code of Good Practice?

Lenders can accede or sign up to the Code of Good Practice simply by notifying the Treasury and Financial Policy Secretary's Office.

1.28 For how long do creditors sign up to the Code of Good Practice?

Lenders sign up for a two-year term, renewable automatically for further one-year terms unless the lender expressly gives notice of withdrawal. Any withdrawal must be notified to the treasury and financial policy secretary's office at least three months in advance.

1.29 Is it possible to withdraw from the Code of Good Practice?

There is no mention of an institution being able to request the withdrawal from the Code, except upon expiry of the initial two year term or subsequent extensions.

1.30 How can you know whether an institution has signed up to the Code of Good Practice?

In the first ten days of January, April, July and October, the Secretary of State for the Economy and Support for Businesses will deliver a decision ordering publication of the list of institutions that have signed up to the Code of Good Practice on the website of the treasury and financial policy secretary's office and in the Official State Gazette.

The Code also requires institutions to widely publicize the terms of the Code, especially among its customers.

1.31 What actions lie open to the debtor if the creditor breaches the Royal Decree-Law or the Code of Good Practice?

In addition to any legal action the debtor may be entitled to bring for breach of contract, if a contractual novation has been agreed or if an administrative claim has been brought for breach of the disciplinary rules governing credit institutions, the Royal Decree-Law establishes that debtors may bring a claim with the Bank of Spain for breach by the credit institutions of the Code of Good Practice, on the same terms as the other claims that the Bank of Spain is responsible for handling and deciding upon.

1.32 Are there any mechanisms to oversee/supervise compliance with the Code of Good Practice?

Compliance with the Code of Good Practice will be supervised by an oversight committee with representatives of the Ministry of the Economy and Competitiveness, the Bank of Spain, the National Securities Market Commission and the Spanish Mortgage Association.

The institutions that have signed up to the Code must send the Bank of Spain, on a quarterly basis, the information they are requested to provide by the oversight committee. This information will include, in all cases, the number, size and characteristics of the transactions requested, implemented and refused under the Code of Good Practice, as well as the claims handled.

On the basis of the information provided to it by the Bank of Spain in this respect, the oversight commission will publish a quarterly report evaluating the degree of compliance with the Code of Good Practice.

2. REFORM OF OUT-OF-COURT FORECLOSURE PROCEEDINGS AGAINST THE DEBTOR'S PRINCIPAL RESIDENCE

The Royal Decree-Law makes significant amendments to out-of-court foreclosure proceedings under the Mortgage Law and its implementing regulations with a view to bringing the rules on out-of-court auctions into line with those on court auctions under the Civil Procedure Law. Out-of-court foreclosure proceedings have been simplified by requiring a single auction and an upset price.

The rules on out-of-court foreclosure proceedings contained in the Royal Decree-Law will apply where the proceedings are conducted against the debtor's principal residence regardless of whether the debtor falls below the exclusion threshold under the Royal Decree-Law:

- The value of the property will be realized in a single auction in which the starting price will be that stipulated in the mortgage deed. If, however, bids are submitted for 70% or more of the value at which the property would have been auctioned, the property will be deemed to be awarded to the highest bidder.

- If the highest bid is lower than 70% of the starting price, the debtor may submit, within ten days, a higher third-party bid which exceeds 70% of the appraisal value or which, if less than that amount, is sufficient to pay off the whole of the foreclosing party's claim.
- If the debtor does not take the step mentioned the previous paragraph within the time limit, the lender may, within five days, request that the property or properties be awarded in exchange for a sum equal to or exceeding 60% of the appraisal value.
- If the lender does not exercise that right, the property will be deemed to be awarded to the highest bidder, provided that the bid exceeds 50% of the appraisal value or, if less, that it at least covers the amount claimed in respect of all items.
- If there are no bidders at the auction, the lender may, within twenty days, ask for the property to be awarded in exchange for an amount equal to or exceeding 60% of the appraisal value.
- If the lender does not exercise that right, the notary will deem the foreclosure proceeding to be at an end and will complete and file the notarial certificate, which will clear the way for the appropriate court proceeding.

Furthermore, it is provided that, within six months from the date of entry into force of the Royal Decree-Law, the government will approve the necessary regulations to simplify out-of-court sale proceedings, which include allowing online auctions.

3. ASSISTANCE TO TENANTS

In addition to establishing specific conditions for rental agreements arising from dations in payment under the Code of Good Practice (see question 1.23), the Royal Decree-Law extends the provisions on assistance to tenants contained in Royal Decree 2066/2008 to:

- Individuals subject to a court eviction order in relation to their principal residence as a consequence of court-based or out-of-court foreclosure proceedings after January 1, 2012, provided that the application for assistance is made not later than 6 months after the eviction order.
- Individuals who enter into a rental agreement as a consequence of the application of the dation in payment mechanism under the Code of Good Practice if their family income does not exceed 2.5 times the Public Multi-purpose Income Indicator, on the terms set forth in Royal Decree 2066/2008.

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