

Understanding the Enforcement Proceedings for Spanish Mortgages Overview of the Regulation after RD 8/2011

Banking and Capital Markets Department

1. Introduction

Spanish real estate is attracting an increasing amount of interest from international investors. On many occasions the interest lies directly on the potential acquisition of a real estate asset which is thought to be underpriced or otherwise attractive but, on some other occasions, transactions including distressed debt acquisition and further foreclosure of security becomes an interesting possibility to approach an asset.

Investors generally find it difficult to understand the procedure for foreclosure of security in Spain and up to what extent such procedure can be creditor-controlled. Issues such as the impossibility of directly appropriating an asset, credit bidding or grounds for opposition within a proceeding become fundamental in the analysis. Also various press releases, some controversial Court rulings affecting the recourse against the debtor for amounts not covered by the security and the enactment of Royal Decree 8/2011 dated July 1st ("RD 8/2011") amending certain features of the judicial enforcement have made this an actual and interesting topic.

This note intends to provide a general overview on the foreclosure mechanisms for real estate assets located within Spain and subject to Spanish security. This note describes two different foreclosure proceedings for real estate assets and it includes the amendments resulting from RD 8/2011 (for the purposes of identification we

have marked the areas where the changes have been implemented together with a description of the former regulation). Please note that any reference to approximate terms, other than those explicitly established in the Spanish legislation, is based on our experience and shall be taken as approximate. For obvious reasons, it is very difficult to predict the precise timing for each of the steps of the proceedings since many determining factors are not under the creditor's control. This Note only refers to Spanish Law. This note is an overview which does not consider all the different alternatives or outcomes. It shall not be relied upon in order to take decisions in particular matters. Legal counsel's advice should be obtained before acting.

2. Enforcing Real Estate Security

The main principle is that according to Spanish law a secured creditor may not directly appropriate real estate assets given as security upon default of the secured obligation. Should the secured obligation not be satisfied, the secured creditor will have to proceed with a foreclosure proceeding. There are two different public auction proceedings: (i) the judicial proceedings, to be followed before the Spanish Courts and (ii) the extrajudicial proceedings to be followed before a Notary Public. The extrajudicial proceedings may only be used if agreed by the parties, generally in the security documents and in practice is rarely used due to certain technicalities¹.

¹ It must be noted that there has been a long discussion on the legality of the extrajudicial proceedings that, up to date, has not been definitively settled. This uncertainty refrains creditors usually from choosing this proceeding, trying to avoid the risk of a judicial pronouncement addressed to stop its development.

2.1. Judicial Proceedings

The process will generally be as follows:

(a) Essential breach by the borrower

After an essential breach the creditor will most likely declare the early termination or acceleration of the secured obligation. Ordinarily after such termination/acceleration the borrower will have a short term to repay the total outstanding amount, this is, principal plus interests accrued. Should the borrower not repay the requested amounts, the secured creditor may initiate the corresponding enforcement proceedings.

(b) Enforcement claim

The enforcement claim must be made against the borrower, and if applicable, against the non-debtor mortgagor and the third party owning the mortgaged assets. The secured creditor shall have to attach to the writ of claim certain specific documents expressly designated in the Spanish legislation and, among others, an enforceable copy of the public deed of mortgage –that is, in principle, a first copy of such public deed–, a certificate of the outstanding debt issued by a Notary Public in accordance with the terms of the agreement, a copy of the notarial request of payment made to the borrower, granting it, at least, a ten (10) working-days term for the repayment and finally, a certificate issued by the Land Registry regarding the property and its encumbrances.

(c) Grounds for opposition

In practice, the borrower has very little grounds to challenge foreclosure in case the enforcement claim has been correctly filed. In any event, once the challenge has been filed, the Court Clerk shall stay the enforcement and shall summon the parties to a hearing before the Court.

(d) Auction

Once the above has been complied with, and at the request of the claimant, the borrower or the third party owner, the property or asset mortgaged shall be auctioned. Auction will generally be made through a closed-envelope process but could also be made through live-verbal bids before the Court on the date fixed for the holding of the public auction. In order to attend the auction, bidders must deposit 20% of the auction price (it was 30% before the 8/2011 RD). The enforcing party may only bid when there are other bidders and will not be required to make a deposit. These are the possible scenarios in the auction:

(i) *Bid equal to or higher than 70% of the price for which the asset is auctioned* (which shall have to be determined in the public deed of mortgage and shall remain without prejudice to the actual value of the asset at the time of enforcement, the "JP Appraisal Value"): the Court Clerk shall, by order issued on the same or the following day, award the foreclosed asset to the highest bidder. Within a time limit of twenty (20) days, the highest bidder shall pay to the consignments account the difference between the amount initially deposited and the total price of the final bid. If the bidder is the enforcing creditor, it will only pay the difference, if any, between its bid price and the outstanding amount owed to it for principal, interest and court fees (thus credit bidding is allowed).

(ii) *Bid higher than 70% of the JP Appraisal Value with deferred payment*: if only bids in excess of 70% of the JP Appraisal Value are made, but offering to pay in instalments with sufficient

bank or mortgage guarantees of the deferred price, such bids shall be notified to the enforcing creditor who, within the next twenty (20) days, may request the adjudication of the property at 70% of the JP Appraisal Value. If the enforcing creditor does not make use of this right, the foreclosed asset shall be awarded to the most favourable of said bids.

(iii) *Bid lower than 70% of the JP Appraisal Value:* if the best bid placed at the auction is lower than 70% of the JP Appraisal Value, the foreclosed debtor may, within a time limit of ten (10) days, present a third party improving the bid by offering an amount in excess of 70% of the JP Appraisal Value or that, albeit lower than such amount, is sufficient for the complete satisfaction of the amount owed to the enforcing creditor (principal, interest and court fees). If, upon expiry of said time limit the foreclosed debtor has failed to proceed as set out in the above the enforcing creditor may, within a time limit of five (5) days, request the awarding of the property for 70% of the JP Appraisal Value or for the amounts owed to him (principal, interest and court fees), provided that this amount is higher than 60% of the JP Appraisal Value and the highest bid (it only had to be higher than the highest bid before the 8/2011 RD).

(iv) *Bid higher than 50% of the Appraisal Value:* in absence of all of the above, the asset will be awarded to the best bidder at 50% of the JP Appraisal Value or, if the best bid is lower such 50%, if it at least covers the amount at which the foreclosure has been ordered (principal, interest and court fees).

(v) *Bid lower than 50% of the JP Appraisal Value:* if the best bid does not meet the above requirements, the parties may allege whether or not the award is admissible and the Court Clerk will resolve on the basis of a series of circumstances, mainly the attitude of the foreclosed debtor regarding its obligations under the agreement. If the Court rejects the award, the rule to be applied is that the secured creditor may request the adjudication of the asset for an amount equal or greater than 50% of the JP Appraisal Value or for the amount owed to him (principal, interest and court fees) but just in case such price is equivalent to or higher than the 50% of the JP Appraisal Value.

(vi) *No bidders:* if there are no bidders to the auction the secured creditor may request the adjudication of the asset for an amount equal or greater than 60% of the JP Appraisal Value (it was 50% before the 8/2011 RD). When the secured creditor fails to use this power within a time limit of twenty (20) days, the Court Clerk will order the lifting of the attachment over the asset at the request of the foreclosed debtor.

2.2. Extrajudicial Proceedings

The extrajudicial proceeding shall only be followed if it has been agreed in the mortgage deed and in case the debtor, in such public deed, has appointed a representative for the sale of the asset and has also determined the value of the asset to be used in the public auction (the "EP Appraisal Value").

The main differences of this process are as follows:

(a) Required Deposit

The secured creditor will be able to bid in the auctions without having

to make any deposit. Other bidders will have to deposit 30% of the price for the first and second auctions and 20% (of the second auction price) for the third auction.

(b) Auction

Once thirty (30) days have elapsed as from the payment request, the process for the sale of the asset in public auction will start. Possible scenarios are as follows:

(i) *First Auction:* no bids under the EP Appraisal Value may be accepted. If no bid is accepted, the secured creditor within the next five (5) days may request the appropriation of the asset as payment of the debt, accepting the persistence of previous charges. The secured creditor will then discharge the total amount of the secured claim.

(ii) *Second Auction:* if the secured creditor does not make use of his right of appropriation a second auction may take place where the value will be 75% of the EP Appraisal Value and no bid under such price may be accepted. If no bid is accepted, the secured creditor within the next five (5) days may request

the appropriation of the asset as payment of the debt, accepting the persistence of previous charges and fully discharging the secured debt.

(iii) *Third Auction:* if the secured creditor does not make use of this appropriation right a third auction may take place. This auction will not be subject to any minimum value, but if the best bid placed is lower than the value set for the second auction the non enforcing creditor, the owner of the property or any third party authorized by them may improve the bid within the time of five (5) days. In this auction, in case no bidders attend it, the creditor is not entitled to obtain the adjudication following the same process set out for the judicial proceedings.

(c) Payment and credit bidding

After the public auction the highest bidder shall pay the difference between the amount initially deposited and the total price of the final bid. If the bidder is the foreclosing party, it will only pay the difference, if any, between its bid price and the outstanding amount owed to it for principal, interest and court fees (thus credit bidding is allowed).

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