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# Investors in mortgage loan portfolios subject to the Real Estate Loan Agreements Act

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*The new Real Estate Loan Agreements Act raises questions and concerns for investors in mortgage portfolios originated with third party lenders.*

## 1. Scope of Act 5/2019

The Official Journal of Spain of 16 March publishes the Real Estate Loan Agreements Act 5/2019 of 15 March ('LCCI'). It enters into force on 16 June.

The statute's subject matter scope is delimited uncritically and prolixly by the Spanish legislator. Playing around with the options of Art. 2, the LCCI will apply to the following loans:

1) Consumer mortgage loan for any purpose and backed by new or used housing or other residential property (not just housing).

2) Mortgage loan to a legal person in whose contractual position the natural person acquiring the housing or residential property is subsequently placed by way of subrogation.

3) Mortgage loan to a non-consumer natural person (self-employed employer) for any purpose backed by housing or other residential property.

4) Mortgage loan to a commercial company for any purpose backed by residential real estate (e.g. real estate developer), the mortgage being granted to a natural person, even if he or she is not a consumer.

5) The same as above, but with the consumer providing a personal non-mortgage surety.

6) A non-mortgage loan to a consumer for the purpose of acquiring or "retaining" property rights in land or real estate, built or to be built (not necessarily residential!).

7) Non-mortgage loan to a non-consumer natural person or a commercial company whose purpose is to acquire or retain property rights in land or real estate, built or to be built, guaranteed by a consumer (not by any natural person).

8) Non-mortgage loans, but rather personal or commercial loans, additionally secured (in addition, where appropriate, of the retention of title to the movable property) with a real estate mortgage over the residential property of a natural person, regardless of who the debtor is.

Where the borrower is a legal person and the guarantor is a natural person, the application of the LCCI must be disaggregated, applying only to the guarantee.

## 2. General rules regarding the transfer of real estate receivables under the LCCI

*Investors in mortgage portfolios affected by Act 5/2019* should generally take these points into account:

a) The LCCI *aggravates* the contractual costs of lenders vis-à-vis borrowers, but on the other hand, it provides these same lenders with *greater legal certainty* (not *complete*, however) in the stability of their contracts. Since the LCCI seeks, above all, to strengthen the protection of borrowers at the contracting stage, it is reasonable to think (although it cannot be predicted with certainty) that indirectly these same measures, if implemented, will favour the stability of mortgage contracts acquired by the investor in loan portfolios.

b) There are essentially no more encumbrances once the loan has been formalized, which would have to be undertaken by the transferees of that loan. In other words, the higher regulatory cost will have already been absorbed by the original financier, without the transferee of the receivable being faced with the need to incur new regulatory costs.

c) The above situation differs significantly if the investor acquires a portfolio of mortgage loans from debtors who are real estate developers of homes for sale. The transferee investor must know that, if he buys the receivable in the development phase, and subsequently a housing consumer takes over, the transferee will have to undertake all the "cost of transparency" of Arts. 6 to 15 of the Act, in addition to carrying out a creditworthiness assessment of each consumer that has subrogated to the duties of the borrower.

d) The law does not give the mortgagor the right to redeem his individual loan paying the share of the distressed price paid by the purchaser of the portfolio.

e) As a matter of principle, investors in mortgage portfolios consisting of consumer loans contracted after 16 June have to cover higher due diligence costs in order to check whether the transferor complied with the material and procedural requirements of the "transparency protocol" of arts. 14 and 15 LCCI when contracting the loan. But in return they gain *greater certainty* (but not *complete* certainty) against future litigation strategies on the part of borrowers. As stated above, however, these investors do not have to incur new regulatory costs, because the relevant costs will have to have been incurred at the original loan origination stage and will have already been incurred before the transfer of the receivable.

**3. Contracts prior to the LCCI and supervening application of the new statute**

*If the loan was arranged before the entry* into force of the LCCI, a*nd is subsequently acquired by transfer,* the investor in the mortgage portfolio will have to take into account the following:

a) Mortgage loans granted before the entry into force of the LCCI are not subject to the new regulation. But they will become so whenever there is an "amending novation" (Additional Provision 6, Transitory Provision 1(2)). This novation would have costly consequences for the transferee of the receivable, as it would now have to comply with the transparency protocol and the notarial requirements under Arts. 14 and 15 plus other rules concerning the subject matter scope.

b) Caution. Any other subject matter novation of the loan agreement, even if not relevant, may trigger the retroactive application of the Act. The consequence of this may be that alate payment interest clause becomes void without the possibility of integration or that a new valuation of the property has to be made or that the multi-currency mortgage scheme has to be adapted to the new statute (which would require the borrower's consent); or that the mortgagee is obliged to cover expenses that were paid in the past by the borrower; or that an assessment of the borrower's creditworthiness has to be made now.

c) *Even if there is no novation of the loan,* the investor should be aware that two new obligations will apply *unconditionally.*

— Firstly, the early repayment scheme of the loan will always be that of the new Act, if, after the transfer, the loan changes from variable to fixed interest, with the consequence that the early repayment fee may not exceed, in the best of cases, 0.15 of the capital repaid early.

— Secondly, in any case, the accelerated maturity of the loan, i.e. the minimum number of monthly defaults that allow for the maturity of the debt (which will be 12 or 15, depending on the case), will be adapted to the new statute. For these purposes, such introduces the fiction that any accelerated maturity clause agreed before the LCCI is a clause accommodated to the LCCI, or that, in short, it is replaced by it, unless at the time of the entry into force of the LCCI foreclosure had begun. This fiction can be very beneficial for holders of mortgage portfolios who acquired mortgages granted under the old regulation.

— However, this is only true for mortgage loans which, at the time of transfer, had not yet been the subject of accelerated maturity by the creditor. If they already were, the new statute does not apply retroactively, which, in fact, means that the receivable acquired is surely subject to an accelerated maturity clause that is unconscionable and that in fact the holder of the receivable cannot and will not be able to enforce (at any time!) to the repayment of the loan.

— If the transferees of mortgage loans find themselves in the situation just described, *the best they can do is to try to novate the acquired loan agreement,* which in this way will become subject to the new Act entirely, and the creditor will be able to proceed with accelerated maturity on the current terms of Art. 24 of the Act.

**4. On whether the transfer of the portfolio is to be regarded as a novation of the loan**

The importance of the above varies depending on whether the loan acquired by the investor was arranged before 16 June or after the entry into force of the LCCI.

But first we have to address the legal doctrine - mistaken, I think, but binding on Registrars - of the Directorate-General for Registers and Notaries ('DGRN') on mortgage loan transferees (other than credit institutions) acquiring loans granted by a lender that was not a lending institution either. Without going into detail on the relationship between the LCCI and Act 2/2009, the DGRN argued that the transferee of the mortgage loan (which was not a credit institution) should be considered a "lender" for the purposes of the Act, for purposes of certainty of the consumer encumbered with the mortgage (Decisions of 13 July 2015, 7 July 2016, 24 November 2016, among others). The result was that these transferees had to be registered as lenders (now under the LCCI, with the Bank of Spain) and *could be* subject to the provision of compulsory insurance, in the terms of the current Art. 36 LCCI and future implementing rules.

In my view, this case law is unlikely to change when it comes to the application of the LCCI. And the negative decision of the Registrars matters to the investor, because the transfer of the mortgage loan must be registered with the Land Registry, registration that the Registrar will refuse if the registration requirement has not been met.

However, the transfer of the mortgage loan *is not a novation for the* purposes of Additional Provision 6 and Transitory Provision 1 LCCI. That is to say, exception made of the Registry and, when it is legislatively implemented, of the civil liability insurance:

1) the transferee of a mortgage loan granted prior to 16 June 2019 does not become the holder of a receivable subject in its entirety to the LCCI, with the exception of that relating to registration and insurance;

2) the transferee of a mortgage loan granted under the application of the LCCI is not a novation that obliges the transferee to repeat the entire "transparency protocol" of Arts. 6 to 15 LCCI.