RMBS / Spain
New Issue Report

# Bancaja 3, Fondo de Titulización de Activos

## Ratings

| Class | Amount (EUR million) | Final maturity | Rating | CE (%) |
|---|---|---|---|---|
| A | 500.1 | June 2034 | AAA | 4.50 |
| B | 10.4 | June 2034 | A+ | 2.50 |
| C | 10.4 | June 2034 | BBB | 0.50 |


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## ■ Summary


This transaction is a securitisation of residential mortgage loans originated in, and secured on property located in Spain. Fitch Ratings ("Fitch") has assigned ratings to the notes to be issued by Bancaja 3, Fondo de Titulización de Activos ("Bancaja 3" or "the Fund") as indicated at left.

At closing, Bancaja 3 will issue notes backed by a portfolio of residential mortgage loans originated by Caja de Ahorros de Valencia, Castellón, y Alicante ("Bancaja" or the "Seller") who will continue to service the mortgages. Bancaja 3 is regulated by Spanish Securitisation Law 19/1992 and Royal decree 926/1998. Its sole purpose is to transform the mortgage loan participations acquired from the participation issuer, Bancaja (rated 'A+/F1' by Fitch), into fixed-income securities. The participations will be subscribed by Europea de Titulización, S.A., S.G.F.T. (Sociedad Gestora) on behalf of Bancaja 3. The Sociedad Gestora is a corporation with the sole purpose of the management of asset-backed funds.

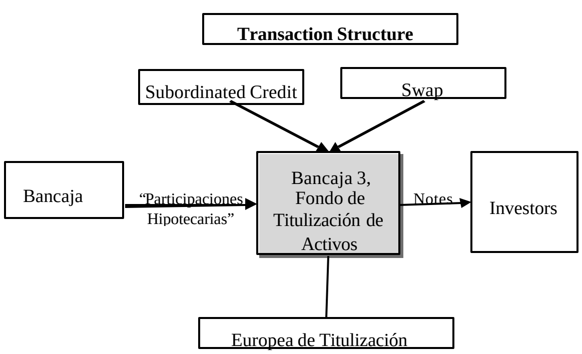
Bancaja is the fourth largest savings bank and the seventh largest financial institution by assets in Spain. It has traditionally focused on the region of Valencia and residential mortgages are one of its core businesses.

The ratings are based on the quality of the collateral, the underwriting and servicing of the mortgage loans, available credit enhancement and the sound legal and financial structures. Initial credit enhancement for the Class A notes, totalling 4.5%, is provided by the Class B and C notes and the subordinated credit. Initial credit enhancement for the Class B notes, totalling 2.5%, is provided by the Class C notes and the subordinated credit. Credit enhancement for the Class C notes, totalling 0.5%, is provided by the subordinated credit. In addition to subordination and the subordinated credit, the transaction also benefits from the 0.60% excess margin guaranteed by the swap.

To determine appropriate levels of credit enhancement, Fitch analysed the collateral using a loan-by-loan mortgage default model specific to Spain. Fitch also modelled the cash flow contribution from excess interest using stress scenarios determined by its default model. The cash flow test showed that each Class of rated notes, taking available credit enhancement into account, can withstand loan losses, at a level corresponding to the related stress scenario, without incurring any principal loss or interest shortfall.

> **Key Information**
>
> **Provisional Portfolio characteristics**
>
> *Total Amount at Closing*: EUR584.6million (of which Eur520.9 million are selected at closing)
>
> *WA Original LTMV* : 68.7%
>
> *WA Current LTMV* : 58.5%
>
> *WA Remaining Maturity*: 13.7 years
>
> *WA Seasoning*: 39.8 months
>
> *Concentration in Valencia*: 87.6%
>
> **Structure**
>
> *Originator & Seller:* Caja de Ahorros de Valencia, Castellón, y Alicante (Bancaja)
>
> *Servicer:* Bancaja
>
> *Fund:* Bancaja 3, Fondo de Titulización de Activos (Bancaja 3)
>
> *Sociedad Gestora:* Europea de Titulización, S.A., S.G.F.T.
>
> *Swap Counterparty:* Bancaja (rated A+/F1)
>
> *Final Legal Maturity:* June 2034

### Transaction Structure




## ■ Credit committee highlights

- Well seasoned pool.
- Gross excess spread guaranteed at 0.60% by a total return swap.
- Five years of substitution during which amortised amounts from the mortgages are used to purchase new mortgages, thereby maintaining the note balance at the same level as at closing. However, a number of substitution conditions are required to be complied with, e.g. maximum original LTV, maximum current LTV, arrears trigger, Bancaja downgrade etc.
- During a period of two years after the substitution period, and subject to certain conditions, principal received by the Fund from the mortgages will be retained in the treasury account and will be paid to the noteholders at the end of these two years. The additional carry cost which this mechanism generates will be covered by the swap agreement.
- 87.6% of the portfolio is located in the *Comunidad* of Valencia. To mitigate this risk Fitch has stressed default probabilities for the loans concerned.

## ■ Financial Structure

The Classes A, B and C notes will receive interest quarterly in arrears at a floating rate based on three months Euribor plus a margin.

The mortgages will continue to be serviced by Bancaja, as the Administrator. Amounts received from the mortgages will be transferred by the latter into the Fund's treasury account every ten days or, if deemed necessary by the *Sociedad Gestora,* on a more frequent basis.

### Priority of Payments

Revenue payments will be allocated, prior to enforcement, on each distribution date in the following priority of payments:

i. The Fund's senior fees and expenses;
ii. Payments due under the interest rate swap agreements;
iii. Interest due on the Class A notes;
iv. Interest due on the Class B notes, if not deferred;
v. Interest due on the Class C notes, if not deferred;
vi. Replenishment of the reserve fund, if the latter has been funded;
vii. Principal retention, either to be used to purchase new mortgages, held in the Principal Account or used to amortise the notes (see below);
viii. Interest due on the Class B notes, if deferred;
ix. Interest due on the Class C notes, if deferred;
x. Interest due on the subordinated credit;
xi. Principal reimbursement to the subordinated credit;
xii. Interest due on the subordinated loan;
xiii. Principal due on the subordinated loan;
xiv. Administrator fee, unless Bancaja has been replaced as the Administrator in which case this fee will be paid as item #1;
xv. Financial intermediation to Bancaja.

Interest deferrals:

- Interest due on the B notes will be deferred if the outstanding balance of mortgages more than 90 days in arrears exceeds 9.7% of the total outstanding balance of the mortgages, and if Class A notes are still outstanding; and

- Interest due on the Class C notes will be deferred if the outstanding balance of mortgages more than 90 days in arrears exceeds 5.6% of the total outstanding balance of the mortgages, and if Classes A and B notes are still outstanding.

In the event the Fund needs to be liquidated the notes will be due and payable, all available funds will be allocated sequentially to interest and principal payments due on the Class A notes, then the Class B notes, and finally the Class C notes, after certain senior third-party expenses.

### Substitution

The Fund will use scheduled and anticipated amortisation amounts received from the mortgages to purchase, on every payment date, starting as of closing and until June 2007, additional mortgages, up to the Maximum Amount of Eur520.9 million. A maximum of 10% of the Maximum Amount can be substituted on each payment date.

However, substitution will be interrupted if one of the following conditions are not complied with:

- The outstanding balance of mortgages more than 90 days in arrears exceeds 1% of the Maximum Amount; and
- The subordinated credit, or reserve fund, as applicable, are not at their required level.

No further substitution will be allowed on any subsequent payment date if any of the following occur:

- Any of the conditions described in the paragraph above have been outstanding for at least four consecutive payment dates;
- Bancaja has started bankruptcy proceedings, is in liquidation or its capacity as a credit entity is in danger;
- Bancaja's short term rating falls below F1; and
- The outstanding balance of mortgages which have become more than 180 days delinquent on a specific payment date have reached the following levels: a) 0.75% during the first year, b) 1.50% during the second year, and c) 2% in each of the third, fourth and fifth years.

Further restrictions are required to be complied with:

- Current balance of each loan can not exceed 0.25% of the total mortgage balance;
- All mortgages have maturity dates of 2 years prior to the notes' final maturity date;
- All mortgages pay on a monthly basis;
- No borrower is in arrears;
- Each mortgage loan can not exceed 65% CLTV;
- Weighted average OLTV does not exceed 68.7%;
- Weighted average CLTV does not exceed 60%; and , among others
- Percentage of mortgages on second homes does not exceed 5% of the current loan balance.

### Principal Retention

Starting from the end of the substitution period (June 2007) till June 2009, mortgage principal receipts will be maintained in the Fund's Principal Account.

However, such amounts will be paid to the noteholders, in the manner described below, should one or more of the following occur:

- Current balance of mortgages more than 90 days in arrears exceeds 2.5% of the outstanding balance of the portfolio; and
- Principal Account's current balance exceeds Eur200 million.

### Principal Redemption

Subject to substitution and principal retention conditions, as described above, the notes will not receive any principal payments before June 2009. Principal payments on the notes will be sequential, with the exception of the Class A and Class B notes being paid *pro rata* if all the following conditions are satisfied:

- the Class B notes represent more than 4% of the outstanding balance of the Class A notes;
- outstanding balance of mortgages more than 90 days in arrears remains below 3%; and
- no principal deficiency exists.

### Interest Rate Risk

The Fund will enter into an interest hedging agreement with Bancaja to cover the basis and margin compression risks. The swap, as described below, will guarantee 0.60% excess margin.

The Fund will pay to Bancaja interest received from the mortgages, and will receive 3-months Euribor plus the margin on the notes and 0.60%.

If Bancaja's long term rating is reduced to below A+, Bancaja will, within 10 days, do one of the following:

- cash, or security, collateralise in an amount satisfactory to the rating agencies;
- find a replacement counterparty, with a long term rating of at least A+; or
- find an entity, rated at least A+, to guarantee its obligations under the swap.

### Credit Enhancement

Initial credit enhancement at closing for the Class A notes, totalling 4.5%, is provided by the Class B and Class C and the subordinated credit. Credit enhancement for the Class B notes, totalling 2.5%, is provided by the Class C and the subordinated credit. Credit enhancement for the Class C notes totalling 0.5% will consist of the subordinated credit.

### Subordinated Credit and Reserve Fund

At closing, the subordinated credit is 0.5% of the original principal balance and thereafter will be the minimum of:

a) 1.6% of the outstanding note balance less the balance outstanding in the Principal Account; or
b) 0.4% of the original principal balance.

However, the required amount will remain the same as on the previous payment date if the sum of:

a. outstanding balance of mortgages performing and less than 90 days in arrears; and
b. balance in the Principal Account

are less than 99% of the outstanding balance of the notes. Moreover, no reduction of the subordinated credit will occur if a principal deficiency exists.

If Bancaja's short term rating falls below F-1 it will, within 10 days, pay the outstanding balance of the subordinated credit into a reserve fund, unless it finds a third party, rated at least F-1, to guarantee its obligations, but subject to the approval of the rating agencies.

### Representations and Warranties

No search of title will be conducted by the Fund or other transaction parties, rather they will rely on the below mentioned representations and warranties provided by Bancaja in relation to the pool of mortgages. If there is an unremediable breach of any of the representations or warranties, Bancaja will be required to repurchase the loan(s) in question.

Specifically, the representations and warranties include the following:

- Bancaja has full right and title to the Mortgage Receivables and the power to sell and transfer, the mortgages;
- Each mortgage loan was originated by Bancaja in accordance with its standard underwriting criteria and procedures;
- Each mortgage loan is registered in the relevant property registry and is first ranking on its corresponding property;
- Bancaja is not aware of any dispute on any of the mortgages;
- Bancaja is not aware that any of the underlying properties has been subject to more than 20% reduction in value;
- Bancaja has full title to all mortgage loans;
- Each property under the underlying mortgage loan has been subject of a valuation as if required by law; and, among others; and
- Each mortgage receivable and the mortgage right and the right of pledge, if any, securing such receivable constitutes legal, valid, binding and enforceable obligations of the relevant borrower.

## ■ Legal Structure

At closing, the mortgage loans have been sold by Bancaja to the Sociedad Gestora on behalf of the Fund. The Sociedad Gestora is a special purpose company with limited liability incorporated under the laws of Spain and is owned by 16 entities among which:

- Banco Bilbao Vizcaya Argentaria, S.A. (83.9%)
- J.P. Morgan España, S.A. (4%)
- Caja de Ahorros del Mediterráneo (1.5%)
- Bankinter, S.A. (1.5%)
- Barclays Bank (1.5%
- Citibank España, S.A. (1.5%)

The Sociedad Gestora's activities are limited to the management of mortgage asset-backed notes.

The participation issuer, Bancaja, will transfer the purchased rights (the loan claims and collateral securing the loans) to the Fund. Bancaja will also transfer or pledge all present or future claims or rights under the various transaction documents to the Fund.

### Collateral

The reference portfolio consists of 14,952 mortgage loans originated by Bancaja in the normal course of their business. All the loans are secured by residential properties in Spain. The security for the loans are mortgages registered in the *'Registro de la Propiedad'* (the official register) and are first ranking.

All the loans are variable-rate loans, 73.6% by outstanding principal balance are linked to the 12-month Madrid Interbank Offered Rate (MIBOR) or Euribor, while the remainder is linked to the average mortgage interest rate from commercial and saving banks in Spain. As of the closing date, no mortgage loans had any payments in arrears.

## Origination and Servicing

As part of its analysis, Fitch has reviewed and analysed Bancaja's origination and servicing guidelines. Fitch conducted an on-site visit of Bancaja and met originator and servicer managers responsible for Bancaja's mortgage loan department.

Bancaja is the fourth largest savings bank and the seventh largest financial institution by assets in Spain. It is rated A+/F-1 by Fitch. A large percentage of its business is generated in the Valencia region, for historic reasons, which is reflected in the entity's mortgage portfolio.

Till March 2001, credit approval was carried out at office level, and since then has been provided by CAT ("*Centro de Autorizaciones Telefónicas*"), a centralised department used for the approval of mortgage applications. The credit analysis is based on a credit scoring system Bancaja started developing 10 years ago, which results in a positive, negative or doubtful score. In the case of the latter a loan might still be approved if additional guarantees and/or conditions are provided/complied with. At least two analysts approve each loan request. Branch directors, however, have a right of veto in such conditions, although this remains relatively uncommon.

Information analysed by the scoring system includes DTI (a maximum of 40% is allowed), negative information from CIRBE (a Bank of Spain database which gathers exposure and non payment information of a borrower to all Spanish entities), RAI (*Registro Acceptación Impagados*) or Experian, in addition to other credit parameters on the financial volatility of the applicant. The maximum LTV allowed is 80%, but is not taken into account in the credit scoring since the latter solely focuses on the ability of the borrower to honour his/her debt payments in a timely fashion. All properties are valued by TINSA, Tasaciones Inmobiliarias, S.A., Spain's largest valuation company, registered and regulated by the Bank of Spain.

Mortgages in arrears are managed by the branches for the first 90 days, and subsequently by the Risk Department. A certain number of letters, automatically originated by the bank's system, and calls (through an external specialised call center) are made, their frequency and content depending on the level of exposure to the borrower. Documentation and procedures required for the foreclosure process are prepared as soon as deemed necessary (even before 90 days of delinquency), with the aim of enabling lawyers to start proceedings in 24 hours once the decision to commence foreclosure is taken. On average, such court proceedings tend to begin after 4/6 months, and currently last around a year and a half. This time to recovery has been decreasing over the years. Bancaja does not favour negotiations or refinancings on repayment of arrears amounts, and these remain negligible.

## Credit Analysis

Fitch analysed the collateral for Bancaja 3 by subjecting the mortgage loans to stresses resulting from its assessments of historical home price movements and defaults in Spain. The analysis is based on the probability of default and expected recoveries determined on the portfolio's individual loans *(see Appendix 1)*.

### Default Probability

Generally, the two key determinants of default probability are the willingness and ability of a borrower to make the mortgage payments. The willingness of a borrower to pay is usually measured by the LTV. Fitch assumed higher default probabilities for high LTV loans and lower default probabilities for low LTV loans. The main reason is that in a severe negative equity situation, borrowers in financial distress but with equity in their homes (low LTV loans) have an incentive to sell and maintain/protect their equity, eliminating the need for the lender to repossess the property.

The ability to pay is usually measured by the borrower's net income in relation to the mortgage payment. As is the case with many Spanish originators this information was not available on a loan-by-loan basis for Bancaja 3. However, Bancaja has a strong focus on a borrower's ability to pay, have comparatively strict origination guidelines in this direction and only allow a maximum DTI of 40%. Therefore, Fitch assumed that borrowers generally have an average ability to pay.

Fitch takes into consideration the specific characteristics of the product in the default probability analysis of the portfolio, assuming the LTV based on the original balance of the initial drawdown as the main measure of the willingness of a borrower to pay.

The securitised pool has a geographical concentration in the *Comunidad* of Valencia, with over 87.6% of mortgages located in this region. Fitch increased default probabilities for these loans by 15% to mitigate for this risk.

Fitch further stressed default probabilities on mortgages backed by second homes, as it believes that a financially distressed borrower is more likely to default on a second home than on a primary residence.

### Recovery Proceeds

To estimate recoveries on the mortgage loans in Spain, Fitch examined house price movements in Spain on a regional basis from 1987–2001. Fitch found significant differences among the regions, most notably between the regions of Madrid, Cataluña and País Vasco, and the rest of the regions in Spain. Cities in these three regions have experienced higher price increases than other cities in Spain. Based on its analysis of the real estate market, Fitch assumed slightly higher market value declines for certain regions as well as for some large urban areas.

To derive market value declines for the respective stress scenarios, Fitch then compared the characteristics of the Spanish real estate market with markets in other European countries. As in its other European mortgage default models, Fitch increased market value declines for higher value properties. These properties are generally subject to higher market value declines in a deteriorating market than homes with average or below-average market values due to limited demand for such properties. Approximately 10% of the reference pool is considered by Fitch to be secured on high value (‘jumbo’) properties.

When calculating recovery value, Fitch’s model reduces each property value by the market value decline, external foreclosure costs, and the cost to the servicer of carrying the loan from delinquency through to default. The cost of carrying the loan depends on the time to foreclosure as well as the applied interest rate, which Fitch assumes to be 5%. Although Bancaja currently experiences a recovery period of a year and a half, Fitch assumes a time to foreclosure of 3 years.

## ■ Cash Flow Analysis

To evaluate the contribution of structural elements such as excess spread, the subordinated credit and others, Fitch has modelled the cash flows based on the weighted average recovery rate and weighted average frequency of foreclosure provided by the loan-by-loan collateral analysis. Recoveries include both interest and principal recovery.

The cash flow model assumes that defaults are spread evenly over a period of three years starting 9 months after closing. The cash flow analysis simulates the cost of carrying the defaulted loans as the difference between the performing balance of the mortgages and the notional balance of the notes. Excess spread, reserve fund and principal have to be sufficient to cover the cost of carry until recoveries are received after 36 months. Interest rates are stressed upwards over time.

The cash flow analysis assumes a high level of prepayments on the mortgages, which stresses the total amount of excess spread available to the transaction. Assumed prepayment levels are respectively 25%, 21% and 18% for the AAA, A and BBB scenarios.

The ratings reflect the highest level of stress assumptions for which there is no interest shortfall during the life of the transaction or principal shortfall at final maturity. The subordinated credit has been sized in order that all note interest payments will be made on a timely basis under the relevant stress assumptions.

## ■ Surveillance

Fitch will monitor the transaction on a regular basis and as warranted by events. Fitch’s structured finance team ensures that the assigned ratings remain, in Fitch’s view, an appropriate reflection of the issued notes’ credit risk.

Details of the transaction’s performance are available to subscribers at *www.fitchratings.com.* Further information on the service is available at *www.fitchratings.com*.

Please call the Fitch analysts mentioned on the first page of this report for any queries regarding the initial analysis or the ongoing surveillance.

## Appendix I: Rating Methodology

To determine appropriate levels of credit enhancement, Fitch analyses the collateral for Spanish residential transactions using a loan-by-loan mortgage default model. The model subjects the mortgage loans to stresses resulting from its assessments of historical home price movements and defaults. Fitch's study showed that the LTV, reflecting the size of the borrower's downpayment, and the borrower's income multiple (original loan advanced divided by income) are the primary indicators of default risk in Spain. Fitch also modelled the cash flow contribution from excess interest using stress scenarios determined by its default model. The cash flow test showed that each class of rated notes, taking available credit enhancement into account, can withstand loan losses at a level corresponding to the related stress scenario without incurring any principal loss or interest shortfall.

### Default Probability

Generally, the two key determinants of default probability are the borrower's willingness and ability to make the mortgage payments. The willingness of a borrower to pay is usually measured by the LTV. Fitch's model assumes higher default probabilities for high LTV loans and lower default probabilities for low LTV loans. The main reason is that in a severe negative equity situation, borrowers in financial distress but with equity in their homes (low LTV loans) have an incentive to sell and maintain/protect their equity, eliminating the need for the lender to repossess the property.

The ability to pay is usually measured by the borrower's net income in relation to the mortgage payment. Historical data available for Spain show low levels of default. Base default probabilities are determined by using a matrix that considers each loan's affordability factor and LTV. The matrix classifies affordability into five classes, the lowest of which (Class 1), encompasses loans with Debt-to-Income ratios (DTI) of less than 20% and the highest of which (Class 5) encompasses all loans with DTIs exceeding 50%. The average DTI for the mortgage market in Spain is circa 27-33%.

### Adjustments

Fitch adjusts the base default rates on a loan-by-loan basis to account for individual loan characteristics of the collateral across all rating levels.

- **product type:** Fitch increases default probability assumptions by 0%-10% for the index volatility experienced by variable-rate mortgage holders
- **repayment type:** Fitch will increase base default rates by 5%-10% for loans to be paid by cuota creciente, whereby the amortization of capital is always the same and the interest payment is increasing
- **loan purpose:** Fitch believes that a finanially distressed borrower is more likely to default on a second home or investment property than on a primary residence. Accordingly, Fitch will double the base default rates in both cases. If the purpose of the loan is not the acquisition of a property in Spain, Fitch will increase the default probability by 50%-100%
- **borrower profile:** Fitch increases default probability on loans to self-employed borrowers by 33%-50% to account for their lack of fixed annual salary.
- **arrears status:** when rating portfolios combining current and arrears mortgages, Fitch increases base default rates for mortgages in arrears by 1-30, 31-60, and 61-90 days by 10%, 35% and 70% respectively, and mortgages over 91 days in arrears (non-performing status) by 100%
- **underwriting quality:** Fitch's review and analysis of the origination process determines whether Fitch decreases default rates by up to 25% or increases them by 0%-200%.

### Loss Severity

To estimate loss severity on the mortgage loans in Spain, Fitch examined home price movements in Spain on a regional basis from 1987–2001. Fitch found significant differences in price development among regions, mainly between the regions of Madrid, Cataluña, País Vasco, and the rest of the regions in Spain. The cities of these regions have experienced higher price increases than other cities in Spain. As in most other countries, rural areas tend to develop on a more stable basis. Based on its analysis of the real estate market, Fitch assumed slightly higher market value declines for certain regions as well as for some large urban areas.

To derive market value declines for the respective stress scenarios, Fitch then compared the characteristics of the Spanish real estate market with markets in other European countries. As in its other European mortgage default models, Fitch increased market value declines for higher value properties. These properties are generally subject to higher market value declines in a deteriorating market than homes with average or below-average market values due to limited demand for such properties.

When calculating recovery value, Fitch's model reduces each property value by the market value decline, external foreclosure costs, and the cost to the servicer of carrying the loan from delinquency through default. For Spain, Fitch assumes external foreclosure costs represent 10% of the loan's balance at the time of default. Loss severity also incorporates the fact that the length of time of the foreclosure process might be longer than the actual one in a recession period. To calculate carrying costs, Fitch uses a worst-case scenario analysis, assuming that the borrower does not pay interest and the collateral is not realised for a period of 3 years.

### Excess Spread

Excess spread represents the monetary difference between the income received by the issuer from the borrowers and the interest on the notes and other expenses paid by the issuer. Any reserve fund will be replenished from available excess spread, if it is drawn. The actual value of excess spread depends on levels of delinquencies, defaults, and prepayments, as well as the weighted average interest rate of the reference mortgage portfolio throughout the life of a transaction. The Threshold Rate calculation is designed to guarantee the issuer a minimum level of excess spread.